INDUSTRY COMMISSION

Vehicle and Recreational Marine Craft Repair and Insurance Industries

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INDUSTRY COMMISSION

15 March 1995

The Honourable George Gear MP
Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Assistant Treasurer

In accordance with section 7 of the *Industry Commission Act 1989*, we submit to you the report on the Vehicle and Recreational Marine Craft Repair and Insurance Industries.

Yours sincerely

M L Parker
Presiding Commissioner

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Associate Commissioner

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ABBREVIATIONS

AAA	Australian Automobile Association
AAAA	Australian Automotive Aftermarket Association
AAMI	Australian Associated Motor Insurance Limited
ABS	Australian Bureau of Statistics
ACA	Australian Consumers Association
ADRs	Australian Design Rules
ALRC	Australian Law Reform Commission
BTCE	Bureau of Transport and Communications Economics
CAFCA	Consumer Advocacy and Financial Counselling Association (Vic)
CAPA	Certified Automotive Parts Association
CFCs	Chloro Fluoro Carbons
CRP	General Insurance Claims Review Panel
CTP	Compulsory Third Party (Personal Insurance)
EC	European Community
FAPM	Federation of Automotive Products Manufacturers
FCAI	Federal Chamber of Automotive Industries
FCLC	Federation of Community Legal Centres (Vic)
FORS	Federal Office of Road Safety
GBE	Government Business Enterprise
IAME	Institute of Automotive and Mechanical Engineers
ICA	Insurance Council of Australia
ISC	Insurance and Superannuation Commission
MTAA	Motor Trades Association of Australia
MTAQ	Motor Trades Association of Queensland
MVRIC	Motor Vehicle Repair Industry Council
NRMA	National Roads and Motorists Association

NRTC	National Road Transport Commission
OE	Original Equipment
PSA	Prices Surveillance Authority
RAASA	Royal Automobile Association of South Australia
RACQ	Royal Automobile Club of Queensland
RACV	Royal Automobile Club of Victoria
SAEA	Society of Automotive Engineers Australasia
TPC	Trade Practices Commission
TPPD	Third Party Property Damage
TTIC	Tow Truck Industry Council
VACC	Victorian Automobile Chamber of Commerce
VEETAC	Vocational Education, Employment and Training Advisory Committee
VIN	Vehicle Identification Number

GLOSSARY

Accident towing	Towing services to remove non-driveable vehicles from accident scenes. Also known as incident, smash or crash towing.
Approved repairer scheme	An agreement whereby an insurer endorses selected repairers as competent to undertake repairs. The schemes are also known as designated, selected, accredited or guaranteed repairer schemes.
Australian Design Rules (ADRs)	Regulations establishing standards for meeting vehicle safety and emission objectives. All new vehicles must comply with the regulations to qualify for registration in Australian states and territories.
Authorised insurer	Any insurer authorised under the Insurance Act to conduct insurance business in Australia. State government owned insurers are not required to be authorised.
Barometer of responsibility agreement	An agreement which acts as a guide in apportioning liability in specified types of multiple vehicle collisions.
Breakdown towing	Towing services to remove vehicles that have broken down from roadways.
Claims expense	The sum of claims outstanding at the end of the accounting period, plus those claims which have been paid in the period, less claims outstanding at the beginning of the period.
Clearway towing	Towing services to remove illegally parked vehicles from designated clearway areas.
Compliance plate	A metal plate attached to a vehicle which states that it complies with the Australian Design Rules. It also contains other information which identifies vehicles and vehicle features.

Comprehensive insurance	Optional insurance that covers damage to the insured's own vehicle, regardless of fault, and damage to property of a third party if caused by the negligence of the insured.
Concentration ratio	The percentage of industry aggregates (eg value added and employment) accounted for by the largest firms in an industry. The greater the percentage, the more concentrated the market.
Deductible or excess	An amount of money which is not covered by an insurance claim.
Direct insurer	An insurer that accepts primary liability for contracted risks from the public, either directly from the insured or through intermediaries.
Drop-fee	A payment made by repairers to tow truck operators in return for the delivery to their yard of a crash damaged vehicle. Also known as drop-off fees, off-the-hook fees, kick-a-brick fees, slings and secret commissions.
Expense ratio	The ratio of underwriting expenses to earned premium revenue. The ratio is calculated after reinsurance.
Genuine parts	New replacement parts carrying the brand name of the vehicle manufacturer.
Insurance claim	A demand by an insured made to an insurer for compensation for an alleged loss covered by the insured's insurance policy.
Insurance premium	An amount charged by an insurer for accepting risk from an insured. It does not include amounts collected on behalf of third parties.
Knock-for-knock agreement	An agreement between insurers to repair damage to their own comprehensive policyholder's vehicle regardless of fault.
Loss assessor (or loss adjuster)	A person who evaluates the extent of loss or damage arising from an accident.
Loss ratio	The ratio of claims expense to earned premium revenue. The ratio is calculated after reinsurance.
No claim bonus	A discount given on premiums in recognition of a claim free record in the preceding claim periods.

Non-genuine parts	All parts other than genuine parts. These include parts made by manufacturers of genuine parts, but marketed by them under their own brand names, as well as all replacement parts made by local and overseas manufacturers, second-hand and reconditioned parts.
One quote system	A system for assessing repair costs that requires only one quote be obtained for the cost of repairs.
Rebirthing	The reregistration of a stolen vehicle using the identification of another vehicle, usually a wrecked vehicle.
Reinsurer	An insurer that accepts insurance business ceded from other insurers. That is, liability for a risk is transferred from the first insurer to another.
Replacement parts	Parts fitted to vehicles as a result of either wear or damage to existing parts. Also known as spare parts or aftermarket parts.
Third party property insurance	Insurance against property damage caused to another person by the negligence of the insured.
Trade towing	Towing to move vehicles within the towing and repair trades, either from one repair shop to another or from a tow truck operator's yard to a vehicle repairer's premises.
Two-quote system	A system for assessing repair costs that requires two repairers to quote for repair work.
Vehicle identification number (VIN)	A unique 17 character alpha/ numeric identification code that identifies all new vehicles sold in Australia after January 1989.

TERMS OF REFERENCE

I, George Gear, Assistant Treasurer, under Part 2 of the *Industry Commission Act 1989* hereby:

1. refer the motor vehicles, towed vehicles and marine craft repair industries and related repair insurance industries to the Industry Commission for inquiry and report within twelve months of the date of receipt of this reference (in this reference "marine craft" are those usually used for recreational purposes);
2. specify that the Commission report on the scope for improving the efficiency of the industries covered in 1. above and options for achieving those efficiencies;
3. without limiting the scope of the reference, request the Commission to report on:
   (a) insurance company competitiveness, including premiums, loss ratios and expense ratios;
   (b) assessment of repair schedules;
   (c) the cost and quality of repairs;
   (d) the use, cost and effect of different categories of replacement parts including:
      - 'genuine' parts usually carrying the trade mark of the vehicle manufacturers and sold through their outlets;
      - parts made by manufacturers of 'genuine' parts but marketed by them under their own brand names through normal retail outlets;
      - after market parts (copies) made by firms that do not supply the vehicle manufacturers and may be of lower specification and price; and
      - used parts;
   (e) competition between insurers, between repairers and between towing firms, including the impact of possible arrangements between insurance companies, towing firms and repairers; and
   (f) arrangements and legal processes for determining claims, including the role of loss assessors and the efficacy of complaints procedures available to clients;
4. specify that the Commission is to avoid duplication of any substantive studies undertaken elsewhere; and
5. specify that the Commission is to have regard to the established economic, social and environmental objectives of governments.

GEORGE GEAR

17 March 1994

OVERVIEW

This report considers the efficiency of two of Australia's largest service industries — the motor and marine insurance and related repair industries. Annual insurance premiums amount to around $3 billion, while the turnover of the repair industry exceeds $7 billion.

The industries' activities directly influence the cost of operating motor vehicles and marine craft and have important implications for safety on Australian roads and waterways. Consequently, their performance is important to the well-being of virtually all Australian businesses and households.

As most concern expressed by consumers and the industries themselves focussed on passenger motor vehicle accident repairs and insurance, the report concentrates on these areas.

The two industries are dependent on each other — insurers depend upon repairers to restore damaged vehicles efficiently and repairers rely on insurers for a significant proportion of their business. Despite this close working relationship, there is considerable tension between the two industries. This is reflected in the claims and counter-claims that each industry makes about the performance of the other. Both industries accept that the existing conflict detracts from their performance.

The Commission has sought to identify relatively low cost solutions which provide incentives for better performance. The answers to some of the problems (eg reducing vehicle theft) are not straight forward. Nonetheless, there is substantial scope for improvement in many areas. In some instances, this will require actions by governments, but many problems should be — and can be — addressed most efficiently by the industries themselves.

Competition

Increasing competitive pressures associated with the privatisation of some government insurance businesses and the breaking down of some traditional market boundaries have increased the incentive for insurers to improve performance and become more customer focussed. New products have been introduced to the market (eg faultless no claim bonuses), some new services have been provided (eg accommodation expenses following an accident) and some new business practices have evolved (eg more business is now conducted over the telephone).

There is vigorous competition in major motor vehicle and marine insurance markets. This has increased the pressures on insurers to become more consumer oriented (Section 3.2).

Largely because of increasing use of multiple quote systems by insurers, competition in the accident repair sector has also increased. Competition for the supply of mechanical repairs remains strong.

Dispute resolution

Efficient dispute resolution procedures are needed to cope with complaints raised by consumers and also disputes between insurers and repairers. Significant progress has been achieved in establishing mechanisms to deal with consumer complaints, but there is currently no satisfactory means of addressing grievances between insurers and repairers.

Consumer complaints

Consumers frequently complain about the performance of both the insurance and the repair industries. Most insurance complaints are about payouts on written-off vehicles and cases where insurers deny liability. Concerns about vehicle repairs encompass complaints about the standard of workmanship, the cost or quality of parts and dishonest practices (eg overservicing and charging for work not performed).

In 1991, an independent body comprising insurance industry and consumer representatives — the General Insurance Claims Review Panel (CRP) — was established to help resolve consumer disputes. A new code of practice is also being developed by the industry in consultation with the Commonwealth Government. The code requires participating insurers to establish dispute handling procedures.

In the repair industry, new codes of practice have been developed. The nature of the codes vary, but most specify standards of workmanship, conduct and dispute resolution procedures. In New South Wales, a government body — the Motor Vehicle Repair Industry Council (MVRIC) — oversees a Disputes Committee comprising both trade and consumer representatives.

The CRP and MVRIC dispute resolution processes allow consumers to pursue their grievances through avenues which they generally perceive as impartial and which avoid the protracted delays and costs of the court system. However, there is scope for improvement.

Dispute resolution procedures should encourage the parties themselves to resolve their dispute. They should be capable of discouraging unreasonable

complaints without impeding legitimate grievances. These objectives are promoted if companies have internal procedures which are simple, informal, timely and perceived as fair by consumers. Internal schemes with these attributes can be most readily established by larger companies — such as most insurers. Indeed, some insurers already have well developed processes in place.

> *Some insurers can improve their internal dispute resolution schemes. They should consider providing their dispute resolution sections with greater autonomy or including a consumer representative on review panels. As a minimum, they should ensure that internal reviews are undertaken by staff not involved in the original decision (Section 3.3).*

The CRP is well regarded by both insurers and consumers. However, the industry should consider broadening its charter (eg to permit consideration of complaints from third parties). Consideration should also be given to improving the CRP's performance by amending its procedures to discourage unreasonable actions by either consumers or insurers.

> *Where claims have been initially assessed by the chair of the CRP or his/her delegate as "unreasonable", a small deposit could be charged, refundable only if the complainant is successful. In all other circumstances, consumers should continue to have free access to the CRP. Inappropriate behaviour by insurers identified by the Panel should be referred to the Code Compliance Committee — the body proposed to be responsible for sanctioning insurers that breach the Insurance Industry Code of Practice (Section 3.3).*

Conflict between the industries

Despite the high level of interdependence, there is an uneasy and often highly adversarial relationship between insurers and repairers. This is reflected in allegations by insurers of poor quality work and malpractices by repairers (eg substituting second-hand parts for new parts) and assertions by repairers about "unfair" practices employed by insurers (eg directing repair work to company "approved" repairers).

Some tension is understandable because of a fundamental conflict of interest — insurers wish to minimise their expenses by driving down repair costs while repairers seek to maximise their returns by achieving the highest possible price for repairs. The large disparities in firm sizes between insurers and repairers add to the tension. While some degree of conflict between buyers and sellers in markets for most goods and services is probably inevitable, the level of animosity that exists between insurers and repairers impairs the effectiveness of communications between the industries and adversely affects performance.

The responsibility for improving relationships lies squarely with the industries themselves. Indeed, there is not a great deal that the government could do to overcome the friction which presently exists.

Many in the industry accept this view and acknowledge that it is in each industry's own interest to work together more closely. However, some contend that a government direction is required to overcome the current inertia. To this end, the Motor Trades Association of Australia sought support for an industry "forum" to help bring the parties closer together.

Convening a forum to discuss the current problems could be a useful first step towards resolving the conflict between the industries. However, if it is to be successful, the forum would need to include representatives of all sectional interests and to focus on developing ways to address the underlying causes of the conflict.

> *The insurance and repair industries should jointly convene a forum to determine processes needed to establish a code of conduct covering matters which impinge on relationships between the two industries and a procedure for resolving disputes between insurers and repairers (Section 3.4).*

Some of the practices employed by insurers add to conflict between the industries, but they are generally consistent with normal business practice. For example, while most repairers would prefer insurers to seek only one quote for a damaged vehicle, two-quote systems used by some insurers are a legitimate method for increasing competition between repairers and so reducing repair costs (and, hence, premiums). In many respects, they are analogous to tender systems which are used widely throughout the business community. Likewise, the adoption by insurers of "approved" (or "preferred") repairer schemes is consistent with initiatives undertaken by firms in many industries to improve productivity by forging closer relationships with their suppliers. In both cases, consumers stand to gain from lower prices and/or higher quality. In neither case is there reason for governments to restrict firms' abilities to enter into such agreements.

One unusual practice is the preparation of repair quotations using time and hourly rate schedules which embody times and rates that both insurers and repairers know to be totally unrealistic. Traditionally, low hourly rates have been offset by the use of time schedules that substantially overstate the real requirements (eg quoted times can be two or three times the true repair time). Their use implies that negotiations on repair quotations take place in circumstances which both parties know are fictitious. This is clearly undesirable in itself, and can further jeopardise relationships between the

industries. There is also a danger that such practices may escalate and lead to fraud and malpractice.

> *The current time and hourly rate schedules used for repair quotations should be abandoned. If time and hourly rate schedules are considered to be useful in preparing quotations, they should reflect true times and costs (Section 3.4).*

The work of insurance company assessors is another source of dispute. Many repairers see assessors as "cost minimisers", whose primary motive is to reduce repair costs, irrespective of the interests of consumers (or repairers). To overcome the perceived shortcomings, some repairers advocate that repair assessments be performed by independent assessors, that assessors be required to have formal qualifications and (where two-quote systems are used) that insurers specify the precise nature of the repairs required.

In the absence of significant safety implications (see below), the Commission has not identified sufficient grounds for governments to intervene in the work of assessors, or in other aspects of the relationships between insurers and repairers. These are matters for the parties themselves to resolve.

Quality and safety of repairs

Most concerns about the quality of repairs were expressed by repairers. Many contend that they are forced to "cut corners" to retain insurance work. As a result, they claim that some repairs are of poor quality and/or some items are not repaired at all. Some repairers allege that vehicles are returned to the road in an unsafe condition.

In any service industry there is likely to be some substandard work and unscrupulous operators. However, the level of consumer complaints about the quality of vehicle repairs is low in relation to the number of repairs performed (see Section 4.3). This could reflect consumer ignorance — the average vehicle owner does not have the technical expertise to assess whether all repairs have been satisfactorily performed. Alternatively, it could mean that the commercial incentives on both repairers and insurers are sufficient to ensure that repairs are generally of a satisfactory standard.

Estimates of the cost of motor vehicle accidents to the community are of the order of $6 billion to $8 billion annually. However, there has been little detailed research into the role of vehicle defects in road accidents and the relationship between substandard repairs and the defects considered to have contributed to accidents.

Australian studies suggest that between 1 and 6 per cent of accidents may be attributable to vehicle defects, but there is little substantive evidence to suggest that poor quality repairs are a major contributing factor to these defects. The overwhelming majority of vehicle defects are likely to be attributable to poor vehicle maintenance (eg bald tyres and faulty brakes) (Section 4.5).

One state — New South Wales — has had a regulatory regime in place (MVRIC) since 1980. The MVRIC arrangements seek to lift repair standards by requiring all repairers to meet specified input standards (ie to employ suitably qualified tradespeople and to possess minimum prescribed equipment levels). Some other jurisdictions have recently considered, or are currently considering, the efficacy of introducing a MVRIC type regulatory framework.

Even if there were valid concerns about the quality of vehicle repairs, a scheme that specifies minimum input standards would be unlikely to provide the most efficient solution. The regulation of input standards will not guarantee that outputs — in this case repairs — are of the desired minimum standard. Such a scheme can also exclude small repairers from the industry, even though many repairs — especially to older vehicles — may not require sophisticated equipment or highly trained technicians.

It is not necessary for governments to prescribe minimum input standards for the repair industry. Even if it could be demonstrated that a quality problem exists, the regulation of inputs would not guarantee output standards. On the other hand, regulation can reduce competitive pressures, increase average repair costs and constrain consumer choice (Section 4.3).

If governments consider that action is needed to lift repair standards, a more cost-effective approach would be to use output monitoring (eg random inspections) in conjunction with a demerit point system. Some features of MVRIC could be central to this approach — namely the registration of all repairers and the ability to impose commercially significant sanctions (eg de-registration). A registration system would also provide scope to monitor repair workshops for compliance with other government regulations, including environmental and occupational health and safety requirements.

A system of output monitoring — in conjunction with compulsory registration of repair establishments and a demerit point system for inappropriate practices — is likely to be a more cost-effective method of dealing with malpractices and unsafe repairs than any approach that relies on the specification of minimum training and equipment standards (Section 4.3).

Replacement parts

Concerns about replacement parts have persisted for many years. The most common allegations are about overpricing of replacement parts produced by vehicle manufacturers and their suppliers (so-called "genuine" parts) and claims that many replacement parts supplied from other sources ("non-genuine" parts) are of inferior quality and, in some instances, unsafe.

Pricing concerns

Both consumers and insurers are concerned about perceived high prices of replacement parts. They are also concerned about price increases which, in recent years, have been well in excess of increases in the consumer price index.

Cost factors, in particular the large depreciation of the Australian dollar against the Japanese currency, undoubtedly help explain some variations in prices. Around 50 per cent of all imported parts and accessories are sourced from Japan. However, the major determinant of parts pricing is likely to be the level of competition in the Australian market.

The pricing of replacement parts was examined by the Prices Surveillance Authority in 1988. It found that price monitoring was not warranted.

Since that time, competitive pressures have increased. Reductions in tariffs have increased the access of overseas parts suppliers to the Australian market. In addition, the cost of tooling required to produce parts has continued to fall. To the extent that consumers take account of operating costs in motor vehicle purchasing decisions, there has also been pressure on vehicle producers to contain the prices of their replacement parts. As competition in the domestic motor vehicle market has intensified, these pressures have also increased.

However, competition in the supply of a relatively small number of parts — mainly body panels — is significantly weaker than it is for mechanical parts. This largely reflects the high fixed costs of tooling. Vehicle manufacturers can defray these costs over their entire production of new vehicles. Moreover, as virtually all insurers (and their policyholders) have a strong preference for genuine parts to be used in insurance repairs, vehicle manufacturers achieve significant additional volumes through aftermarket sales. This generally drives competitors to use lower volume technology which cannot produce panels that match the quality of those produced by vehicle manufacturers.

> *At present, competitive pressures generally appear to provide an effective constraint on manufacturers' pricing behaviour. However, producers of some body panels have considerable discretion in setting prices (Section 5.3).*

One factor which has the potential to significantly reduce competition is design protection. Under the *Australian Designs Act 1906,* producers of replacement parts — and most other products — can receive an exclusive right to the design of their product in an analogous fashion to the patent protection available to inventors. In the past, Australian motor vehicle producers have used the Act sparingly. However, manufacturers are now seeking to register a greater number of parts.

In assessing the merits of design protection, trade-offs must be made between encouraging innovative design and inhibiting competition. The extent of design work carried out in Australia is unlikely to be increased by the availability of design protection for spare parts. Design work by vehicle manufacturers is mainly undertaken to improve the attractiveness of new vehicles, not their parts, and is generally carried out at the most cost-effective location. The amount of design work currently performed in Australia is relatively small. Thus, most of the benefits of design protection would accrue to foreign companies — possibly at the expense of design work in re-engineering which domestic suppliers would otherwise undertake. Importantly, greater use of design protection would restrict the key role played by competition in holding down the prices of spare parts, particularly smash parts where direct competition from alternative suppliers is weak.

> *Design protection should not be afforded to motor vehicle parts which either "must fit" or "must match" some larger assembly (ie a vehicle) which they are intended to repair (Section 5.2).*

Similar limitations to design protection apply in the United Kingdom and many other European countries.

Concerns about safety

Replacement parts need not comply with the Australian Design Rules (ADRs) which apply to new motor vehicles and original equipment parts. However, safeguards are in place to help ensure that inferior quality replacement parts do not jeopardise vehicle safety:

- provisions of the Trade Practices Act — administered by the Federal Office of Road Safety (FORS) — allow for the recall of parts with safety defects and/or the banning of parts from sale;
- product liability laws and consumer protection legislation provide legal redress where defective products cause injuries or other losses; and
- legal requirements under state and territory legislation require that owners ensure their vehicles continue to comply with ADRs.

Notwithstanding these safeguards, it is frequently contended — mainly by motor vehicle producers — that many non-genuine replacement parts threaten vehicle safety. This concern encompasses some parts which are frequently perceived as "cosmetic" (eg panels which manufacturers claim form part of vehicles' crumple zone), as well as parts which are clearly safety related (eg brakes).

Some non-genuine replacement parts are of lower quality than genuine parts. However, lower quality does not necessarily mean that a part is unsafe. Indeed, vehicle producers claim that many of their parts far exceed the minimum safety standards specified in the ADRs. Hence, provided safety is not jeopardised, a lower quality part may be the most sensible option if it is available at a lower price or if it is fitted to an older vehicle with a limited life.

There are clearly some replacement parts which are of lower quality than genuine parts. It is likely that some are defective. However, the available information suggests that defective parts (genuine as well as non-genuine) are a very minor contributing factor to motor vehicle accidents (Section 5.4).

In the Commission's view, a requirement that all replacement parts comply with ADRs or undergo an independent certification process cannot be justified. The administrative and compliance costs of meeting any such requirement would be high. More importantly, there is little evidence to suggest that the safety mechanisms currently in place are not working effectively. Nonetheless, suppliers of faulty parts should be subject to financial penalties, as well as the cost of replacing the part.

Parts suppliers that knowingly supply parts that pose a significant safety risk should be subject to substantial financial penalties (Section 5.3).

Towing sector

The market for accident towing services is unusual in that work is not allocated on the basis of price or quality of service, but is generally secured by the tow truck that arrives at the accident scene first. Largely as a consequence of this feature, there is an incentive for tow truck drivers to speed to accident scenes. In some instances, vehicle owners are harassed to sign a towing authority and other tow truck drivers that arrive at the accident scene are intimidated. These practices are clearly undesirable. Nevertheless, it is important that tow trucks arrive promptly in order to clear the accident scene and avoid undue congestion.

There are very disparate views on the extent of the problems. Some consider that any problems are relatively minor and that little or no government

involvement is required. Others contend that chronic problems exist which can only be satisfactorily addressed by extensive government regulation.

The form and extent of regulation of the towing sector varies. Some jurisdictions (eg Tasmania) have extensive regulations in place (eg schemes to allocate tow trucks to accidents, restrictions on entry to the industry and "fit and proper person" tests). Others (eg New South Wales) rely mainly on a licensing system and penalties for harassment and intimidation. Most governments have made it illegal for tow truck drivers to accept drop-fees (ie payments made by repairers in return for the delivery of a damaged vehicle) and spotters' fees (payments for information about the location of an accident).

Much of the regulation currently in place is poorly targeted and fails to recognise adequately the incentives underlying the behaviour witnessed in some jurisdictions. Consequently, its effectiveness is limited. This particularly applies to the regulation prohibiting the payment of drop-fees and spotters' fees.

> *Substantial difficulties are associated with enforcing the existing criminal sanctions concerning the payment and receipt of spotters' fees and drop-fees. Even if enforcement were cost-effective, it is unlikely to have a marked impact on smash chasing and harassment problems (Section 6.3).*

Currently, most regulations are targeted at tow truck drivers and are intended to improve driver behaviour. In the Commission's view, the behavioural problems could be more efficiently addressed by making tow truck *owners* accountable for the behaviour of their drivers.

> *In those jurisdictions where smash chasing, harassment and intimidation by tow truck drivers are perceived to be serious problems, a demerit point system should apply to tow truck owners. Owners would lose demerit points, be fined and/or lose the right to operate a tow truck if their drivers are convicted of driving or related offences while in charge of a tow truck (Section 6.3).*

Multiple objectives underlie the use of allocation schemes by some governments. In some cases, the schemes appear to primarily serve the interests of incumbent operators rather than those of the broader community. The Commission considers that allocation schemes are not the most effective means of addressing behavioural problems in the tow truck sector.

> *A demerit point system could be introduced in those areas where tow truck allocation schemes apply. If it is successful in reducing behavioural problems, the allocation scheme should be abolished. If governments opt to maintain allocation schemes, they should be funded by industry. Governments should consider the removal of entry restrictions that apply to some schemes (Sections 6.4 and 6.5).*

Vehicle theft

Each year, around 125 000 vehicles are stolen throughout Australia. The direct cost is approximately $400 million — but substantial additional costs are incurred by vehicle owners and the community generally (eg policing and court costs).

Many of the measures in place to deter theft have been initiated by vehicle manufacturers and consumers. Manufacturers have incorporated "primary" antitheft devices to increase the difficulty of stealing vehicles (eg engine immobilisation systems) and "secondary" devices to reduce the value of stolen vehicles to thieves (eg fitting security coded stereo equipment). Consumers have contributed by fitting alarms, using steering locks and etching identification on vehicle windows. Governments are also active (eg through policing activity and registration checks). However, more can be done to help prevent theft — especially professional theft (ie the reregistration of stolen vehicles under a false identity or the theft of vehicles for the purpose of dismantling and selling the parts).

Vehicle theft is a difficult matter to deal with and the efficacy of alternative options will not always be clear in advance. Because of this unavoidable uncertainty, the Commission has proposed a range of "no regrets" initiatives which create scope for significant benefits if they are successful, but which would impose very low costs if they did not live up to expectations. The proposals call for more vigilant administration of regulation directed towards ensuring the integrity of vehicle identification systems, together with new approaches to increase the vehicle security information available to consumers and to add to the incentives on all parties to improve vehicle security.

All jurisdictions require that vehicles presented for reregistration be inspected. However, some registries undertake only cursory examinations which are insufficient to verify whether a vehicle has undergone a change in identity. In addition, information held by police and registry authorities about vehicles formerly registered in other jurisdictions is not always consulted, largely because of difficulties in accessing the relevant information.

> *Commonwealth, state and territory governments should recognise vehicle theft as a major microeconomic reform issue. They should accelerate the development and implementation of systems to integrate data bases held by state and territory government bodies so that they are accessible to registries in all jurisdictions. Responsibility for progressing this issue should ultimately rest with the Council of Australian Governments (Section 7.3).*

The capacity to reregister a stolen vehicle under a different identity is, in the first instance, created by the use of aluminium identification plates. The plates can easily be detached from one vehicle (usually a wreck) and fitted to another (ie a stolen vehicle). This could be largely overcome by changing the form of the identifiers.

The practice of attaching vehicle identification to vehicles by means of aluminium plates should be abolished. The information should be attached by means of self-voiding adhesive labels (Section 7.3).

There is some evidence to suggest that market forces can promote the development of antitheft strategies. For example, for much of the 1980s little progress was made in improving vehicle security. However in the late 1980s, aided by the development of a security rating system by one insurer, there was growing consumer recognition of the value of antitheft devices. In turn, this increased the competitive pressures on vehicle manufacturers to improve vehicle security. Subsequently, Australian manufactured vehicles have gone from having very low theft security to being world leaders.

Theft and vehicle security could be brought to the attention of all new vehicle buyers in a way which would intensify this competitive process by helping consumers to make more informed choices about their vehicle purchases. One organisation — the NRMA — currently compiles an index which could be used as a basis for better informing consumers about the security of vehicles sold in Australia.

A comprehensive and up-to-date index of vehicle security encompassing both primary and secondary security features can make an important contribution to reducing vehicle theft. To increase its usefulness, the Commonwealth Government should require new vehicle suppliers to provide information to consumers about the security rating of each model they sell.

Labelling of vehicle parts can also help reduce theft. Labelling increases the costs associated with disguising a vehicle's identity. It also makes it more difficult to dispose of stolen parts by enhancing the prospects of police identifying and successfully prosecuting offenders.

Some participants contend that parts labelling should be made compulsory. However, the Commission has reservations about the cost-effectiveness of a compulsory system. The compulsory labelling system currently embodied in draft ADR 61 could be subverted because it does not require manufacturers to label replacement parts. This would enable thieves to remove labels from stolen parts, repaint the parts and claim that they had been purchased as replacement parts. Schemes requiring replacement parts to be labelled and which impose

comprehensive record keeping requirements on repairers and wreckers could involve substantial compliance costs. On the other hand, voluntary parts labelling would involve lower costs than a regulated approach and it may well be more effective as it would allow scope for innovation by firms competing to improve the security of vehicles. If parts labelling offered a cost-effective means of reducing vehicle theft, the index of vehicle security mentioned above would intensify commercial incentives on manufacturers to engage in parts labelling. Governments can, and should, facilitate the development of voluntary parts labelling by providing appropriate legislative support.

Governments should make it an offence to remove or damage identification labels with the intent of concealing identity (Section 7.3).

Insurers should also pursue antitheft strategies more actively. In particular, they should encourage their policyholders to improve the security of their vehicles (eg to etch windows).

Insurers should promote improvements in vehicle security by offering premium discounts or other financial incentives to policyholders who invest in proven antitheft measures (Section 7.3).

Although many of the problems of vehicle theft have been well known for some time, progress in addressing the problems has been slow. Cooperative endeavours by governments have suffered from a lack of commitment — manufacturers have only recently given vehicle security a high priority (albeit with considerable success) and most insurers have not placed a high priority on encouraging the adoption of antitheft strategies by consumers or vehicle manufacturers.

The Commission recommends that motor vehicle theft and means to combat it be reviewed in 1999.

Compulsory third party property damage (TPPD) insurance

Unlike many countries, there is no requirement in Australia for vehicle owners or drivers to be insured against damage they may cause to other individual's property. As a result, in some accidents caused by uninsured drivers the cost of rectifying the damage falls to the innocent party or, if that party is comprehensively insured, to an insurer. If the damage costs are paid by insurers, most of the costs are spread over the insurance pool (ie over all vehicles comprehensively insured). Rough estimates suggest that this cost is between $22 million and $65 million annually.

Insurers oppose the introduction of compulsory TPPD insurance. They argue that administrative costs associated with introducing a scheme in each state and territory would be high, particularly if — as insurers contend — governments intervene to restrict their ability to determine premiums and impose other conditions which constrain insurers' capacity to act commercially.

In the Commission's view, the payment by insurers of damages incurred by innocent parties does not diminish the case for compulsory TPPD insurance. While it avoids the possibility of an innocent party having to pay all of the damage cost, the total cost is paid by all comprehensively insured drivers, and not by the party at-fault (ie the uninsured driver).

The costs of any compulsory TPPD scheme would depend crucially on the design of the scheme. However, the Commission considers that many of the arguments mounted against compulsory TPPD insurance are overstated. For instance, there seems little reason for fraud to increase. Similarly, knock-for-knock and other arrangements currently employed to reduce costs and adversarial dealings could also apply under a compulsory TPPD scheme.

However, given that the gains available from compulsory TPPD insurance are not large, it cannot be justified unless it involves very low administrative and compliance costs. The only scheme which the Commission is confident would meet such requirements is one which did not introduce administrative procedures to verify compliance. Such a scheme would make it an offence to drive and/or to register a vehicle without TPPD insurance, but compliance would only be monitored by police in the course of their general road traffic duties.

Such an approach would not, however, address all concerns raised by proponents of compulsory TPPD. For instance, it would not guarantee that premiums were "affordable" to all, or that all drivers would have protective cover for accidents involving unidentified drivers (although they would still be free, as they are now, to insure against this possibility). However, if governments were to regulate premiums or otherwise limit insurers' underwriting flexibility, the benefits would be significantly eroded (eg premium regulation would lead to cross-subsidies between consumers and concomitant economic costs).

It would be inappropriate for state/territory governments to introduce a compulsory TPPD scheme in any form that limits insurers' underwriting flexibility (Section 8.3).

Environmental issues

The motor vehicle and marine craft repair industries interact with the environment in a number of ways. These include: the release of environmentally hazardous substances during repairs (eg CFCs, paint and other vapours); waste disposal (eg lubricants and coolants, solvents, tyres and batteries); and the implications of substandard servicing and repair (eg poor engine tuning may result in excessive exhaust emissions).

A range of regulations addresses these problems. Most of the legislation applies generally rather than specifically to the industries under reference. Some environmental issues are also covered by codes of practice developed by industry. However, there is concern that in some jurisdictions environmental regulations are not adequately enforced.

> *Governments should ensure that adequate resources are available to monitor environmental regulation and that appropriate sanctions for breaches of the regulations apply. Vehicle inspection procedures employed in some jurisdictions provide one means of checking emission standards. Random inspections could be used to check the environmental performance of repair workshops. In both instances, cost-effectiveness would be improved by targeting "high risks" — notably older cars and repairers with a history of poor compliance (Section 4.6).*

RECOMMENDATIONS

Insurance issues

1. The internal dispute resolution schemes of insurers would be improved if they were to provide their dispute resolution sections with greater autonomy. Alternatively, they should consider including a consumer representative on review panels or, as a minimum, ensuring that internal reviews are undertaken by staff not involved in the original decision (Section 3.3).

2. If the number of unreasonable complaints received by the Claims Review Panel is considered a problem, a small deposit could be charged for the lodgement of claims which have been initially assessed as likely to be unreasonable or capricious. The fee would be refunded only to successful complainants (Section 3.3).

3. Inappropriate behaviour by insurers identified by the Claims Review Panel should be referred to the Code Compliance Committee, the body proposed to be responsible for sanctioning insurers that breach the Insurance Industry Code of Practice (Section 3.3).

4. The current time and hourly rate schedules used for repair quotations should be abandoned. If time and hourly rate schedules are considered to be useful in preparing quotations, they should reflect true times and costs (Section 3.4).

5. The insurance and repair industries should jointly convene a forum to determine processes needed to establish a code of conduct covering matters which impinge on relationships between the two industries and a procedure for resolving disputes between insurers and repairers (Section 3.4).

6. State and territory governments should not introduce a compulsory TPPD scheme in any form that limits insurers' underwriting flexibility (Section 8.3).

7. The insurance industry, with the support of motor traffic authorities, and in consultation with consumer groups, should develop a targeted education program to advise motorists of their legal/financial responsibilities in the event of an accident for which they were responsible. In conjunction with this, motor traffic authorities should modify registration and drivers' licence documentation so that drivers are better informed of their responsibilities (Section 8.4).

8. Governments should introduce measures to allow the revocation of the licences of at-fault drivers who do not pay for damages they cause (Section 8.4).

9. The implications of regulations that limit the capacity of insurers to set premiums that reflect risk for compulsory third party personal insurance should be reviewed (Section 8.4).

Parts and repair issues

10. Design protection should not be afforded to motor vehicle parts which either "must fit" or "must match" some larger assembly that they are intended to repair (Section 5.3).

11. Part suppliers that knowingly supply parts that pose a significant safety risk should be subject to substantial financial penalties (Section 5.3).

12. Repairers and/or insurers should provide consumers with details of all parts used in repair work. Both parties should consider incorporating disclosure requirements into codes of practice (Section 5.3).

13. An independent review should be conducted of the scope for greater harmonisation of accident data bases held by police and insurance companies. The review should consider community wide costs and benefits, including the extent to which these data bases could be used in the evaluation of the cost-effectiveness of alternative road and vehicle safety measures (Section 4.5).

Towing issues

14. In those jurisdictions where smash chasing, harassment and intimidation by tow truck drivers are perceived to be serious problems, a demerit point system should apply to tow truck owners. Owners would lose demerit points, be fined and/or lose the right to operate a tow truck if their drivers are convicted of driving or related offences while in charge of a tow truck (Section 6.3).

15. The administration costs of tow truck allocation schemes should be funded by the industry, and not by governments (Section 6.4).

16. Where allocation schemes are used, they should be run with a view to protecting the public's interest in receiving cost-effective towing services. To this end, performance should be monitored and performance indicators

published — in particular, response times to accidents and measures of the quality of service provided (Section 6.4).

17. Governments using tow truck allocation schemes that encompass entry restrictions should consider removing such restrictions. If appropriate, the restrictions should be phased out (Section 6.5).

18. Governments, in consultation with industry, should examine the scope for re-structuring the arrangements for the supply of towing services with a view to obtaining competitively priced outcomes. If governments consider fee regulation is necessary, they should regularly review settings to ensure they are not giving rise to significant market distortions and should periodically assess the merits of approaches used in other jurisdictions (Section 6.6).

19. Governments should not mandate the introduction of independent holding yards for collision damaged non-driveable vehicles (Section 6.7).

20. Governments should periodically review, and remove or modify where necessary, all regulations applying to accident towing capacity limits and equipment types (Section 6.7).

21. Governments should review the existing regulation of non-accident towing and remove, or modify where necessary, all regulations that do not confer net benefits on the community (Section 6.7).

Vehicle theft

22. Commonwealth, state and territory governments should recognise that vehicle theft is a major microeconomic reform issue. They should accelerate the development and implementation of systems to integrate existing data bases and enable them to be quickly accessed by registration authorities in all jurisdictions. Responsibility for progressing this issue should ultimately rest with the Council of Australian Governments (Section 7.3).

23. Each jurisdiction should maintain comprehensive and up-to-date registers of wrecks and stolen vehicles (Section 7.3).

24. State and territory governments should ensure that, before reregistration, vehicles are thoroughly inspected by personnel with appropriate training and/or experience. Inspectors should consult listings of wrecks and stolen vehicles held by authorities in the state/territory in which the vehicle was previously registered (Section 7.3).

25. The practice of attaching identification to vehicles by means of aluminium plates should be abolished in favour of adhesive self-voiding labels (Section 7.3).

26. Governments should require new vehicle suppliers to make publicly available information about the security rating of each vehicle they sell (Section 7.3).

27 Governments should legislate to make it an offence to remove or damage vehicle identification labels with a view to concealing identity (Section 7.3).

28. Insurers should promote improvements in vehicle security by offering premium discounts or other financial incentives to policyholders who invest in proven antitheft measures (Section 7.3).

29. To allow governments to monitor developments in antitheft strategies, insurers should, for a limited period, report annually to government on the progress they have made in encouraging policyholders to take cost-effective antitheft measures (Section 7.3).

30. The current vehicle security regulation — ADR 25/02 — has become redundant and should be abolished (Section 7.3).

31. Progress in implementing strategies to combat theft should be reviewed in 1999 (Section 7.4).

Attention is drawn to the Commission's comments on:

- the effectiveness of random inspections, performance audits and demerit point systems in improving repair standards (Section 4.3) and ensuring adherence to environmental and other regulations (Section 4.6);
- the efficacy of compulsory registration of repair establishments (Section 4.7);
- in those jurisdictions in which tow truck allocation schemes operate, making it an offence for smash repair shops to accept a towed vehicle from an accident site without a towing authority (Section 6.4);
- using concealed labels and dual labelling systems to reduce the incidence of vehicle theft (Section 7.3); and
- the scope for increasing compliance with registration requirements by increasing the penalties for non-compliance and expanding the role of parking inspectors to include registration checks (Section 8.3).

1 THE INQUIRY

This report examines two of Australia's larger industries — the vehicle and marine insurance and repair industries. Collectively, the two industries have an annual turnover in excess of $10 billion. The industries' activities significantly influence the cost of operating motor vehicles and marine craft, and their operations also have implications for safety on Australian roads and waterways. Consequently, their efficiency directly affects the well-being of most Australians.

The scope of the inquiry

The terms of reference for the inquiry are broad ranging (see page xiv). They cover most insurance and repair activities associated with a wide variety of motor and towed vehicles and recreational marine craft.

All forms of vehicle and marine craft insurance are covered by the inquiry, other than compulsory third party person insurance which is not directly under reference. Repair activities covered by the terms of reference include mechanical repairs (eg brake repairs and engine reconditioning), vehicle maintenance and servicing (eg tuning and lubrication) and accident (or "smash") repairs.

The terms of reference encompass the insurance and repair of a broad range of motor and towed vehicles. In addition to passenger motor vehicles, they include: commercial vehicles such as trucks, buses, vans and utilities; special purpose vehicles (eg mobile cranes and earth moving equipment); farm equipment (eg harvesters); motor cycles; caravans; and trailers. The coverage of marine craft is considerably narrower — only the insurance and repair of craft used for recreational purposes are under reference.

While the emphasis is on options for improving the efficiency of the insurance and repair industries, the terms of reference also require the Commission to report on a number of other matters including:

- the level of competition in the supply of insurance, repair and towing services;
- the cost and quality of repairs;
- the implications of the use of different categories of replacement parts; and
- dispute resolution arrangements.

The main focus of participants' submissions was on insurance and smash repair of privately owned passenger motor vehicles. Only limited concern was expressed about maintenance and servicing of passenger motor vehicles. Similarly, very little information was supplied, or concerns expressed about, the insurance and repair of other types of motor vehicles (eg commercial vehicles and motor cycles) or recreational marine craft.

Most issues affecting efficiency and the other matters raised in the terms of reference identified by the Commission also relate to passenger motor vehicles and smash repairs. Consequently, the major focus of this report is on these areas.

Inquiry issues

The terms of reference raise an extremely disparate set of issues. On most issues, the views held by the different interest groups participating in the inquiry differ considerably. For example, while many insurance companies are concerned that the cost of repairs is too high, most repairers consider that they are paid too little to undertake repairs adequately. Even within industry sectors, there is little unanimity on some issues. For example, some repairers support the existence of "approved repairer" schemes, while others contend that they are anti-competitive. Similarly, some repairers (and insurers) consider that increased government regulation of the repair sector is needed to improve the quality of repairs. Others believe that such regulation would simply add to repair costs.

With some exceptions (eg it is generally recognised that vehicle theft is an ongoing problem), there are also considerable differences in perceptions about the major problems confronting the industries. Even where there is consensus that a problem exists (or that there is room for improvement), there is a range of views about possible solutions. Some participants look to governments for further regulation, while others consider that solutions are best left to industry (eg through the adoption of codes of practice).

Despite these differing perceptions, a number of matters stand out as important determinants of the performance of the insurance and repair industries and are canvassed in this report. They include:

- *Inter-industry relationships:* Why are relationships between the insurance and repair industries poor? How can they be improved?
- *Cost and quality of repairs:* Is there a problem with the quality of repairs? Is vehicle safety being jeopardised? How are costs and quality influenced by relationships between insurance companies and repairers?

- *Replacement parts*: Is competition effective in constraining the price of spare parts? Are there safety issues arising from the use of "non-genuine" parts?
- *Accident towing:* Are there problems with accident towing? If so, what are the underlying causes and how can they be most efficiently addressed?
- *Dispute resolution*: How effective are existing mechanisms for resolving disputes? What are the relative merits of industry operated mechanisms and legal remedies?
- *Stolen vehicles:* Is it possible to devise cost-effective procedures to reduce the incidence of theft? The 125 000 vehicles stolen each year impose costs in the order of $400 million on Australian motorists and increase insurance premiums by around 9–10 per cent.
- *Third party property damage insurance*: What are the costs imposed on other motorists and the community generally by accidents caused by uninsured third parties? Should third party property insurance be made compulsory as in some other countries?
- *Environmental concerns*: What impact does the repair sector have on the environment? How can these concerns be most efficiently addressed?

The Commission's approach

The insurance and repair industries are undergoing change. This has seen, amongst other things, the privatisation of most government insurance businesses, the expansion of some larger insurance companies into new markets, the development of new insurance products, the adoption of new repair technologies and changes in the relationships between the insurance and repair industries. The changes are an inevitable consequence of changes in the demand and supply conditions for insurance and repairs, as well as evolving commercial practices. Like other industries, the insurance and repair industries must adapt to changing market circumstances if they are to perform to their full potential.

In examining the issues raised by this inquiry, the Commission has been cognisant that many of these developments reflect changes in economic circumstances. It is important that structural adjustments are not impeded. Consequently, the Commission has sought to identify any obstacles which could prevent adjustment, and its concomitant benefits, from emerging.

The Commission has also tried to identify factors which impair the performance of the insurance and repair industries in other ways. Some factors are common to most industries (eg to varying degrees, all industries are affected by

government interest rate policy and by occupational health and safety requirements). Consequently, the Commission has focused mainly on matters which are specific to the insurance and repair industries.

Where the Commission has identified specific problems, it has attempted to develop least cost solutions or canvass options. This has involved consideration of whether there is a role for government, whether the problem is most efficiently addressed by industry, or whether there is a need for action by both parties.

Consideration of the role of government has required the Commission to examine a range of government legislation and regulation which presently directly, or indirectly, applies to the industries' activities. This encompasses regulation at both the Commonwealth and state level, and regulation which applies specifically to the insurance or repair industries, as well as regulation which applies to commercial activity generally.

The existing industry specific regulations have been promulgated for a variety of reasons. Much of it stems from government concerns to protect the interests of consumers in those instances where they have insufficient information to make fully informed decisions (eg to determine whether insurers are financially viable). However, some regulation is primarily intended to address "external costs" which can be associated with the industries' activities (eg to control the discharge of CFCs and other environmentally harmful substances into the atmosphere or to reduce the incidence of speeding by tow trucks).

At the Commonwealth level, current regulation includes the *Insurance Act 1973*, the *Insurance Contracts Act 1984* and the *Insurance (Agents and Brokers) Act 1984* which, amongst other things, establish a system of prudential supervision of non-government general insurance companies and put in place safeguards to protect the public (eg controls over the content of contracts and over the actions of agents and brokers). Examples of Commonwealth legislation which has more general application include the Corporations Laws, the Trade Practices Act and the Designs Act (legislation which provides exclusive rights over the design of newly manufactured goods that have a unique appearance).

A wide range of industry specific and general regulation also exists at the state/territory level. While all states and territories have generally applicable fair trading legislation to protect consumer rights, there are considerable differences in the industry specific legislation in each jurisdiction. This is most apparent in relation to the repair industry. For example, New South Wales has established a Motor Vehicle Repair Industry Council (MVRIC) and an associated licensing regime (specifying minimum skill and equipment levels) which seeks to improve standards of motor vehicle repair. To date, other

governments have not followed suit (although some are presently considering introducing comparable legislation). The approaches adopted by governments in relation to the tow truck sector also vary considerably. For example, there is extensive regulation in some jurisdictions (eg Victoria and South Australia), while in others (eg New South Wales and Queensland), there is "light-handed" regulation.

In keeping with its policy guidelines, the Commission has assessed regulatory and other options for improving efficiency in an economy wide context. Thus, options for change have been developed having regard to their implications for consumers, other industries and the economy generally, and not simply from the perspective of the insurance and repair industries. The policy guidelines also require the Commission to have regard to the desire of the Commonwealth Government to encourage the development of efficient industries, facilitate structural adjustment and reduce unnecessary industry regulation. They also require that the Commission report on the social and environmental consequences of any recommendations it makes.

Inquiry processes

In preparing this report, the Commission has drawn mainly on participants' submissions, information tendered at public hearings, previous studies, discussions with participants and its own research and analysis. Participants who provided a written submission and/or attended public hearings are listed at Appendix A.

Structure of the report

This report consists of eight chapters and a number of supporting appendices. The next chapter outlines some of the key features of insurance and repair markets. Chapters 3 and 4 examine a range of issues relevant to the insurance and repair industries respectively. Chapter 5 discusses replacement parts, while the following chapter explores towing issues. Chapter 7 considers various options for reducing the incidence of vehicle theft. The final chapter examines the merit of compulsory third party property insurance.

2 KEY STRUCTURAL AND OPERATING CHARACTERISTICS

This chapter provides an overview of the insurance and repair industries. The first section discusses the insurance industry. Subsequent sections consider the repair industry (Section 2.2) and the tow truck sector (Section 2.3). Many of the matters raised are explored in greater detail in later chapters.

2.1 The insurance industry

Size and structure

The Australian motor vehicle and marine insurance industry is part of the general insurance industry. Motor vehicle insurance is the largest component of private sector general insurance business in Australia, accounting for about one-third of all general insurance premium income. Marine insurance is far smaller, representing only about 3 per cent of direct premium income. Most large motor vehicle and marine craft insurers also provide a range of other insurance (eg home buildings, home contents and life insurance).

Most companies offering motor vehicle and marine craft insurance fall into one of three categories: capital stock companies owned by stockholders; mutual insurers owned by members (eg the insurance arms of state motoring associations); and government owned insurance businesses.

In recent years, government owned insurance businesses have been privatised in New South Wales, Victoria and Western Australia. Suncorp (owned by the Queensland Government), the South Australian State Government Insurance Commission and the Territory Insurance Office in the Northern Territory are the only remaining government owned insurance businesses which offer motor vehicle and marine insurance. In another significant change, the largest mutual general insurer in Australia — the NRMA — is seeking to become a capital stock company.

In 1992–93, there were 93 private general insurers providing motor vehicle insurance and 54 supplying marine hull insurance (including insurance of commercial vessels). ISC data (see Table 2.1) show that earned premiums amounted to approximately $3 billion in 1992–93, the bulk of which (92 per cent) related to motor vehicle insurance. In the wake of recent privatisations, the market share held by government owned insurers was 6 per cent, down from

16 per cent in the previous year and 19 per cent in 1983–84. In real terms, earned premiums increased by an average of around 3 per cent per annum over the nine years to June 1993. Growth was higher for motor vehicle insurance — 3.5 per cent per annum compared with around 1 per cent for marine hull insurance.[1]

Table 2.1: Earned premiums[a], selected years ($ million)

	1983–84	*1985–86*	*1987–88*	*1989–90*	*1990–91*	*1991–92*	*1992–93*
Motor vehicles							
private	963	1 224	1 703	2 046	2 153	2 289	2 572
government	248	276	380	439	465	465	175
Marine hull							
private	125	157	204	230	226	219	235
government	7	7	8	10	12	10	10
Total	1 343	1 664	2 295	2 725	2 856	2 983	2 992

a Earned premium is the proportion of premium income relating to that part of the period of insurance which has expired.

Source: ISC (sub. 55, Appendix C).

There is significant foreign ownership of motor vehicle and marine craft insurers. In 1992, a little over 25 per cent of premium income was attributable to foreign owned companies.

Although there are over 90 companies providing motor vehicle insurance and in excess of 50 providing marine hull insurance, the market is dominated by a substantially smaller number of companies. Indeed, in 1991 only 14 motor vehicle insurers and 17 marine hull insurers enjoyed market shares of more than 1 per cent.

Concentration is highest in the domestic motor vehicle sector where, in 1993, the top five private sector companies accounted for 63 per cent of the national market (see Table 2.2). The comparable figures for commercial motor vehicle insurance and marine hull insurance were 36 per cent and 55 per cent respectively. Although some classes of general insurance have higher concentration levels (eg professional indemnity and product liability insurance

1 The data in Table 2.1 exclude the premium income of non-authorised insurers such as Lloyd's Associations and small mutual insurers (eg some taxi co-operatives) with premium incomes less than $500 000 annually.

which are around 80 per cent), the corresponding level for the general insurance sector as a whole was significantly less — 35 per cent.[2]

Concentration is higher at the regional level. For example, in Victoria, the five largest insurers are estimated to hold around 73 per cent of the domestic motor vehicle insurance market. However, moves by some insurance companies to extend into new markets (eg Suncorp and the NRMA have recently entered the northern New South Wales and Victorian markets respectively) have reduced concentration in some regional markets.

Table 2.2: Concentration of total premiums, private sector direct underwriters, 1993
(per cent)

Class of Business	*Companies*			
	Top 5	*Top 10*	*Top 15*	*Top 20*
Commercial motor vehicle[a]	36	63	79	90
Domestic motor vehicle	63	77	86	92
Marine hull	55	75	87	94
All classes of general insurance	38	57	70	77

a Includes all fleet vehicles, as well as trucks, buses, special vehicles etc.
Source: Data supplied by the ISC.

The nature of insurance

The following subsections discuss insurance principles and the nature of insurance available for motor vehicles and marine craft.

Insurance principles

Broadly speaking, motor vehicle insurance involves a contract whereby for a specified payment — a premium — individuals can enter into an arrangement that provides for some compensation in the event that they suffer a specified loss in relation to their vehicle (usually accident damage, fire or theft) and/or in the event that they incur liability for damage to third parties' vehicles or property. Such arrangements are sought by individuals who are classed as "risk

2 Concentration data exclude government insurance businesses.

averse" — they are prepared to trade off income in return for greater financial security.[3]

Insurance companies set premiums with a view to recouping claim and administrative costs, and earning a return on assets. In practice, this is a complicated and information intensive exercise. Insurers need to be well informed about the risks being indemnified to enable them to tailor premiums to the risks attached to insuring different individuals, or groups of individuals. If insurers' information bases do not permit them to adequately differentiate between high risk and low risk individuals, low risk individuals may face premiums which are high relative to the true level of risk. These people may choose not to insure. This can result in only relatively high risk individuals seeking insurance. Pending adjustment to premium levels, this can expose insurers to significant losses. This outcome is commonly referred to as "adverse selection".

Another problem for insurers is "moral hazard". Moral hazard is said to exist when insured individuals can influence the probability of an insurance claim (eg by driving in a reckless manner). Partly to overcome moral hazard problems, insurers typically seek to share claim costs with insureds by means of "excesses" and no-claim bonuses.

The premiums charged for motor vehicle insurance are closely related to the type of insurance cover sought (see below). However, other important factors include: the type of vehicle (eg "sports" or "family" sedan); the geographical area of risk; the age of the nominated driver; claims experience; and the commercial strategies and objectives of individual insurers. Rating factors for recreational marine craft include: the type of vessel; its length; engine size; and area of use (eg inland waters or open sea).

Within the broader insurance industry, it is common for insurers to reduce their underwriting risk by "reinsuring" their risks with other insurers (reinsurers). This generally takes the form of an agreement whereby, for a specified premium paid by the insurance company, a reinsurer will pay a designated proportion of an insurer's liability, or all outlays above a stated level, should events prescribed in the agreement occur. Reinsurance is common for classes of insurance which are susceptible to unforseen events with the potential to involve large scale losses (eg natural disasters). Although motor vehicle and marine craft claim

[3] Many large companies do not insure assets such as motor vehicles. Although they presume that their motor vehicle fleet will incur some "average" level of accident damage, they consider that it is more economic to bear the cost themselves and avoid paying the administrative and other costs which are incorporated in insurance company premiums. Private motorists and smaller businesses do not possess sufficient vehicles to allow them to individually "spread" the risks in this way. Consequently, many decide to insure.

levels can be influenced by "freak" events which are relatively costly (eg hailstorms), insurers' risk exposure is smaller and more predictable than is the case with some other forms of insurance. Consequently, the need for, and use of, reinsurance is somewhat less.

Unlike other forms of general insurance, some motor vehicle and marine insurers employ arrangements between companies to reduce administrative costs. These are:

- knock-for-knock agreements where, in incidents involving signatories to the agreement, each insurer pays the cost of repairs for its own policyholder(s), irrespective of which party is at fault; and
- barometer of responsibility agreements which apportion liability in specified types of multiple vehicle collisions.

Forms of insurance

There are four main classes of motor vehicle insurance.

- *Comprehensive* insurance covers the insured vehicle or marine craft for loss or damage plus the legal liability for damage to property belonging to third parties.
- *Third Party Property Damage (TPPD*) insurance covers the legal liability for damage caused by the insured's vehicle to property belonging to third parties. In some countries, a form of third party property insurance is compulsory. It is not currently compulsory in any Australian state or territory.
- *Fire, Theft and Third Party Property Damage* insurance covers fire and theft damage to the insured's vehicle up to a specified sum insured, plus legal liability for damage to property belonging to third parties.
- *Third party personal* insurance compensates individuals injured in accidents where they were not at fault. This form of insurance, which is compulsory in every Australian state and territory, is not directly under reference in this inquiry.

In recent years, insurance companies have introduced a number of extensions or variations to these core policies. For example, comprehensive insurance offers:

- Faultless no claim discount which protects policyholders from losing no claim entitlements following involvement in an accident.
- Faultless excess which, in specified circumstances, exempts policyholders from paying the standard or driver age excess.

TPPD often includes an "uninsured motorists extension", or an option to purchase such insurance. This covers damage to vehicles (up to a specified

limit — usually $3000 – $5000) caused by identified, at-fault, uninsured third parties.

Operating characteristics

The activities of motor vehicle and marine craft insurers are supervised by the Commonwealth Insurance and Superannuation Commission (ISC). It derives its power from a number of Commonwealth Acts.

All private sector insurers must be authorised — and hence conform with a range of legislative requirements and be subject to ISC scrutiny — if their annual premium income exceeds $500 000 and they meet certain other specified conditions. The legislation does not apply to state or territory government insurance enterprises. However, in a bid to provide these enterprises with a more commercial focus, some have moved to voluntarily meet the regulatory requirements applying to private sector insurers, although they are not directly supervised by the ISC.

Two major objectives of the regulations are to, first, ensure the solvency of insurers and, second, protect the public generally. By and large, these objectives are met by prudential requirements with which private insurers must comply and specified contractual arrangements between the insurer and the insured (eg insurers must clearly explain the nature of the insurance cover provided).

To augment these regulations, the Government intends to introduce legislation during 1995 which will require all general insurance companies to be party to a code of practice approved by the ISC. A draft code prepared by the ICA has been released and will be finalised when endorsed by the relevant government agencies (see Box 2.1).

While imposing certain disciplines on insurance companies, the legislative package permits considerable variation in marketing strategies. In this context, the ISC (sub. 55, pp. 1–2) commented:

> ... it should be also emphasised that the rules of competition in that market are shaped very much by the Trade Practices Act 1974 which promotes price and product competition. By contrast, many overseas jurisdictions limit competition by controlling product innovation and premiums or creating barriers to the entry to new (especially foreign) insurers to the market.

Consequently, while there are many similarities in the operations of Australia's major insurance companies, there are also significant differences. Operating characteristics are briefly discussed below in relation to: distribution channels; product differentiation; damage assessment; warranties; and dispute resolution.

Box 2.1: Insurance industry code of practice

The ICA has released a draft code of practice in anticipation of legislative changes to the *Insurance Act 1973* which will require each authorised general insurer in Australia to adopt a code of practice approved by the ISC. The following provides an indication of its coverage:

Agents and employees: Agents must be trained in prescribed areas. There will be an obligation on insurers to ensure that employees possess "necessary skills", are "adequately trained" and are familiar with the provisions of the code.

Policy documentation: Insurers must use plain language in policy documentation. They must inform consumers of their duty of disclosure (and the consequences of non-disclosure) and identify all information ordinarily required to be disclosed. Previous refusals to insure need not be disclosed if they were based on grounds other than risk assessment (eg because the insurer has ceased to offer the cover).

Claims handling: Insurers must respond to a claim within 15 days of receipt. Where a claim is rejected, an insurer will be required to provide the claimant with the reasons for that decision.

Dispute resolution: Insurers must have a fully documented internal process for handling disputes with consumers. The process must be free, readily accessible by consumers, "fair" and "timely". If a dispute is not resolved to the consumer's satisfaction, the insurer will be required to provide general reasons for its decision and information on other avenues for appeal, such as the Claims Review Panel.

Responsibility, review and sanctions: Insurers must report annually on compliance with the code. Sanctions may be imposed for non-compliance (eg imposing a timetable for rectification procedures, requiring a compliance audit, requiring corrective advertising and naming the insurer in the overseer's annual report). Apart from the provisions for enforcement and sanctions in the code, a breach of the code will not give rise to any legal right or liability.

It is proposed that provisions relating to dispute resolution and responsibility, review and sanctions will operate for insurance contracts issued from July 1995. The remainder will operate from July 1996.

Distribution channels

The major sales avenues are through insurance companies' own outlets or through intermediaries (ie agents and brokers).

The Insurance (Agents and Brokers) Act defines a *broker* as a person who carries on the business of arranging contracts of insurance as an agent for policyholders and intending policyholders. A broker's role can also extend to assisting with claims preparation and presentation. Brokers charge their client a fee and also receive a commission payment from the insurer. According to the ISC, client fees for motor vehicle and marine hull policies commonly range between $15 and $30.

An insurance *agent* arranges contracts on behalf of one or more insurers. The ISC commented that client fees charged by agents are not dissimilar to those charged by brokers. The ISC (sub. 55, p. 10) also noted that:

> ... commissions in the motor vehicle and marine craft areas are competitive, perhaps averaging around 6% (motor) and 12% (marine) over the last 10 years. This compares with commission levels up to 20% in certain other classes.

Some larger companies (eg the RACV) rarely use brokers or agents. Other companies use them extensively, mainly because they can provide a wide geographical coverage without the need to establish a network of regional offices.

Product differentiation

Aside from price, insurance products offered by most insurers are broadly similar. For example, the ICA (sub. 23, p. 6) stated:

> The majority of individual motor vehicle insurance policies for private cars offer similar insurance cover, generally along the lines of the prescribed cover of the Insurance Contracts Act.

However, some differentiation exists in relation to: write-off values; choice of repairer; and the "value added" components offered by some insurers.

Write-off values: Write-off values — the value attributed to a vehicle which is stolen or is damaged beyond repair — may be specified in terms of an "agreed" value or a "market" value. Agreed values are a prescribed amount determined at the time a policy is renewed. Market values are determined and based on the type and condition of the vehicle at the time of write-off. Some companies offer policyholders a choice, while others adopt one basis for valuation.

Agreed value policies eliminate one significant source of dispute about claims between insurance companies and their clients. With an agreed value policy, the value of the vehicle is agreed between both parties. Hence, there is limited scope, or reason, for a dispute to arise about the payout if the vehicle is written-off. In contrast, there is considerable potential for disagreement if the policy is specified in terms of current market value. After an accident, it can be difficult to assess the pre-accident condition of a vehicle. In addition, perceptions of the

meaning of "market value" vary. On the other hand, a market value policy takes account of changes in the value of a vehicle over the term of the policy. This may avoid a situation where, at write-off, the agreed value is less than the market value.

Choice of repairer: In the event of an accident, some insurers allow policyholders to nominate a repairer of their choice. Others retain the right to choose the repairer. Frequently the repairer specified by the insurance company will be one of its "approved" or "preferred" repairers. The criteria for repairers gaining accreditation vary between insurers, but generally reflect previous business relationships, equipment and skill levels.

Those insurers that allow policyholders to select a repairer contend that this allows freedom of choice and alleviates any concerns that insurance companies are seeking low cost repairs at the expense of quality. Those insurers that retain the right to nominate the repairer believe that it gives them better control over both costs and quality. From the repairer's perspective, the major advantage of insurance company accreditation is the volume of insurance company work that they can attract.

"Value added" components: Insurance companies offer a variety of additional benefits which are available with core insurance policies or can be purchased as options at additional cost. These include: accommodation and travel expenses following an accident; the short-term provision of a replacement vehicle after an accident or theft; compensation for personal property losses; and provision for damage to a towed trailer.

Assessment of damage

Traditionally, most insurance companies have required policyholders to obtain more than one quote for driveable vehicles. However, in the case of vehicles that are towed from the accident scene (non-driveables), only one quote is generally obtained (in most cases from the repairer to which the vehicle has been towed).

A small number of insurers use a different procedure for non-driveables. AAMI employs what it terms a "competitive quotation system". This involves moving non-driveable vehicles to a customer service centre and inviting two repairers to quote on the vehicle. (Usually at least one is an AAMI recommended repairer.) AAMI considers that this decreases costs by reducing repairers' incentives to pay "drop-fees" and other "commissions" (see Chapter 4), and by introducing an element of competition to the assessment of repair costs. In it submission on the draft report, AAMI (sub. 95, p. 2) indicated that it is now considering expanding its competitive quoting process to include parts as well as labour and paint.

In assessing quotes, all companies use loss assessors either employed by the insurer or by an independent company. Their role is to determine the accuracy of the quotation and, in most cases, to authorise repairs on behalf of the insurer. From the viewpoint of insurers, assessors play a significant role in addressing ambit claims by repairers and "unethical practices in the repair industry" (RACV, sub. 10, p. 10). However, many repairers consider that assessors are more appropriately considered as "adjusters", whose overriding concern is to minimise costs, often at the expense of quality.

In examining quotes, assessors frequently have regard to time and hourly rate schedules for particular repair operations. Many participants suggested that the time schedules are unrealistic, but are compensated for by insurers applying "standard" labour cost rates which are equally unrealistic. For example, Woods Accident Repair Centres (sub. 11, p. 4) commented that:

> Time schedules and manuals prescribe times which are a little generous but this is compensated for by tight allowance of $'s per hour.

Similarly, Bemak Assessing and Investigations (sub. 28, p. 2) stated that:

> Most insurance company assessors agree to a fudging of hours to bolster the hourly rate ...

Warranties

Most insurance companies offer some form of warranty. The MTAA (sub. 27, p. 19) claims that, in reality, it is generally repairers that provide the warranty:

> ... both in law and in practice, it is the repairer who carries out the work and who in turn is then responsible for any guarantee which arises on that account.

Nonetheless, if repairs cannot be honoured under a repairer's warranty (eg because the firm has been liquidated), it is the insurer that ultimately meets the warranty.

Dispute resolution

The incidence and nature of consumer complaints about motor vehicle insurance are discussed in Section 3.3. To address grievances, insurance companies typically have their own internal dispute resolution processes. Under the proposed general insurance code of practice, insurance companies will be required to provide an internal dispute handling process and access to an external complaints mechanism (see Box 2.1).

If a complainant has unsuccessfully tried company avenues, an approach can be made to the General Insurance Claims Review Panel (CRP). The Panel, which was established in 1991, presently covers the majority of insurance companies. It includes industry and consumer representatives. Determinations issued by the

Panel are binding on insurers (up to $100 000), but consumers retain their full legal rights to pursue claims (eg by arbitration or in Local, District or the Supreme Courts). The scheme is supervised by the Insurance Industry Complaints Council, which also comprises consumer and industry representatives.

The GIO previously provided its own separate body (the SIO Consumer Appeals Centre) to handle disputes arising from its Victorian operations. The SIO Consumer Appeals Centre has now merged with the General Insurance Claims Review Panel.

Other options open to policyholders with a grievance include state government Consumer Affairs Departments and the Trade Practices Commission. Dispute resolution procedures are discussed in more detail in Section 3.3.

2.2 The repair industry

Size and structure

The Australian motor vehicle fleet comprises around 10.5 million vehicles. Of this number, approximately 8.3 million are cars, the average age of which now exceeds 10 years.

In recent years, the effect of an ageing fleet in increasing demand for vehicle repair and maintenance services has been outweighed by the economic downturn and lower repair and maintenance costs due to increased reliability of cars and a reduction in servicing needs. In 1988–89, average weekly household expenditure on the repair and service of motor vehicles was about $33 (equivalent to a little under 5 per cent of total weekly expenditure).[4] There is also substantial expenditure by fleet owners and commercial truck operators.

Given this demand for repair and maintenance services, it is not surprising that the repair industry is one of the larger service industries in Australia.[5] In 1991–92, the industry had a turnover in excess of $7 billion and employed well over 95 000 persons (see Table 2.3).[6]

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4 Includes expenditure on comprehensive insurance.

5 In this chapter, the term “repair industry” refers to both repair and maintenance activity.

6 These data understate the true figures because they do not take account of repairs undertaken by dealerships and petroleum retailers. Repair data undertaken by these establishments are not separately recorded by the ABS.

Table 2.3: Selected repair industry data, 1991–92

Main activity	*Locations*	*Persons employed*	*Wages & salaries*	*Turnover*
	No.	No.	$m	$m
Smash repairing	6 438	32 269	552	2 135
Automotive electrical services	2 024	8 353	120	604
Automotive repair and services nec	13 550	54 705	739	4 048
Fuel retailing	7 667	53 155	585	11 211
Vehicle retailing	5 398	60 684	1 503	24 955

Source: ABS (1993).

The repair industry is characterised by a large number of repair shops, each of which typically employs relatively few people. Average employment by the 6500 smash (or "body") repairers covered by the 1991–92 ABS census was five persons, a little higher than the average employed by automotive electrical establishments.

The overwhelming majority of repair shops are individually owned. AAMI (sub. 30, p. 21) stated that of the 1600 repair shops in Victoria:

> ... there are only four large panel shop groups owning more than five shops; the largest operates 15 repair shops.

In most states, it is now common for repairers to form cooperative buying groups to secure volume discounts on purchases of replacement parts.

Several participants suggested that there are too many workshops servicing the body repair market. For example, GIO (sub. 36, p. 3) commented:

> ... the industry as a whole has too many workshops (which are accordingly underused for the capital investment in them).

Establishments engaged in providing repairs can be broadly classified as:

- independent workshops (most smash repairers, for example, fall into this category);
- service station workshops, which can be independent or franchised workshops (eg Shell Autocare and BP Car Care Centres);
- franchised dealership workshops;
- other franchised workshops (eg Ultra Tune and Better Brakes); and
- company owned chains (eg Kmart and Goodyear).

Some vehicle maintenance and repair services are provided by mobile mechanical services. These can be franchised operations, part of company

owned chains or totally independent. Repairs to farm vehicles, mining and other special purpose vehicles are often provided at the farm, mine or other work site.

A significant proportion of vehicle repairs is undertaken by what the industry terms "backyarders". Much of this activity would not be included in the census data shown above. Backyard repair activity is usually a one man operation and may or may not be a registered business. The individuals involved may have no formal training or may be highly trained technicians "moonlighting" (ie working after hours to supplement their regular income).

The structure of the repair industry is changing. The increased sophistication of vehicles (eg computerised engine management systems, anti-lock brakes and electronically adjustable suspensions), improved paint finishes and greater use of plastics, aluminium and specialty steels make it increasingly difficult for smaller less well-equipped workshops to compete. The NRMA (sub. 54, p. 20) suggested:

> Increased technology and sophistication in "new generation" vehicles has and will continue to have, a profound effect on the shape of the body repair industry. ... with the passage of time, there will be a sharp decline in small shops and an increase in large shops, dealer body repair shops and increased specialisation in particular marques.

Small repair shops are also facing increasing pressure from dealer franchises. To some extent, this is being fuelled by extended warranties on new vehicles and the involvement of dealership workshops in body repairs. In this context, the RACV (sub. 10, p. 14) noted:

> Increasingly, car manufacturers want to control the servicing and repair of their products for the whole of the product life in a bid to keep the individual customers for life.

Use of replacement parts

Replacement (or aftermarket) parts comprise all parts other than those produced for use in the assembly of new vehicles. In essence, they are parts used to repair and maintain the existing vehicle fleet. While the major user is the repair industry, purchases by individuals, large fleet operators who service their own vehicles and "backyard" mechanics are also significant.

Official statistics do not provide a satisfactory basis for estimating the size of the replacement parts market. However, the Australian Automotive Aftermarket Association estimates annual sales to be in the order of $4 billion. According to the ICA, parts used for smash repair amount to approximately $800 million.

Replacement parts are supplied from a variety of sources including: local vehicle manufacturers and their original equipment (OE) suppliers; other local parts manufacturers; overseas vehicle manufacturers and their OE suppliers; other overseas suppliers; and sellers of second-hand and reconditioned parts (eg wreckers). New replacement parts carrying the brand name of vehicle manufacturers are commonly termed "genuine parts". "Non-genuine parts" include parts made by the manufacturers of genuine parts, but marketed by them under their own brand names, as well as all aftermarket parts produced by other suppliers.

Operating characteristics

Although many workshops are specialised and perform a relatively narrow spectrum of work (eg brake repairs), the majority are involved in a wide range of servicing and mechanical repair functions. Smash repair workshops tend to be more specialised. Most perform both insurance and non-insurance work.

The distribution of maintenance and service work between dealer workshops and other workshops is not known. Generally, the older the vehicle the more likely it is that owners will have maintenance and servicing performed by non-dealer workshops. Extended warranties now available on many new vehicles would tend to increase demand for dealer-performed services. However, because a large proportion of new motor vehicles are sold to commercial operators who organise their own servicing and maintenance, many vehicle dealers only retain a small proportion of servicing and maintenance work during the warranty period — often less than 50 per cent. On the other hand, the average new car owner tends to have the vehicle serviced at a dealership, largely because of the perception that service and repairs during the warranty period must be carried out by the manufacturer's authorised dealer if the warranty is to remain valid.

Vehicle manufacturers own some dealerships, but the overwhelming majority are independently owned. The dealer generally enters into an agreement with the manufacturer/distributor of the vehicles. The agreement sets out certain obligations with which the dealer must comply in order to remain part of the dealership network.

Manufacturers typically determine the number and location of dealerships for their vehicles. They have a commercial interest in ensuring the viability of their dealers, and usually restrict the number of franchises in any region. Franchise periods are determined by negotiation between dealers and vehicle manufacturers. In many instances, dealers hold a franchise for more than one make of vehicle.

Smash repair workshops attract business in a number of ways. A large proportion of the work is gained by: having accreditation with one or more insurers; owning a tow truck which allows them to pick up vehicles form accident sites; and/or by "buying" work from tow truck operators (ie paying so-called "drop-fees"). Vehicle owners may nominate a particular smash repair shop. However, in the case of most undriveable vehicles, the repair shop to which a vehicle is initially towed is determined by the tow truck driver who is successful in gaining the tow. A high proportion of undriveable vehicles are repaired by the repair shop to which they are first towed.

The quality of repair work varies between repair shops. Largely because of consumer concerns about the standard of repair work and allegations of dishonest practices, in 1980 the New South Wales Government established the Motor Vehicle Repair Industry Council (MVRIC) and the Motor Vehicle Repair Disputes Committee under the Motor Vehicle Repairs Act (see Box 2.2).

The operators of repair shops in other jurisdictions are not subject to similar legislation, although Queensland, Western Australia and the ACT have recently undertaken, or have ongoing, reviews of their repair industries and have considered the option adopted by New South Wales. However, in all states and territories, repair businesses are required to comply with legislation that has more general application. This includes occupational health and safety, environmental and development/zoning regulations. In all jurisdictions, there also exists a degree of self-regulation by industry associations such as the Motor Trades Association, the Institute of Automotive Mechanical Engineers and the Society of Automotive Engineers. These organisations have codes of practice which prescribe certain minimum standards and set out various rules of conduct by which their members are expected to abide.

Box 2.2: Motor vehicle repair industry regulation in New South Wales

MVRIC was established under the *Motor Vehicle Repairs Act 1980* to promote and improve vehicle repair standards in New South Wales. The legislation requires that every repair business hold a repairer's licence in the appropriate classification of work. Additionally, all persons engaged in motor vehicle repair work must either hold a tradesperson's certificate issued by the MVRIC or be an apprentice under the supervision of a certified tradesperson. The Act also requires motor vehicle loss assessors to be licensed.

MVRIC can take action against *licence* holders for certain actions including: fraudulent or dishonest conduct; repair work which is below the usual trade standards; and having insufficient material, manpower and financial resources to carry on a repair business. MVRIC can also take action against tradesperson *certificate* holders for actions such as incompetence in repair work in the class of work for which the certificate is held and failure to comply with conditions of certification. MVRIC may dismiss the action, caution the repairer or tradesperson, or revoke and suspend the licence or certificate.

A Motor Vehicle Disputes Committee was also established under the Act to investigate and determine disputes between vehicle owners and repairers involving the standard of repairs, the cost of repairs and any other matter relating to the Motor Vehicle Repairs Act.

2.3 Tow truck sector

Size and structure

The tow truck sector comprises several segments:

- *Accident towing*, which is also called incident, crash and smash towing, involves the removal of non-driveable vehicles from accident scenes. Approximately one in five vehicles involved in accidents require towing.
- *Trade towing* encompasses the movement of vehicles within the towing and vehicle repair trades, either from one repair shop to another or from a tow truck operator's yard to a vehicle repairer's premises.
- *Breakdown towing* involves the removal of vehicles that have "broken down" from roadways or roadsides to a location specified by the owner. Motoring associations which provide breakdown services for members account for the majority of breakdown tows. While the trucks typically

carry the emblem of the motoring organisation, they are usually independently owned.

- *Clearway towing* involves the removal of illegally parked vehicles from designated clearway areas.

In some jurisdictions, the term "non-accident" is used to cover trade, breakdown and clearway towing.

Limited information is available about the extent of the different types of towing activity. However, in Queensland, 25 per cent of towing is accident towing, 40 per cent breakdown towing, 32 per cent is trade towing and the remainder — less than 5 per cent — is clearway towing (Queensland Transport 1993, p. 3). In New South Wales, accident and breakdown towing account for approximately equal amounts of the reported industry workload (42 and 38 per cent respectively) (New South Wales Government 1993, p. 5).

The overwhelming majority of accident towing services are for passenger motor vehicles. In New South Wales in 1991, 93.6 per cent of the vehicles which required accident towing were passenger motor vehicles (see Table 2.4).

Table 2.4: Vehicles requiring accident towing by type, New South Wales, 1991

Vehicle type	*Total number*	*Per cent*
Passenger motor vehicle	59 012	93.6
Light truck	2 771	4.4
Heavy rigged truck	535	0.8
Articulated truck	439	0.7
Bus	161	0.3
Emergency vehicle	185	0.2
Total	63 103	100

Source: New South Wales Government (1993).

There is significant vertical integration within the tow truck and repair sectors. AAMI believes that about 70 per cent of tow trucks are owned by smash repairers, with the remainder being "independent". In South Australia, around 90–95 per cent of tow truck operators are vehicle repairers. A New South Wales Government review (1993, p. 5) found that, of those drivers that performed mainly accident towing, 55 per cent operated trucks owned, leased or financed by smash repairers and 86 per cent were "linked" to smash repairers.

Operating characteristics

In rural areas and small centres where the demand for towing is limited, one truck may perform all types of towing services. In major centres, there is a degree of specialisation. For instance, approximately a third of the operators in New South Wales rely predominantly upon income from accident towing and another third on breakdown towing. The remaining third rely on the income from both smash and breakdown towing services.

A high proportion of breakdown towing is on behalf of motoring organisations. For example, in 1991–92, over 85 per cent of the 80 000 breakdown tows performed in Queensland were for the Royal Automobile Club of Queensland. In 1992–93, breakdown tows by the NRMA numbered around 175 000 in metropolitan areas (Sydney, Newcastle, Wollongong and Canberra) and 46 000 in country areas.

Motoring organisations normally have contract arrangements with private operators to perform breakdown towing services. Typically, they require that the operator carry the motoring organisation's emblem and meet performance and conduct standards.

A recent development has been the offer of breakdown services by motor vehicle manufacturers as part of warranties offered on some new vehicle models. As with the motoring organisations and fleet owners, these are contracted out to towing specialists.

Accident towing is organised along different lines to other forms of towing. To some extent, this reflects regulatory requirements which apply in most states and territories. Although the regulations differ between jurisdictions, the principal objectives are broadly similar. As described by the Queensland Minister for Transport at the time of the introduction of the legislation in Queensland:

> The Bill was to provide a measure of control over the activities of unscrupulous tow truck operators who prey on unfortunate motorists involved in accidents. The object of the Bill is to stamp out the unsolicited and unwarranted snide tactics and practices of an undesirable minority element now operating in tow trucks (Queensland Parliament Hansard 1973, pp. 2423–4).

The regulations typically address this objective in two ways:

(i) requiring licensing or certification of owners and drivers. This generally involves authorities checking whether applicants have a criminal record. It can also involve driver training and testing; and/or

(ii) regulations forbidding certain behaviour at accident scenes (eg harassment and intimidation, misrepresentation and paying spotters' fees).

In a number of jurisdictions, allocation schemes limit the number of tow trucks attending accident scenes. Under these schemes, licensed tow trucks are placed on a roster which applies to defined geographic zones. In some schemes, tow truck licences and positions on the roster are restricted.

Where allocation systems are not in operation, and sometimes even where they are, tow truck operators learn about accidents by:

- receiving a telephone call from the vehicle owner, driver or vehicle passenger;
- being called by police;
- listening to police and emergency service broadcasts on scanners;
- receiving information from people aware of an accident ("spotters"); or
- waiting in likely accident spots.

There is provision for the regulation or specification of metropolitan and rural towing fees in most jurisdictions. Where regulated, fees are determined by the relevant government authorities in consultation with tow truck operators and the insurance industry. In Queensland, towing fees are determined jointly by the insurance industry and tow truck sector. A number of jurisdictions also have provision for the regulation of storage and release fees.

In addition to the carrying capacity restrictions which apply under general road regulations, standards apply to the type of equipment which can be used in some jurisdictions. In some regions, additional restrictions apply. For example, in South Australia, regulations specify minimum truck numbers that can be held by each licensee, storage facility size, security arrangements and insurance. Moreover, to obtain a licence, four persons must be employed.

The regulations usually apply across entire jurisdictions. Queensland is a notable exception, with the regulations only applying to major metropolitan centres (eg Brisbane, Gold Coast, Townsville etc). The tow truck sector is discussed further in Chapter 6.

The payment of "drop-fees", although illegal in all jurisdictions except Western Australia, is a key feature of the relationship between many tow truck operators and smash repair shops. Drop-fees are paid by repair shops to a towing operator, in addition to the authorised or regulated towing fee, in return for the delivery of a damaged vehicle.

3 INSURANCE ISSUES

The motor vehicle and marine insurance industry affects virtually all Australian industries and most households. Consequently, it is important that it perform efficiently.

This chapter discusses a range of issues relating to the operation of the industry including its corporate structures (Section 3.1); competitiveness and performance (3.2); consumer complaints and dispute resolution procedures (3.3); and a number of matters which influence the relationship between the insurance and repair industries (3.4). Two other insurance related issues — motor vehicle theft and compulsory third party property insurance — are discussed separately in Chapters 7 and 8 respectively.

3.1 Corporate structures

The ownership arrangements and corporate structure adopted by an insurer can affect its commercial orientation (eg the incentive to maximise profits). They can also affect a company's capacity to compete in terms of its cost structure and the products and markets it can supply (eg many government owned insurers have traditionally been permitted to operate only in their home state or territory).

In Australia, motor vehicle and marine insurance has been provided mainly by companies having one of three corporate forms. These are capital stock companies, mutual organisations owned by members and state government owned insurance enterprises.

The most pronounced difference has been between government and other insurers. This has been reflected in both commercial orientation and cost structures.

The objectives of government owned insurance businesses have generally been broader than those of capital stock companies. As a rule, government insurers have not been required to maximise profits. In addition to meeting commercial objectives, they have typically been required to meet non-commercial objectives (eg to offer price discounts to disadvantaged groups). Moreover, their incentive to perform efficiently has been reduced because they have not been subject to the daily scrutiny associated with listing on the share market or to takeovers. They have also been exempt from the restrictions implicit in Commonwealth Government prudential requirements and ISC supervision.

Historically, the underlying costs of government business enterprises (GBEs) operating in many spheres of activity have also been different from their private sector counterparts. For instance, many GBEs have not been required to pay taxes or to pay dividends to their owners (ie governments).

Exemptions from certain charges and taxes have provided government insurance businesses with a cost advantage over other insurers. This has reduced the need for them to function efficiently. At the same time, non-commercial objectives imposed on them have detracted from their performance. Suncorp (sub. 38, Appendix F, pp. 4–5) commented that it:

> ... has in the past been obliged to pay claims in circumstances when many other insurers would have avoided the policy ...

The commercial orientation and cost structures of mutual companies are also perceived to be different from capital stock companies.

Although not large in number, some of the biggest motor vehicle and marine craft insurers operating in Australia are mutual companies (eg the insurance businesses of state motoring associations). Some of the large life insurance companies which also provide motor vehicle and marine insurance (albeit limited) are also mutual companies (eg the AMP Society and Colonial Mutual Life). In common with government insurers, profit maximisation is generally not the sole objective of mutual companies. Most are also concerned to provide high levels of service to their members and to contain premium costs.

Insurance businesses which are mutual organisations are considered by some to be advantaged relative to capital stock companies, mainly because they need not pay annual dividends.[1] On the other hand, mutuals are restricted in their capacity to raise additional capital. As a result, they have to adopt relatively conservative policies to reserve and maintain capital. According to the NRMA (sub. 54, p. 8):

> To a large extent this [the need to set reserves conservatively] can offset the competitive advantage of not paying dividends when determining premiums.

In recent years, concerns over differences associated with the various corporate structures adopted by insurers, and their implications for competition, have lessened. Governments have introduced measures that seek to place those GBEs that compete directly with the private sector on a similar footing to privately owned firms (eg government insurance businesses and other

[1] This is not to imply that their members are disadvantaged. Members of mutual organisations join in the expectation that higher quality service levels and/or lower premiums will substitute for dividend payments.

government owned financial institutions).[2] Moreover, privatisation has reduced the number of government owned insurance businesses providing motor vehicle and marine insurance in Australia. The three that remain supply about 6–7 per cent of the national market. They continue to be exempt from ISC prudential supervision, but the ISC (sub. 55, p. 5) notes that, in practice, some state governments:

> ... impose requirements on their GBEs similar to those placed on private sector insurers. Some States subject their GBEs to supervision on a similar basis to that carried out by the ISC.

Moves towards de-mutualisation by some insurers (eg the NRMA, National Mutual Life and Colonial Mutual Life) suggest that the disadvantages of a mutual structure may now outweigh the advantages for large mutual insurers. In this context, the ISC (sub. 55, p. 2) stated that:

> While insurers structured as mutuals may dispose of reserves through rebates to members, so as to maintain or expand market share, there is evidence from recent moves towards de-mutualisation that mutuals do not consider these rebates to be an important part of any competitive edge they may have.

These changes have placed a greater proportion of insurers on a similar footing and increased the intensity of competition. However, there are concerns that competition in the insurance industry is not as vigorous as it could be. This issue is discussed in the following section.

3.2 Competitiveness and performance

Assessing the performance of the insurance (or any other) industry is a difficult task. One approach involves examining in considerable detail cost structures, operating procedures and the nature and prices of outputs with a view to assessing whether the products produced are appropriate to users' needs, are produced at least cost and are priced efficiently. This is a formidable task, especially if there are a large number of producers.

An alternative approach which is not as informationally demanding relies on the presumption that, if a market is competitive, there are forces at work which provide a powerful stimulus for firms to operate efficiently (eg if effective competition exists, firms face an ongoing threat of losing market share, making financial losses and, ultimately, being forced out of business). The latter approach is adopted in this section. More specifically, structural and

[2] Similar accounting standards for both private and government owned general insurers have been operational for financial reports produced since 30 June 1992, although government insurers have some leeway in meeting these standards.

behavioural aspects are briefly examined to see whether there are factors existing which could mute competitive pressures. Both "static" indicators (eg concentration ratios) and dynamic considerations (eg ongoing changes in the nature and intensity of competition) are considered.

Number and concentration of insurers

As reported in Chapter 2, a relatively large number of insurers operate in Australia. ISC data show that 93 companies offer motor vehicle insurance and 54 companies provide marine hull insurance.[3] Many of these companies have a relatively small share of the motor vehicle and marine insurance market and operate only in a few selected markets. For example, ISC data show that, in the Northern Territory, which has the smallest number of insurers of any state/territory, there are 16 domestic motor vehicle and 17 marine hull insurers.

The majority of motor vehicle and marine hull insurance in Australia is provided by a number of relatively large companies. Data provided by the ISC (see Table 2.2) show that the top 5 private sector companies provide between 35 and 63 per cent of insurance in the major business classes. At the state/territory level, concentration is generally somewhat higher. For example, the top five domestic motor vehicle insurers in New South Wales and Victoria account for 86 per cent and 73 per cent respectively of the volume of premiums.[4] In some regional markets, the number of suppliers could well be less, and industry concentration could be higher. There is, however, little doubt that, at least in major markets, there is fierce competition on price, in the nature of the products provided and on quality of service. The ISC (sub. 55, p. 3) referred to:

> ... quite active levels of price and product competition in all of the key classes of businesses of the (general insurance) industry.

Furthermore, competition in some markets is likely to be increasing following moves by some large insurers (eg NRMA, GIO and Suncorp) to extend into new markets. Thus, while the structure of the motor vehicle and marine craft insurance industry does not adhere to the conventional text book view of competition — many sellers, with none having a significant market share — it is difficult to claim that the existing structure is indicative of a lack of effective competition between insurers. However, to arrive at any view as to the intensity of competition, it is necessary to consider other factors such as barriers to entry and exit, and dynamic considerations relating to market conduct and financial performance.

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[3] According to the ISC, Australia has a relatively large number of general insurers relative to its population (ie 163 private insurers compared with 98 in Italy and 70 in Japan).

[4] In New South Wales, one insurer — the NRMA — has over 40 per cent of the market.

Barriers to entry and exit

Competitiveness within an industry is influenced by barriers to entry and exit. More specifically, the greater the freedom to enter a market, the greater is the pressure on incumbents to minimise costs and price efficiently. Failure to do so creates profit opportunities which, in the absence of barriers to entry, new entrants would soon seek to exploit. In markets characterised by low barriers to entry, even a sole producer may have little market power.

The significance of exit barriers is less obvious. However, exit costs can be an important influence on decisions about entry. Broadly speaking, the higher are the costs associated with leaving an industry (eg losses incurred on asset sales), the higher are the risks associated with entry.

In the insurance industry, new entrants clearly face problems in obtaining all of the relevant information about the risks they wish to insure. On the other hand, much of the required information about risk can be inferred from the premiums charged by other companies. This information is publicly available and can be assembled at a low cost. New entrants also face costs associated with developing the business to a scale where it can compete profitably with the premiums offered by established firms. In addition, there may be problems in attracting the necessary capital.[5] However, firms wishing to enter most industries face analogous problems, and it is doubtful whether such costs can be construed as significant entry barriers. There has been some entry and exit from the industry over recent years, but much of this is as a result of structural adjustment within the industry (ie mergers and rationalisations).

One feature of the Australian market has been the entry of affiliates of leading overseas insurance companies. Such companies now comprise about half of all general insurance companies operating in Australia. In turn, some local companies have established overseas markets "proving that they are indeed competitive by world standards" (ISC, sub. 55, p. 2).

Some provisions of the Insurance Acquisitions and Takeovers Act could potentially pose a barrier to entry. The Act provides the Commonwealth Treasurer with the power to deny proposals to acquire an interest in, or control over, an authorised insurer. It also places some constraints on the supply of insurance and other financial services by the same enterprise. However, the provisions in the Act do not prevent an insurer from owning shares in another

[5] Cost disadvantages associated with the scale of operations and capital raising are likely to be less for a new entrant that has already established a presence in other forms of general insurance. For example, existing insurers have an established sales force and distribution system which they can use to promote new forms of insurance.

business, or being owned by another business. The ISC (sub. 55, p. 18) stated that:

> Neither the insurance industry, banking or other finance industry organisations have provided information to the effect that these measures may constrain intersectoral ownership and competition. The overriding concern is to preserve, to the greatest extent possible, funds required to pay policyholders' claims and we are unaware that the supervisory framework unreasonably fetters prudent market processes.

Financial performance

As noted above, there are clear indications of quite vigorous price competition between insurers. Over recent years, new products have been introduced to the market (eg fault free no claim bonuses and other "value added" options such as the provision of replacement cars) and new business practices have evolved. The level of competition has intensified following the privatisation of some government insurance offices and the breakdown of some traditional market boundaries. For example, Suncorp is now competing in Northern New South Wales, the NRMA has entered the Victorian market and GIO has commenced operations in Victoria and Western Australia. All of these factors suggest increasing competitive pressures.

A guide to the strength of competitive pressures is provided by considering financial performance. If competitive pressures are weak, individual insurers may be able to exercise market power and achieve higher than normal profits.

In addition to measures of profitability for the enterprise as a whole, it is common to use some partial measures to help assess insurance companies' financial performance. These include: the loss ratio (ie the ratio of claims expense to premium revenue); the expense ratio (ie the ratio of underwriting expenses to premium revenue); and the underwriting result (ie premium revenue less claims and expenses).

Financial data supplied by the ISC illustrate a key feature of general insurance markets: both private and public sector insurers generally incur underwriting losses. Nevertheless, most insurers have made profits on their overall insurance business, largely because of the profit resulting from investing premium income (which is typically paid six or twelve months in advance) and reserves. Deloitte et al (1994, p. 23) commented:

> Although the industry claims ratios have been falling over the past three years for private sector direct insurers, the industry has still been making underwriting losses.

Aggregate underwriting results for private sector motor vehicle and marine insurers between 1983–84 and 1992–93 show underwriting losses (ie aggregate claims and expenses exceeded premiums) in most years. The only exception

over the period was relatively small underwriting profits made by private marine hull insurers during the mid-to-late 1980s. Aggregate underwriting results for public sector motor vehicle and marine insurers between 1983–84 and 1992–93 also show underwriting losses for most years. In 1992–93, the aggregate underwriting loss on motor vehicle and marine hull insurance by all private and public sector insurers was $138 million — the smallest loss for many years.[6]

Loss and expense ratios over the period 1983–84 to 1992–93 varied between private and public sector insurers and between motor vehicle and marine hull insurance. Average loss and expense ratios over the period are shown in Table 3.1.

The ISC commented that a study comparing loss ratios of general insurers in Australia and 13 other countries over a six year period (between 1980 and 1986) found that loss ratios were highest in Australia. It added (sub. 55, p. 3) that:

> From the viewpoint of insurance company shareholders this may be unfortunate. However, for Australian policyholders, it provides evidence that they may be getting better value for their insurance dollar than any other of the thirteen countries surveyed.

Table 3.1: Average loss and expense ratios, 1983–84 to 1992–93 (per cent)

	Motor vehicle		*Marine hull*	
	Private	*Public*	*Private*	*Public*
Average loss ratio	88	87	71	76
Average expense ratio	25	22	32	36

Source: ISC (sub. 55, Appendix C).

Financial data including investment income are available only for the broader general insurance sector.[7] These show that, in 1992–93, private sector direct underwriter general insurers incurred an underwriting deficit of $465 million, but made an aggregate *after* tax profit of $396 million. As the market value of assets employed was $22.7 billion, the after tax return on assets was about 2.1 per cent. This compares with 4.8 and 3.9 per cent in 1990–91 and 1991–92

[6] In 1990–91 and 1991–92, the aggregate underwriting loss was $459 million and $273 million respectively.

[7] Motor vehicle and marine insurance business accounts for about 33 per cent of general insurance direct premium revenue.

respectively. Returns of this magnitude represent a relatively low return on capital.[8]

Summary

There are over 100 companies providing motor vehicle and marine hull insurance to Australian consumers. This relatively large number masks a degree of concentration in the industry — the top five companies account for around 50 per cent of premium income. However, in major markets there is strong competition between insurers for market share. This is evidenced by the entry of several of the larger insurers to new markets and by the development of new products and new ways of conducting business. Financial data suggest that overall industry profitability is relatively low.

There is vigorous competition in major insurance markets covered by the reference. The intensity of competition has increased following the privatisation of some government insurance businesses and the breaking down of some traditional market boundaries. This has increased the pressures on insurance companies to function efficiently and be responsive to users' needs.

Despite the evidence of effective competition, there is a considerable number of complaints made by consumers about the industry. This issue is discussed in the following section.

3.3 Consumer complaints and dispute resolution procedures

Level and nature of disputes

Based on complaints made to the General Insurance Claims Review Panel (CRP), more disputes arise over motor vehicle insurance than any other form of general insurance. In 1992–93, 42 per cent of all complaints about general insurance related to motor vehicle insurance. In terms of the number of disputes which were formally referred to the CRP, the proportion is somewhat lower —

[8] A study published by Deloitte Touche Tohmatsu (1993, pp. 26–8) reported that the after tax return on shareholders funds for private sector direct insurers in 1991, 1992 and 1993 was 2.9 per cent, 5.3 per cent and 9.8 per cent respectively. In respect of the 1993 outcome, the study (p. 27) commented that "... private sector insurance industry returns of 9.8 per cent for direct insurers ... are on the low side due to the minimum statutory solvency requirement and the conservative nature of the business".

around 37 per cent.[9] In 1992–93, domestic motor vehicle insurance represented approximately 45 per cent of general insurance policies.

Complaints received by the CRP in 1992–93 exceeded those received in 1991–92, its first year of operation. However, this increase could well reflect wider knowledge of the existence of the Panel and its capacity to resolve disputes rather than an increase in the underlying level of complaints.

An indication of the nature of complaints received by the CRP in 1992–93 is shown in Table 3.2 below. The largest category of complaint — about 26 per cent of all motor vehicle complaints — relates to the settlement amount in instances where vehicles are written-off. Several insurers commented that the source of this disagreement is often the method used to determine the settlement amount, particularly if the value is based on the "market" value rather than a predetermined "agreed" value. The second most common complaint related to denial of liability by insurers. Complaints to the CRP about the quality of repairs are rare.

Table 3.2: Motor vehicle insurance complaints to the CRP, 1992–93

Type of complaint	*Number*	*Per cent*	*Type of complaint*	*Number*	*Per cent*
Settlement quantum	792	26	No claim bonus	45	1
Liability denied	706	23	Policy interpretation	40	1
Settlement — other	603	19	Cancellation/refund	41	1
Delay	322	10	Cover availability	41	1
Excess	245	8	Staff attitude	22	1
Premium level	78	3	Other	168	6

Source: GICRP (1993)

Dispute resolution procedures

The time and resources required to resolve disputes can impose considerable costs on the parties involved and, where disputes are progressed through the court system, on the community in general. Consequently, it is important that processes are in place which encourage parties to settle disputes between themselves wherever possible, using legal channels only as a last resort. To establish such a culture, it is important that this expectation is clearly conveyed to the relevant parties.

[9] The corresponding figures for marine pleasure craft are approximately 1 per cent and 3 per cent respectively.

To achieve this objective, dispute resolution procedures should ideally possess certain minimum characteristics. They should be: independent[10]; extensive in coverage; fair; inexpensive; easy to use; conducive to making decisions which are enforceable with appropriate sanctions; capable of providing quick results; well known and accessible to consumers[11]; and capable of discouraging unreasonable complaints without impeding legitimate complaints. The procedures should encourage the parties themselves to search for a resolution of their dispute before taking the matter further. To help meet these requirements, personnel involved in the operation of the scheme need to have sufficient technical expertise and procedures need to be in place to provide assistance to consumers in formulating and lodging complaints. Information about dispute resolution schemes should be made readily available (eg included on claim forms and policies).

A multi-tiered dispute resolution process has been developed by the general insurance industry. The first level involves direct negotiation between the policyholder and the relevant insurer. If necessary, this is followed by mediation through the ICA or consumer organisations. If the dispute remains unresolved at this point, it can be lodged with the CRP — although not all consumers and not all types of complaints are covered by the scheme (eg the scheme does not cover most commercial insurance or third party disputes). In addition to these industry-based mechanisms, consumers have recourse to government consumer affairs agencies and to the court system.

Insurer initiated processes

Most queries are resolved in-house by frontline counter staff. Matters that are not settled at this stage often progress to the insurer's in-house dispute resolution department, although not all insurers have a separate section that deals specifically with consumer complaints.

According to the NRMA, the costs associated with running an internal customer relations department are far outweighed by the benefits. It claimed that the benefits include: retaining business; reducing negative "word of mouth" advertising; saving management time (since the customer does not go back and forth between different managers in an attempt to secure a satisfactory result); and providing insurers with feedback on areas of business which require improvement.

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[10] Internal schemes can be effective even if they are not completely independent. However, the greater the autonomy of an internal scheme, the greater the credibility of the scheme from consumers' point of view.

[11] Including those in non-metropolitan areas or for whom English is not a first language.

In-house schemes meet many of the desirable qualities outlined above (eg they are low cost and easily accessible). However, they are almost invariably not independent and may not enjoy the confidence of some consumers. In this regard the Trade Practices Commission (TPC) (sub. 110, pp. 2–3) submitted:

> Internal schemes can be made more autonomous and credible by:
>
> - ensuring that a review of an insurer's decision is undertaken by a person who has not previously been involved in the original decision or the complaint;
> - providing for consumer representation in internal schemes; or
> - funding an independent scheme ...

The General Insurance Code of Practice requires that, effective from July 1995, each insurer must have a fully documented internal process for handling disputes with customers and must advise customers on the availability of dispute resolution schemes (internal and external) at the time a claim is denied.

Mediation

Mediation can provide a means of injecting an independent party into negotiations between consumers and insurers, often at little or no cost to consumers. The services most frequently used are those provided by state and territory consumer affairs agencies and the industry association.

If consumers are not insured, or if they have motor vehicle insurance, but their insurance company is not a member of the CRP, they can call on state consumer affairs organisations to mediate and/or advise on how to pursue the dispute through the courts. Persons insured with ICA member companies have the additional option of approaching the ICA. The ICA refers complaints to the head office of the relevant member insurance company. This ensures that the matter is brought to the attention of senior managers in a final attempt to prevent the dispute from escalating and passing on to the CRP or to the courts.

Some legal firms also offer mediation services. Although relatively costly, they can be cheaper than proceeding through the courts.

General Insurance Claims Review Panel

The ICA, in consultation with its members, established the independent dispute resolution scheme known as the CRP in 1991. Membership of the CRP scheme includes all ICA members and some non-member companies. Each is required to nominate one or more senior staff members to act as an ICA/Panel contact person. Once the Panel receives a complaint, panel officers contact these representatives to request a final review of the claim. Participating insurers then have 30 days to finalise their decision and notify their policyholder. Unresolved disputes are formally submitted to the Panel for determination.

The Panel comprises an independent chair appointed by the Insurance Industry Complaints Council, a consumer affairs representative appointed by the Commonwealth Minister of Consumer Affairs and an industry representative appointed by the ICA.

The CRP process is free to policyholders of member companies, but involves significant costs to insurers. Complaints referred to the Panel for determination currently cost the insurer $1250 if its decision is changed by the Panel and $500 if the Panel finds in the insurer's favour or if a settlement is reached before determination. A fee of $50 is charged if a panel officer has to call or write to an insurer.

Of the 671 complaints referred to the Panel from September 1991 to June 1993, 25 per cent were resolved in favour of the consumer, 20 per cent in favour of the insurer, 12 per cent were rejected, 17 per cent were settled prior to the Panel making a decision, around 2 per cent were withdrawn and 24 per cent remain unresolved. The use of consumer officers and the establishment of a second Panel has helped to reduce delays.

While the Panel's decision is not binding on the insured — who may take the matter further if not satisfied — it is binding on the insurance company. Refusal on the part of an insurer to settle a claim according to the Panel's decision can result in a fine of up to $1 million.

Recent changes to the scheme include the creation of a referee to deal with allegedly fraudulent claims and small business disputes.[12] In the case of allegedly fraudulent claims, a finding by the referee that there are grounds for the allegation results in the complainant being advised that it is not appropriate for the CRP to determine the matter. The complainant retains the option of pursuing the matter through the courts. If the referee finds no grounds for believing the claim to be fraudulent, he/she can determine the claim. Oral hearings may now be held on request from either party with the consent of the Panel Chair or referee.

[12] The referee system is entirely funded by insurers — $1600 in the event that the referee upholds an insurer's decision to deny liability and between $2350 and $3100 if it does not.

The CRP approach meets most of the desirable characteristics for an effective dispute resolution scheme. This is reflected in its endorsement by both consumers and insurers. For example, consumer groups — such as the Consumer Law Centre of Victoria — consider that the CRP has been a "great innovation", although they see some room for improvement. A number of consumer groups suggested that the scheme would be improved further if its terms of reference were expanded to include:

- complaints by third parties (whether insured or not) seeking to make a claim against an insurer;
- underwriting complaints such as refusals, rating, excesses or special conditions attached to policies;
- broker disputes;
- privacy complaints; and
- disputes arising out of the Code of Practice.

The CRP scheme appears to be well regarded by its member insurers. AAMI (sub. 30, p. 62) stated:

> From the insurer's perspective, the Claims Review Panel and what it offers to consumers is consistent with good business practice and, just as importantly, the findings of the Review Panel provide insurers with important educative information which assists us in modifying poor behaviour or attitudes among staff and keeping our customers satisfied. It also provides valuable feedback for product development and marketing purposes.

However, some insurers were concerned that policyholders have free access to the scheme without being bound by the Panel's decision. For example, AAMI (sub. 30, p. 62) submitted:

> In our view, consideration should be given to creating some cost for consumers who elect to use the services of the panel. We also believe that the panel should have the discretion to make a costs order against a consumer, at least in the case of a capricious complaint.

An inspection of records of Panel determinations suggests that the Panel hears a significant number of cases which are initiated by consumers acting unreasonably and "trying their luck" in circumstances in which they bear none of the CRP's costs (see Box 3.1). Each of these cases cost the insurer approximately $500 in fees to the CRP, and probably significantly more than this in legal fees. These costs must ultimately be recouped from consumers.

In its draft report, the Commission suggested that if a small deposit were charged for access to the CRP scheme — refundable on the success of a claim — the number of unreasonable claims would fall. In response to this suggestion, consumer groups argued that a fee, however small, would

discourage low income earners from using the scheme. They pointed out that, under the CRP's terms of reference, the Panel Chairman has the authority to reject vexatious claims.

Box 3.1: CRP cases initiated by unreasonable claims

The Commission examined CRP reports for 1993 to obtain an indication of the proportion of cases which, in its opinion, were initiated by unreasonable complaints. The Commission assessed around 12 per cent as "clearly unreasonable". In each of the following examples, the Panel found in favour of the insurer. However, the insurer incurred costs in the form of fees to the CRP of approximately $500 per case plus their own legal expenses.

Driving under the influence: While driving his car the insured collided with a parked car. The insured had a blood alcohol level of 0.205 per cent. The legal permissible limit was 0.05 per cent. Consistent with a clause in the insurance contract, the insurer denied liability on the grounds of the insured's intoxication.

Policy lapsed: The insured's car was stolen in June 1992. When he made a claim he was advised that his insurance policy had lapsed in 1990. The insured claimed he had changed address and, although he had advised the insurer, he did not receive a renewal notice. Under the *Insurance Contracts Act 1984*, the insurer is required to forward a renewal notice. If the insurer fails to do so, the policy is extended for a period equal to the original term. In this case, the insurer claimed to have sent the renewal notice. However, the insured had changed addresses. Even if the insurer had failed to send the 1990 renewal notice, the policy would only have been extended until October 1991. Thus, the insurer was not liable.

Proposal misrepresentation: An insurer denied liability on a claim on the ground that the insured had failed to provide correct answers about his driving record. In particular, he failed to reveal that, within the last 5 years, he had been sentenced to prison and disqualified from holding a driving licence for 5 years as a result of driving offences. The insurer established that it would not have covered the risk had it known the truth about the insured's driving history.

Based on its examination of 1993 reports, the Commission considers that insurers adopted "unreasonable" defences in several disputes determined by the Panel. Insurers have a financial incentive to limit the number of unreasonable defences, whereas consumers incur no financial penalty for initiating an unreasonable claim. Nevertheless, it may be appropriate for additional sanctions to apply to insurers in such circumstances (see following discussion).

The TPC (sub. 110, p. 5) also expressed concerns about charging for access to the CRP:

> A fee that is small enough not to discourage legitimate complaints may also not be large enough to discourage unreasonable complaints ... the approach presumes that an unsuccessful case is necessarily an unreasonable one. This is not the case, and many of the CRP's determinations show that unsuccessful cases are often finely balanced.

The TPC suggested that, if unreasonable complaints are a problem which cannot be solved by the Panel Chairman rejecting vexatious claims and the imposition of a fee is considered necessary, an approach based on that used by the Banking Ombudsman's office could be employed. This would involve the CRP assessing claims and advising complainants of its preliminary views. Consumers who are advised initially that their complaint is unreasonable or capricious would then be required to pay a fee which would only be refundable if the Panel found in their favour.

Court system

The final avenue for dispute resolution is through the court system. This is generally far more time consuming than the procedures outlined above. It is also more costly, both to the parties involved and (to the extent that there is not full cost recovery) society as a whole.

Courts can order the payment of significant financial penalties for breaches of legislation such as the Trade Practices and State Fair Trading Acts. They may also issue orders for compensation where a person has suffered loss or damage through a breach of legislation. And they can require that action be taken — such as disclosure of information or the publication of advertisements — to remedy the consequences of a breach.

Motor vehicle insurance disputes are dealt with by Small Claims Courts, Magistrates' Courts and sometimes by District Courts.

Small Claims Courts — sometimes called Small Claims Tribunals or Consumer Claims Tribunals — deal with disputes involving small sums of money (up to about $15 000 depending on the jurisdiction) between consumers and businesses or between two consumers.[13] Usually no lawyers are involved and consumers present their own case. The court's decision is final and can be enforced by a Magistrates' Court if necessary. Appeals against a decision are allowed only in exceptional circumstances. Court costs faced by each party vary by state and by claim value, but are generally low. For example, in Queensland, they range

[13] The upper limit varies between jurisdictions. The limits are: $15 000 in Queensland; $10 000 in New South Wales; $6000 in Western Australia; and $5000 in South Australia, the Northern Territory and the ACT. In Victoria, the Small Claims Court does not have jurisdiction to hear motor vehicle cases. These must be heard by the Magistrate's Court.

from $11 to $58. The court can order that a party be reimbursed for these costs, but cannot order the recovery of other costs, such as search fees.

Most motor vehicle property disputes are decided at the busiest level of the court hierarchy — Magistrates' Courts — which have a higher claim limit than Small Claims Courts.[14] In Queensland, 245 complaints were filed in the Magistrates' Court in 1993 relating to motor vehicle damage claims, 19 of which were listed for trial. The size of claims ranged from $250 to $40 000. Like Small Claims Courts, Magistrates' Court costs depend on the amount of the claim and vary by state. In Queensland, they start at $103 for claims of $2500 or less and increase to $149 for claims in excess of $10 000. However, legal costs can be substantial, and are usually passed on to the losing party. This discourages speculative and unreasonable litigation, but can also disadvantage those who cannot afford to use the court system. The Federation of Community Legal Centres (Vic) (FCLC) (1989, pp. 5–6) argued:

> There is a clear advantage to the wealthy. In particular, insurance companies with their superior economic strength can afford to litigate and lose little through delayed litigation. The combination of cost and delay inevitably denies justice to many Victorians.

The FCLC estimated that the prescribed legal costs which would be passed on to an unsuccessful litigant on a claim of $1500 would be $890.50. This does not include the costs of the unsuccessful party's own legal representation. The time taken to process a motor vehicle property dispute through the Magistrate's Court varies by state, but delays of up to twelve months are not uncommon.

The District Court rarely becomes involved in motor vehicle property damage disputes. It mainly becomes involved in situations where an appeal to a Magistrates' Court decision has been granted.[15]

The TPC (sub. 110, p. 7) commented that access to the court system could be improved through the enforcement of relevant legislation by public agencies:

> ... where contraventions of the Trade Practices Act are alleged, the TPC is given powers to initiate an action (or take over an action already commenced) on behalf of one or more consumers. The Insurance and Superannuation Commission has recently been given a similar power in relation to contraventions of the Insurance Contracts Act.

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[14] The Magistrates' Court deals with motor vehicle claims up to: $50 000 in the Australian Capital Territory; $40 000 in New South Wales, Queensland and the Northern Territory; $30 000 in South Australia; $25 000 in Victoria and Western Australia; and $2000 in Tasmania (known as the Court of Requests). Claims over $2000 in Tasmania must go to the Supreme Court.

[15] The District Court is an intermediate court which can consider motor vehicle civil claims up to: $250 000 in New South Wales and Western Australia; $200 000 in Victoria and Queensland; and $80 000 in Western Australia. There is no upper limit in South Australia.

Assessment

In-house dispute resolution schemes operated by insurers are attractive to consumers because they can be accessed quickly and are a low cost form of dispute resolution. They are also attractive to insurers, who have a commercial incentive to settle as many complaints as possible in-house. A disadvantage of internal schemes is that the independence of complaints departments within insurance companies is limited. However, this can be addressed by insurers forming an independent dispute resolution agency (as previously employed by GIO) or, if this option is not possible, by providing for consumer representation in internal schemes and/or ensuring that internal review procedures are undertaken by personnel not previously involved in the case. One major insurer indicated that it is presently considering having consumer representatives participate in its in-house dispute resolution procedures.

Internal dispute resolution schemes should be as autonomous and credible to consumer complainants as possible. Insurers should consider providing their in-house dispute resolution sections with greater autonomy. Alternatively, they should consider including consumer representation or, as a minimum, ensure that internal reviews are undertaken by staff not involved in the original decision or complaint.

Concerns about the lack of independence of informal dispute resolution mechanisms are largely overcome by the CRP scheme. It appears to be a cost efficient means of addressing many motor vehicle insurance concerns and has the support of both insurers and consumer representatives. The effectiveness of the CRP may be increased if its charter were broadened. However, changes suggested by some participants may require considerable changes to the composition of the Panel and to its mode of operation. Complaints from third parties could possibly be accommodated within the existing framework.

Given the costs that insurers bear to fund the CRP scheme, it is understandable that some are keen to recoup a proportion of costs from complainants. The capacity of the Panel to charge consumers would also help deter unreasonable complaints. On the other hand, the imposition of a charge on consumers would be counterproductive if it discouraged legitimate complaints and undermined consumer confidence in the scheme.

If unreasonable complaints are considered a problem, one option would involve providing preliminary advice to complainants about whether their claim is considered unreasonable. If the complainant proceeds to have the matter determined by the Panel after it is initially assessed as being unreasonable, a small deposit could be levied and refunded in the event that the Panel found in favour of the complainant. This approach would minimise the number of

complainants with "reasonable" disputes who would be discouraged from utilising the CRP if a fee were charged to all complainants.

Proposals regarding the expansion of the CRP's charter are most appropriately determined by the industry in consultation with consumer organisations. If the number of unreasonable complaints received by the CRP is considered a problem, the industry — in conjunction with consumer organisations — should consider amending the CRP procedures to enable a small deposit to be charged for the lodgement of claims which have been initially assessed by the chair of the Panel or his/her delegate as likely to be unreasonable or capricious. The deposit would only be refunded if the complainant is successful.

Insurers involved in CRP cases face quite significant costs, irrespective of whether they are found to be at fault. Nevertheless, in instances where insurers are found to have behaved inappropriately (ie adopted unreasonable defences), sanctions should be considered.

Breaches of the Insurance Industry Code of Practice identified by the CRP should be referred to the Code Compliance Committee, the body responsible for sanctioning insurers that breach the Code.

While a full assessment of the court system as it applies to motor vehicle property damage disputes in Australia is beyond the terms of reference of this inquiry, it is clear that resolving disputes through the courts can be time consuming and costly. This suggests that there should be an incentive for all parties to resolve their disputes through mediation and industry mechanisms as far as possible. The cost effectiveness of court systems would be improved in some jurisdictions by raising the monetary limits applying to Small Claims Courts; thus ensuring that litigants have access to a speedy and informal legal channel for resolving disputes. The limits should be reviewed periodically.

3.4 Relationships with the repair industry

There are strong linkages between the insurance industry and the smash repair sector. Insurers rely on smash repair workshops to repair vehicles in an efficient and cost-effective manner, and repairers rely on insurers to underwrite the cost of repairs. This interdependence entails on-going communication and negotiation in relation to the cost, quality and timing of repairs.

Despite the interdependence of the two industries, an uneasy relationship exists with each industry being sceptical about the actions of the other. Car Craft (sub. 5, p. 8) summed up the situation in the following terms:

> The prevailing attitude is that insurers and assessors simply don't trust repairers and vice-versa ...

The large disparities in firm size between insurers and repairers undoubtedly add to the tension. Many in the repair sector see themselves as "minnows" whose destiny is controlled by the large insurance corporations that have the power to direct repair work as they see fit and to dictate the terms and conditions applying to repairs. A more fundamental reason for the tension may be conflicts of interests between buyers (ie insurers) and sellers (ie repairers). In essence, insurance companies wish to minimise their expenses by driving down repair prices. Repairers, on the other hand, seek to maximise their returns by extracting as much as they can from insurance companies.

In markets for other goods and services, it is not unusual for a degree of animosity to exist between buyer and seller. Nonetheless, the relationship between the insurance and repair industries is not as good as it could be.

Repairers identified a number of practices on the part of insurers which they allege undermine relationships between the industries and/or are not in the interests of the repair industry or the wider community. The bulk of the criticism concerned efficiency, equity or quality issues. Particular criticism was directed at: two-quote systems; time schedules and hourly rates; approved repairer schemes; and loss assessors. These matters are discussed in the following subsections. Concerns were also expressed about the safety implications of some insurers' practices. Safety aspects are addressed in the following chapter.

Two-quote systems

Although some insurers only require one quote, most require two quotes for assessing the repair costs of driveable vehicles. In the case of non-driveable vehicles, the opposite is true — most companies require only one quote.

According to some repairers, the two (or "competitive") quote system for non-driveable vehicles forces repair shops to adopt unduly low cost repair techniques and to "cut corners" in order to "win" the job. They claim that this jeopardises the quality of the repair and, in some instances, vehicle safety. For example, Panelcare (sub. 39, p. 3) claimed that the two-quote system:

> ... has caused many vehicles to be returned to the road improperly repaired and possibly dangerous. The "two-quote" system does not fairly consider the owner or the repairer, only the insurance company.

The two-quote system was also criticised because it does not guarantee that owners can have their car repaired by the repairer of their choice, and because it involves additional costs which can offset savings in repair costs. The

additional costs are seen to stem from the need to prepare two rather than one estimate for each job and, in the case of the AAMI system for non-driveable vehicles, the cost to the insurer of operating a holding yard and additional towing costs.

Where vehicle owners have the option of selecting the repairer, the question of a second quote does not arise. In this context, Car Craft (sub. 5, p. 5) said that policies offering choice of repairer:

> ... clearly provide the owner with greater control in terms of their vehicle, the methods of repair and the repairer. The selection of the repairer most able to complete the repairs is based on the technical competence and quality workmanship of the repairer and not simply on the price of the repairs.

It is clearly not in a motorist's interest to have crash-damaged vehicles poorly repaired. Equally, this is not in the interests of insurance companies. Poor repairs undermine an insurer's business reputation and could lead to legal claims.

While some trade-offs are possible, insurance companies generally wish to minimise costs and preserve their reputation (and market share). The system adopted by some insurance companies to pursue this objective — the two-quote system for non-driveable vehicles — is not an unusual commercial practice. It is also widely used by insurers to assist in assessing repair costs for driveable vehicles — a practice which does not attract significant criticism from repairers. Indeed, by general commercial standards, the practice of obtaining only one quote is the more unusual of the two. Those insurance companies that favour a two-quote system believe it is effective in reducing their costs, and that the savings achieved can be passed back to policyholders in the form of lower premiums.

Two-quote systems are consistent with normal business practice. They do not infringe consumer rights since consumers have the choice of insuring with those companies that do not have a two-quote policy and allow policyholders the choice of repairer. However, policyholders need to be fully informed of company policy and its implications.

There would be reason for concern if there were evidence that insurance companies were using the system to reduce not only the overall quality of repairs, but the safety of repairs. This issue is discussed in the following chapter.

A number of repairers contend that it would be "fairer" if, where two-quote systems are employed, insurers prepared a repair specification as a basis for repairers' quotations. These repairers consider that this would establish a "level playing field" and eliminate any advantage one repairer may gain over another

by failing to quote on all items in need of repair. Some repairers suggest that the specification should also state the method of repair required. For example, Panelcare (sub. 39, p. 7) stated:

> All automotive loss assessors must establish a correct and agreed method of repair in liaison with the intended repairer ... Negotiation would only be allowed on items not fixed in the specification. If, because of genuine and justified disagreements, it is then necessary to obtain other estimates, the same specification is adhered to by all parties. In this way the correct and ideal repair method is maintained. Price variations of completing the repair to the specification is then seen to be true and fair competition.

The Commission understands repairers' concerns about the lack of a repair specification. It acknowledges that there may be some advantages in adopting a repair specification. However, the need to prepare detailed specifications could increase costs and the time taken to complete repairs. The stipulation of repair methods could also deter repairers from using innovative and less costly repair techniques. This could fetter competition by reducing — or in some instances eliminating — the scope for repairers to determine repair methods.

The basis for obtaining repair quotations is essentially a matter for insurers to determine in consultation with repairers. The Commission can see no reason for government involvement unless it can be demonstrated that current practices jeopardise vehicle safety (see Chapter 4).

Time schedules and hourly rates

The use of time and hourly rate schedules in determining repair quotations has been common in parts of the industries for many years. Some schedules have been established predominantly by insurers and others have been negotiated between insurers and trade associations (representing the interests of repairers). Consequently, the schedules themselves differ considerably (eg hourly rates appear to vary between $20 and $30 per hour).

Not all insurance companies use time and hourly rate schedules. For example, some insurers (eg AAMI) that use a two-quote system generally have no need to use schedules.

Many repairers consider that the hourly rates used by insurance assessors when assessing a quote are totally unrealistic. According to some, hourly rates should be around double the current rates to enable them to achieve a satisfactory return. However, many concede that low hourly rates are compensated for by the use of time schedules that overstate the real requirements. This system, which has been described as "funny time for funny money", was said by Panelcare (sub. 39, attachment B, p. 1) to induce body repairers to include in their quotes:

> ... a time component of between two and three times the real repair time to compensate for the unrealistic hourly rate which, although never acknowledged by insurers, is generally accepted by their assessing staff in negotiations on the cost of repair although there is a large area in such a fiction for disputation.

Despite the scope for inflating the time required to complete repairs, many repairers contend that their remuneration is not sufficient to allow them to earn a satisfactory return on funds employed. However, in some areas at least, the number of repair shops is increasing, despite the concerns about excess capacity identified in Chapter 2. According to AAMI, since 1986 there has been a 9 per cent increase in the number of body repair shops in Victoria. It is difficult to reconcile such increases with average returns which are claimed to be exceedingly low.

The use of "funny" time and hourly rate schedules does, however, raise some concerns. It requires that negotiations on repair quotations between insurers and repairers take place in circumstances which both parties know is fictitious. This is an unsatisfactory basis upon which to develop business relationships. It also encourages repairers to engage in other practices which impair the relationship between repairers and insurers. For example, Footscray Panelcare (sub. 15, p. 3) stated that:

> ... in order to remain in business, panelshops are forced to quote inflated repair times, quote for unnecessary parts or include "ghost" repairs (ie repairs that are not really there).

There is a danger that practices such as these can escalate, contributing to fraud and malpractice on a larger scale. As Panelcare (sub. 39, attachment B, p. 1) submitted:

> These fictions are fertile ground for deception, aggression and confrontation on both sides and it is but a short step from playing this game to over stepping the broad grey line to fraud and other bad business practices, including duress and coercion.

This outcome is clearly unacceptable for consumers, insurers, the repair industry and the community generally. It is a problem which should be addressed as a matter of priority, either by the industry abandoning the use of time and hourly rate schedules or by establishing realistic schedules. The purpose of any new schedules should be to facilitate negotiations rather than to fix prices or to impose uniformity throughout the industry. Repairers and insurers should be free to negotiate prices above or below those implied by any schedules used.

Time and hourly rate schedules which are based on unrealistic times and rates of remuneration are not conducive to sound business practices. They encourage dishonest practices and undermine relationships between the insurance and repair industries. The current schedules should be

abandoned. If time and hourly rate schedules are considered to be useful in preparing quotations, they should reflect true times and costs.

Approved repairer schemes

There is a trend, both in Australia and overseas, for industries to develop closer working relationships with their suppliers. Rather than playing off numerous suppliers (and potential suppliers) against each other, some firms deal with, and forge closer relationships with, a small number of suppliers. By this means they seek to reduce costs and improve competitiveness.

These developments in industry are generally mirrored by approved repairer schemes — that is, agreements between some larger insurance companies and selected repairers that provide each party with certain commercial benefits.[16] Details of the relationship between the insurer and the approved repairer are usually contained in a contractual agreement and/or a mutually agreed code of practice. Some companies do not have approved repairer schemes.

Approved repairer schemes can benefit insurers and repairers in a number of ways. Perhaps the most significant benefits are the potential to build closer relationships between insurers and repairers and develop cooperative endeavours to improve efficiency. They also provide insurers with an opportunity to use their "leverage" (in terms of the volume of work they control) to gain cost reductions and greater control over quality. For repairers, there is the prospect of a larger and more predictable work flow and lower "marketing" costs, although there can be some costs (eg average margins may be lower and they may be subject to conditions they perceive as "unfair"). One repairer's perspective of the advantages and disadvantages is shown in Box 3.2.

[16] These schemes have a variety of names. They are also known as "preferred", "designated", "selected", "accredited" or "guaranteed" repairer schemes.

Box 3.2: Advantages and disadvantages of approved repairer schemes — a repairer's perspective

Woods Accident Repair Centres generally supports the use of approved repairer schemes. However, the company (sub. 11, pp. 3–4) claims that there are both advantages and disadvantages associated with participation in the schemes:

"The advantages of being an Approved Repairer include the following:

- Improves the volume and flow of work resulting in shops being used to capacity.
- Building a relationship with an insurer leads to increasing awareness of the other party's needs and provides information on industry information, technology, training etc.
- Prompt payment for work performed.
- Improved standard of quality of work — standards set by insurance company and they provide an ongoing audit.
- As the relationship develops, systems can be introduced to streamline quoting, assessing, and accounting eg electronic interface etc.
- Cross endorsement of both party's product and service.

The disadvantages of being an Approved Repairer include the following:

- Ongoing threat of losing a large proportion of business, although in general such punishment is well deserved.
- There is the possibility that an individual could sabotage the relationship.
- In general this type of work involves a lower margin. Therefore the repairer is required to give priority to work that is less profitable.
- May jeopardise the soundness of the business in having one dominant customer.
- The repairer may be forced to purchase equipment or perform operations against their wishes."

Some participants consider that the schemes work to the detriment of the repair industry. For example, the MTAA (sub. 27, p. 12) stated that:

> ... insurance company recommended repairer schemes are discriminatory, anti-competitive and are used by the insurance companies to enhance their control of costs through manipulation of the market place.

Panelcare (sub. 39, attachment B, p. 2) considered that the schemes have been useful in building better working relationships between insurers and repairers, but expressed concern that they could eventually act against the interests of the repair sector:

> So far so good, but there is a fear in the body repair industry that the current trend could lead not just to a rationalisation of the industry as there are overall more repairers than work available at this time, but that the body repair industry may well go along the same road as the service station industry and end up becoming the servants not of a particular oil company but a particular insurer, with all the duress, disadvantages and loss of independence that the service station industry is now the captive of.

The MTAA expressed concerns that under approved repairer schemes:

- not all repairers meeting the qualifying criteria are permitted access to the scheme;
- the terms and conditions give insurance companies control over the repairer and his method of operation;
- repairers may be required to offer price reductions; and
- there is undue restriction on policyholders' choice.

Given that repairers can opt not to become an approved repairer — indeed the majority of repair shops do not have "approved" status — there seems little wrong in insurers specifying conditions of entry to a scheme, providing that the conditions do not infringe the Trade Practices Act. It is to be expected that insurers will apply conditions to schemes as a *quid pro quo* for the benefits received by the repairers (eg higher work volumes and quicker financial settlements). Repairers will presumably only apply to join the scheme (and remain members) if the expected benefits to them exceed the costs (ie they also share in the gains from the arrangements).

Approved repairer schemes can give an insurer greater control over costs by directing work to those repairers who have demonstrated that they can perform work to the company's requirements. Conversely, it can be argued that they are intended to prevent individual policyholders directing work to highly visible, relatively high cost "prestige" repairers, or repairers who have not performed satisfactorily in the past. While insurance companies argue that this is part and parcel of their responsibility to control costs, it undoubtedly restricts the choice of repairer available to their policyholders..

Like repairers, consumers also have a choice — they can insure with a company which has an approved repairer scheme, or with one that does not. Consequently, as long as policyholders are informed of the scheme — and of its implications for the selection of the repairer — consumers themselves can decide whether or not they wish to have more or less freedom of choice in selecting a repairer.

The MTAA expressed concern that not all eligible repairers are able to become "approved". However, one reason for establishing a scheme is to build up the relationship between an insurer and its repairers by developing a network of

repairers that undertake a significant proportion of work on behalf of the insurance company. Clearly, this cannot be achieved in the insurance industry (or elsewhere) if the number of designated suppliers is so large that the company's business is a relatively minor part of the overall workload of any one repairer. It also needs to be recognised that meeting an insurer's technical requirements for access to an approved repairer scheme does not guarantee that it will be possible to form close working relationships.

Approved repairer schemes are consistent with strategies adopted by many other industries to improve relationships with their suppliers. The schemes have the potential to improve productivity and so benefit both insurers and repairers. To the extent that repair costs are reduced, consumers will also benefit (in the form of lower premiums).

Loss assessors

The majority of assessors are employed by, or work on behalf of, insurance companies.[17] Many repairers see this as inevitably biasing assessors in favour of their employer (ie seeking to minimise repair costs). For example, Bemak (sub. 28, p. 3) stated that:

> It is our experience that a majority of assessors are simply price cutters and have no thought for their policy holder, the repairer or the finished product of the vehicle.

Bemak's view was supported by many other repairers. However, contrary views were also expressed. For instance, it was suggested that some assessors conspire with repairers to inflate quotes. The Professional Towers' Club (sub. 19, p. 3) commented that:

> ... insurance assessors are actively involved in the promotion of such corruption... For this the assessor is paid a cash kickback which is usually based on the size of the fraud the panel beater has been able to commit.

Similarly, Taylors Automotive Services (sub. 74, p. 26) said:

> Some assessors and repairers have gone as far as increasing the estimate/quotation to areas of the vehicle not damaged, that is then split up between repairer and assessor.

There is also concern that some assessors lack the necessary expertise. Bemak (sub. 28, pp. 2–3) stated that:

> Unfortunately the insurance industry has employed as assessors ex army personnel, tow truck drivers, spare parts salesmen and in one instance a cabinet builder to assess damaged motor vehicles and discuss the repairs and method of repair with the smash repairer having had none or very little experience in the industry.

[17] There are also some independent assessors who work for insurance companies (on a contract basis), panel shops and individual vehicle owners.

Concerns about the expertise of assessors were also raised in relation to recreational marine craft repairs. The Boating Industry Association of South Australia (sub. 32, p. 1) commented:

> A difficulty experienced from time to time by our members centres around the experience, particularly the lack of it, with Assessors engaged by Insurers. The lack of experience can cause both irritations and unnecessary delays.

Many repairers are worried that, in pursuing a complaint against an assessor, they risk losing future insurance work. However, a number of participants claimed that some of the problems associated with assessors could be overcome if assessors were, first, independent of insurance companies and, second, appropriately qualified. At present, only motor vehicle assessors in New South Wales are required to have formal qualifications.

These proposals raise questions about the rights of insurance companies to undertake their own repair assessments. It is difficult to identify strong grounds for denying insurers this right. Even if it could be demonstrated that the community at large is disadvantaged because there is a strong link between assessors, substandard repairs and vehicle safety, it is unlikely that this would be most efficiently overcome by targeting only one input into the process (ie assessors). There are also some doubts about whether the use of independent assessors would remove the problems associated with assessment procedures. For example, AAMI (sub. 30, p. 11) expressed reservations about the work of independent assessors:

> ... certain independent assessors actively work in with certain repairers to defraud insurance companies. They do so not only to guarantee an income, but also to receive gratuities.

While "on the job" training undoubtedly substitutes to some extent for a lack of formal qualifications, a requirement for assessors to undertake formal training programs may improve the effectiveness of assessors in liaising between the insurance and repair industries. It may also be appropriate for the industry to develop guidelines recognising the need for assessors to have relevant experience and/or formal training. Indeed, the ICA's recently released Code of Practice for the General Insurance Industry (Section 5.4 (b)) states that insurers shall ensure that assessors are members of an assessing or loss adjusting professional body or have sufficient expertise. However, it is not clear that governments should insist on assessors having formal qualifications. Such a requirement could exclude experienced tradesmen who lack formal qualifications.

The work of insurance company assessors is a source of dispute between the insurance and repair industries. However, this matter is most appropriately addressed by the industries themselves. There is no

justification for governments to mandate that insurance assessors possess prescribed qualifications.

Improving inter-industry relationships

Comments by a number of participants suggest that, over recent years, there has been greater consultation between the insurance and repair industries, and a better understanding has developed of each industry's attitude on the matters discussed above and on some other factors which continue to thwart the achievement of better working relations. Nonetheless, it is evident that, in both industries, certain entrenched attitudes stand in the way of a speedy resolution to the problems which contribute to ongoing tension between the industries. This view is aptly encapsulated in the following comment by the MTAA (sub. 98, p.1):

> Separately and in virtual isolation each sector has developed its own rationale supporting what has become for each an inflexible and polarised attitude and each now believes, in the best tradition of waring nations, that "God is on our side".

Both industries accept that the existing conflict detracts from their performance — it gives rise to antagonistic communications and provides incentives for both insurers and repairers to engage in undesirable and unethical practices. It inhibits firms from realising the gains stemming from the development of closer working relationships with suppliers enjoyed by firms in most other industries. Ultimately, this uneasy environment imposes costs not only on the insurance and repair industries, but also on consumers. It is clear that there are significant benefits to be gained by improving relationships between the industries.

The responsibility for improving relationships lies squarely with the industries themselves.

There already exists some foundation for the development of better relationships. Each industry has, for example, taken steps towards developing codes of ethics and/or practice. In the insurance industry, a code is being negotiated at the national level. In the repair industry, initiatives to develop appropriate codes have largely been undertaken on a state/territory basis. However, the codes have been developed by each industry in isolation from the other. Hence, while they may help in improving standards of conduct and work *within* each industry, they do not adequately address issues concerning relations *between* the two industries. Further, they do not have the support or confidence of the other industry. For example, the Victorian Automobile Chamber of Commerce (VACC) has a voluntary code for body repairers. Repairers found to have breached the spirit or letter of the code can have their accreditation withdrawn. However, the value of the code is reduced because some insurers

do not have regard to VACC accreditation when allocating repair work. In this context, the MTAA stated (transcript, p. 710):

> ... the system of accreditation that we have is excellent, but it needs support... But the problem is if we act against a member — and we have, and taken their sign away — it's up to the insurer whether they continue to do business with that particular repairer. Some do and some don't.

In its draft report, the Commission noted that there is little that government can do to resolve the friction between the industries. A number of participants indicated that they accept this view and acknowledged that it is something which is clearly in each industry's own interests to rectify — particularly in view of the interdependence of the two industries. However, there was also a view that a government directive is required. The MTAA (sub. 93, p. 9) claimed that, in order to provide the impetus required to overcome the uneasy tension and bring the industries closer together, the Commission should:

> ... at a minimum, recommend that the major parties in the industry, within each state or territory, work together to resolve continuing problems in the industry.

The MTAA suggested the establishment of "a forum" to allow representatives of the insurance and repair industries to identify and discuss mutual concerns.

The Commission supports the basic concept of a forum. If it is to be successful, the forum would need to be structured appropriately and to focus on those areas which mainly underlie the friction which presently exists between the industries. It would need to be convened at a national level and encompass representatives of all major stakeholders. Insurers, repairers and consumers would all need to be represented, and there would be merit in considering government representation (eg the Trade Practices Commission which has had a role in developing self-regulatory codes in other industries), as active participants or as observers.

The forum would have at least two major matters to address. These would involve the establishment of processes to:

- form an on-going consultative body to develop codes of practice governing issues which affect the relationship *between* the two industries; and
- determine a mechanism for resolving disputes which arise between insurers and repairers. The procedures could be incorporated in, or linked to, a code of conduct.

The first of these matters — the development of an appropriate code(s) of conduct could be devolved to a committee appointed by the forum. The code(s) would need to outline standards for commercial conduct and, importantly, provide a means of applying sanctions to those insurers or repairers that breach

the code. This would involve consideration of the benefit of registering signatures to the code. Performance against the code would need to be monitored.

The second task would involve the identification and formation of a dispute resolution process that would be perceived by both insurers and repairers as an independent and impartial means of addressing inter-industry disputes. The options include independent tribunals, an ombudsman or a conciliator. An approach involving an ombudsman, along the lines of the Australian Banking Industry Ombudsman Limited, would provide legislative back-up to any code, described in the memorandum and Articles of Association, through company law. Whatever the arrangement (independent tribunal or an ombudsman), a potential weakness that would need to be addressed is the reluctance of some repairers to pursue cases against insurers for fear of losing future insurance work.

The Commission recommends that the insurance and repair industries jointly convene a forum to determine processes that should be put in place to establish a code of conduct covering matters which impinge on relationships between the two industries and to establish a dispute resolution mechanism to resolve disputes between insurers and repairers.

4 REPAIR INDUSTRY

The Commission has been asked to consider the scope for improving the efficiency of the repair industry and to report on the cost and quality of repairs. In exploring these matters, two central themes recur — the meaning of the term "quality" and the significance and extent of competition in the repair industry.

Quality means different things to different people. Some define it in terms of the standard of work (ie how effectively and efficiently the service, diagnosis and repair functions are performed). While this is undoubtedly important, consumers are generally also interested in getting "good value" for the money spent on repairs. There is also a concern that the repairer restore the vehicle to a safe condition, and that service levels in repair shops are appropriate (eg vehicles are clean and ready for pick-up on time). Quality has been interpreted in this broader sense.

Competition has implications for both quality and efficiency. As consumers of repair services have differing preferences with respect to quality and price, their interests are likely to be best served when the market provides a range of price/quality alternatives. A competitive market encourages the provision of services to cater for users' varying requirements. It also creates incentives for repairers to operate efficiently and to price appropriately. Factors impinging on competition in the repair industry are explored in Section 4.2.

Other sections look at repair costs (Section 4.1); cost and quality issues (4.3); dispute resolution mechanisms (4.4); safety issues (4.5); environmental issues (4.6); and the case for compulsory registration of repair establishments (4.7).

4.1 Repair costs

There is little information available on the components of repair costs and trends in costs over time. Most of the information supplied by participants related almost exclusively to body repairs.

According to the Australian Road Research Board (sub. 108, p. 2), the average accident repair cost for passenger motor vehicles in 1991 was approximately $4 300.[1] Insurers indicated that replacement parts comprise around 50 to 60 per cent of the average smash repair bill. However, costs vary with the severity and location of the damage. The importance of parts in the repair charge can also

[1] Average damage repair costs for passenger motor vehicles (excluding four wheel drives and vans) based on information drawn from insurance company accident claim forms.

differ between vehicles. For some vehicles (particularly certain imports), vulnerable and commonly replaced crash parts such as headlights, windscreens, bumpers, bonnets and alloy wheels can each cost several hundred, and in some cases more than a thousand dollars to replace.

Some suggest that non-insurance repairs are generally cheaper than equivalent repairs carried out under an insurance claim, the concern being that insurance companies are overcharged by repairers. While there could be an element of truth in this (see Section 4.2), many other factors contribute to observed differences. For example, the NRMA (sub. 54, p. 25) commented:

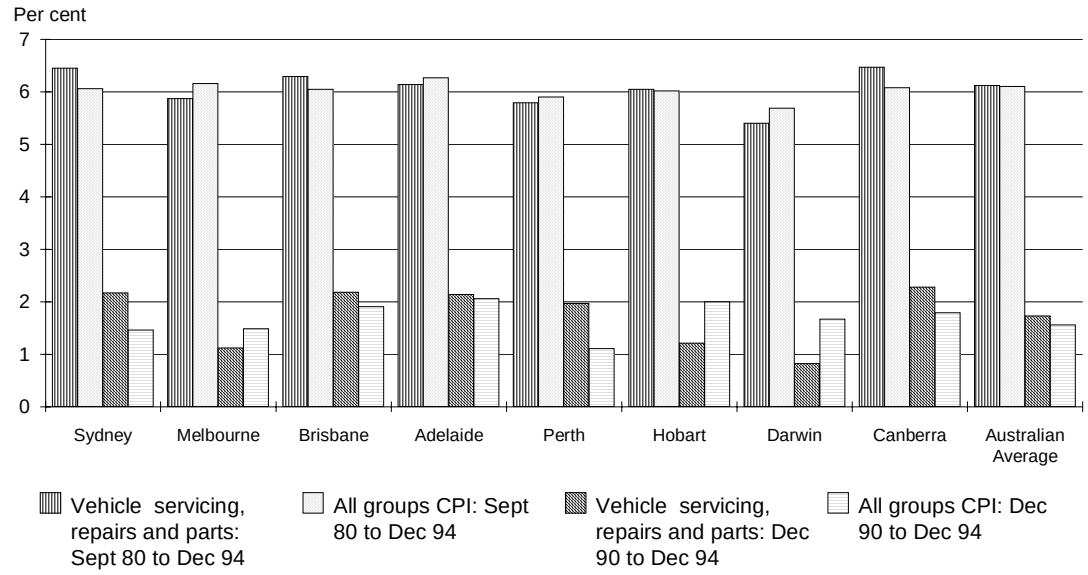
> If it is a cash job, the customer may be prepared to compromise and accept a lower standard of repair when paying the bill personally. Also some repairers are prepared to discount for cash. NRMA advises customers that it pays to shop around for both insurance and private work.

Another factor is that, with an insurance repair, the repairer is generally required to restore the car to its pre-accident condition. On the other hand, private customers may be willing to accept a less than perfect repair in order to save money (eg they may wish only to restore the vehicle to a workable or saleable condition). Of course, in some cases a private repair job will be more expensive because the vehicle owner has not shopped around and is not in a position to discern whether a quote is excessive.

It is possible to get a broad indication of movements in repair costs from quarterly consumer price index (CPI) data published by the ABS. Over the period from the September quarter of 1980 to the December quarter of 1994, the average annual increase for the "vehicle servicing, repairs and parts" component of the CPI was 6.1 per cent, which mirrored the average increase for the "all groups" CPI. The highest average increases in the vehicle servicing, repairs and parts component were recorded in Canberra and Sydney (6.5 per cent) and Brisbane (6.3 per cent) (see Figure 4.1).

For the four year period from the December quarter of 1990 to the December quarter of 1994, the average annual increase for the vehicle servicing, repairs and parts component of the CPI was 1.7 per cent. In comparison, the "all groups" average CPI increase was 1.6 per cent. The increase exceeded the CPI in four of the eight capital cities. In Melbourne, Perth, Hobart and Darwin, however, the average price increase for the vehicle servicing, repairs and parts component was less than the national increase in the CPI.

Figure 4.1: Average annual change in CPI, all groups and motor vehicle servicing, repairs and parts



Source: ABS, Cat. No. 6401.0

Many participants contend that increases in smash repair costs are mainly attributable to the escalating price of replacement parts (see Chapter 5). For example, the RACV (sub. 10, p. 18) stated in relation to insurance repairs that:

> The cost of repairs has increased but, over recent years this has mainly been due to the increase in the cost of replacement parts. Due to high levels of competition, the cost for labour has increased by only about 7% over the past 3–4 years.

A number of factors directly controllable by governments were also said to inflate repair prices. However, most of these factors (eg OH&S and compulsory superannuation requirements) apply to virtually all industries. A significant exception is the regulation applying to the repair industry in New South Wales discussed in subsequent sections of this chapter.

4.2 Factors impinging on competition

In many respects, the market for general mechanical and smash repair services is highly competitive. The MTAA (sub. 27, p. 2) stated that the market for motor vehicle repair services "is almost a model of perfect competition."

Some participants believe there is an oversupply of independent body repair shops and, in some regions, dealership workshops. High turnover rates — especially in the smash repair sector — suggest that barriers to entry and exit are relatively low. Because it is relatively easy to move in and out of the sector at low cost, any problems of oversupply are likely to be shortlived. The recent recession may have contributed to an oversupply of workshops.[2]

There may, however, be less competition in: particular geographical regions (especially in smaller country towns); in the market for repairs to certain high performance or prestige vehicles; in the repair of vehicles other than passenger motor vehicles (eg heavy trucks and agricultural tractors); and in the supply of some specialised repair services. Nonetheless, competition generally appears to be vigorous.

Notwithstanding these observations, participants identified a range of factors which they claimed detract from competition in the repair sector. These factors, which are discussed separately below, relate to: information shortcomings; dealer servicing arrangements; the New South Wales Motor Vehicle Repairs Act; and the quoting system used by some insurers.

Information imbalances

Consumers often lack the technical competence and knowledge to make informed choices. Where they are poorly informed, the market may not impose the usual discipline on repairers to provide services of a standard or cost that would be demanded were consumers better informed.

In the extreme case where consumers have no information to enable them to differentiate between services provided by repair establishments, there would be no incentive for repairers to offer higher quality services since consumers would have no way of recognising and therefore valuing that higher standard. This could result in high cost/high quality repairers being forced to lower their quality, since consumers would be unwilling to pay a higher price for their services. Ultimately, this could result in lower safety and quality levels than consumers would demand if they possessed better information.

This imbalance in information is likely to apply mainly to *individuals* seeking mechanical and smash repairs. As a rule, insurance companies (which act on behalf of individuals in arranging smash repairs) and fleet owners generate

[2] Exit costs are likely to be lower if there is a competitor or a new entrant that wishes to acquire additional premises and/or equipment. During an economic downturn, the number of potential buyers is likely to be relatively low. Thus, recession can contribute to oversupply both by reducing demand for repairs and increasing the costs associated with leaving the industry.

sufficiently high volumes of repair business to be relatively well informed about the capabilities of different repairers.

A range of measures is available to help redress the information shortcomings of individuals seeking to have their vehicle repaired. These include:

- listings of accredited repairers by motoring organisations, trade associations and insurers;
- provision of technical advisory services by motoring organisations;
- information contained in consumer and motoring journals; and
- efforts by repairers to promote their business/brand names (eg by choosing to offer warranties).

In addition, for many types of repair services the consumer can "shop around" and compare diagnoses and/or quotes. Motoring organisations also recommend that vehicle owners establish and maintain a good working relationship with a particular repairer. Having selected a repairer, the risk averse consumer can increase the probability of a satisfactory repair by: requesting a written quote; demanding that no additional repairs be carried out without authorisation; and asking for replaced components to be returned.

The imbalance of information in the vehicle repair market may be little different from that faced by consumers of many other goods and services. The consumer of domestic appliance repair services, for example, is generally no better placed to assess the nature of the repairs required or the quality of the repairs performed by a tradesperson. Indeed, in some respects, consumers of vehicle repair services are better organised (through membership of motoring organisations) and have a greater opportunity to obtain informed advice than are consumers of many other services.

There would be reason for concern about information deficiencies if costs were being imposed on parties not involved in the repair transaction (eg because safety is jeopardised or harmful environmental emissions occur). These costs are sometimes called "externalities" or "spillover" costs. In the case of safety, the concern is that accidents involving cars that have been returned to the road in an unsafe condition may impose costs (pain and suffering as well as economic costs) not only on the vehicle owner, but also on passengers, other road users, pedestrians and the broader community. Clearly, substandard repairs to domestic appliances and certain other goods also have safety implications, but the risk is more likely to be confined (eg to appliance owners and their immediate household). Safety and environmental issues are discussed in Sections 4.5 and 4.6 respectively.

Dealership arrangements

It has been argued that dealership arrangements have anti-competitive elements, namely: conditions associated with new vehicle warranties; aspects of the dealer franchise; and limitations on the extent to which service information provided to the manufacturer's own dealers is also available to other repairers.

Warranty conditions

In recent years, vehicle manufacturers have increased factory warranties from the typical 12 month/20 000 kilometres to anything up to three years or 100 000 kilometres. The MTAA (sub. 27, p. 24) commented:

> For dealers, the longer factory warranty offered by manufacturers/distributors is an excellent marketing tool which coincidentally serves to guarantee that the car returns to the dealership to be serviced for at least the period of the warranty.

The Commission understands that warranties generally require only that the vehicle be properly and regularly serviced in accordance with the manufacturer's recommendations, and not necessarily by a member of the dealer network. However, new vehicle owners may not be aware that it is an option to have their vehicle *serviced* by non-dealer repair establishments. It is clearly not in the interests of the vehicle manufacturers or their dealers to promote this option. It may also be the case that, even if they were fully informed, many consumers would be reluctant to have their vehicles serviced outside the dealer network during the warranty period. This reflects the perception that the vehicle manufacturer and dealer may be less likely to meet their warranty obligations because there may be scope for (perhaps unfairly) attributing the failure of a component or system to the work of an alternative repairer. Some consumers also consider that having their vehicle maintained by authorised dealers adds to the resale value.

Warranty *repairs*, however, are a different matter. Most warranties impose much stricter conditions on which repairers can perform the work without risk of voiding the warranty. Ford (sub. 20, p. 11), for example, stated that:

> Ford Australia generally insists that warranty repairs on vehicles be performed by Authorised Ford Dealers. (Owners may request, under certain situations, to have work performed by the nearest repairer) but Ford Australia strongly recommends ... that the repair be performed at a Ford dealer.

Restricting warranty repair work to dealers is understandable from the manufacturer's perspective and may not be an overriding concern for consumers since, in most cases, these repairs are performed by the authorised dealers at no cost to the vehicle owner.

Dealer franchise arrangements

For services and repairs outside warranty, dealers operate in a very competitive market. Consumers have the option of "shopping around" for the best quote. This is especially the case for routine services and repairs where the vehicle is driveable.

There is a relatively large number of dealer franchises (eg Mitsubishi and Toyota each have around 300), many of which are concentrated in the major urban centres. The NRMA argued that in some areas the market is oversupplied with dealers. However, most smaller centres are serviced by only one or perhaps two dealerships for a particular marque. In these areas, the lack of choice is reinforced insofar as vehicle owners feel they are "locked in" to having warranty services performed by authorised dealers.

Vehicle manufacturers typically provide their dealerships with suggested service times and recommended prices for parts. To the extent that these are followed, the scope for price competition could be limited. However, the information is provided as a guide only and dealers are free to compete on the basis of the hourly labour rates charged. There is also scope for competition in terms of the quality of the service provided.

Even where a particular market is serviced by a single dealer, the ability of the dealer to take advantage of any market power is constrained by dealerships in neighbouring centres and the threat of losing the franchise.

Access to service information/diagnostic equipment

The complexity and advanced technology that are features of modern motor vehicles place dealers at a competitive advantage, principally because of the training, technical information and specialist diagnostic equipment made available to them by manufacturers. The situation is made more difficult for non-dealer repairers because they typically service and repair a range of makes and models, and must have a wider basic knowledge than dealers. The Automobile Association of Australia (AAA) (sub. 41, p. 3) expressed the following concern:

> Some manufacturers already limit the amount of detailed service information being made available to the independent repairer. The longer term result could be that repair work would only be undertaken by a relatively small number of franchised repair outlets. It is considered necessary that detailed information continue to be made available to the wider motor vehicle repair industry.

Section 74F of the Trade Practices Act places an obligation on vehicle manufacturers to ensure that there is a reasonable supply of parts and repair facilities. However, the Act does not specifically deal with the provision of

service information. As long as the dealer network provides reasonable access to repair facilities there would not appear to be any additional responsibility on manufacturers to ensure that owners themselves have ready access to specialised/technical service information/specifications, or that repair workshops competing with dealers have access to such information.[3]

In these circumstances, vehicle manufacturers can provide their dealer networks with a competitive advantage by withholding service information and specialised diagnostic equipment. Nonetheless, manufacturers must balance this desire to support franchise dealers against the need to ensure ongoing customer satisfaction and to contain ownership costs. For this reason, most manufacturers participating in this inquiry maintained that they provide some information to repair workshops competing with their dealerships. Toyota and Mitsubishi indicated that they make workshop service/repair manuals available to non-dealer repairers. In addition, Toyota (sub. 31, p. 11) stated that:

> Toyota Australia training staff have been made available to train non-Toyota repair shops and organisations ... We believe that it is in our interest to ensure technical data is available to these organisations, so that the market-place understands that Toyota vehicles are easily repaired; require minimal maintenance; and have lower repair down-times.

Manufacturers nevertheless have an incentive to ensure that their dealers have a competitive edge in terms of equipment and information. In this vein, Ford (sub. 20, p. 10) commented:

> Authorised Ford dealerships are ... the best equipped service organisations to provide competent service to customers of new vehicles, because they have ... Access to the latest technical service information and service publications, Ford specified special service tools and diagnostic equipment ...

Assessment

Some vehicle owners may feel that they are "locked in" or captive to a limited number of franchised dealers for service and replacement parts. Moreover, some factors (eg information constraints and the use of recommended retail prices by dealers) may limit competition. However, other factors restrict the capacity of motor vehicle companies and their dealers to exploit their market position.

One important factor relates to motor vehicle operating costs. To the extent that new vehicle buyers take account of all operating costs (including service

[3] The Commission understands that, in the United States, General Motors has sent licensing agreements to independent publishers demanding $100 000 for six months use of their technical information and royalty fees on all products produced and sold as a result of that access. At present, this type of information is provided free in Australia.

charges and the cost and availability of replacement parts), it is in the interests of vehicle manufacturers to ensure they are competitive in these areas, as well as in the initial purchase price of the vehicle. Ford (sub. 20, p. 11) submitted:

> One of Ford Australia's key objectives is to seek a competitive advantage in the cost of ownership ... [including] crash parts, service parts and mechanical parts ... Ford Australia recognises that the maintenance and running costs of the vehicle are key considerations when making a "why buy" decision. A particular model's insurance classification [which is influenced by repair costs, including part prices] is a further consideration in the cost of ownership.

These types of considerations have encouraged motor vehicle manufacturers to make available *some* detailed service information and diagnostic equipment to non-dealers, and in some instances to assist in training of non-dealer staff.

In the major cities, there are generally many dealers franchised to sell the more popular makes of vehicles. While the use of list prices may blunt price competition, the number of dealerships — and the availability of repairs from alternative workshops — limit the capacity of dealers to exploit consumers.

The Commission considers that dealership arrangements are not presently a significant constraint on competition.

As vehicles become more technically complex, the potential for dealers to have information and equipment advantages will increase. However, as long as there is strong competition between vehicle manufacturers on the basis of vehicle operating costs, this trend should not detract significantly from competition in the repair sector. If the witholding of information and/or equipment is considered in the future to be seriously constraining competition and compromising the efficiency of the industry, non-dealer repairers could seek to have the issue investigated by the Trade Practices Commission.

The NSW Motor Vehicle Repairs Act

Regulatory approaches such as MVRIC that involve licensing and minimum standards can reduce competition by excluding from the industry all repairers who do not meet the prescribed standards.

Prior to the introduction of the legislation in 1980, one of the repair industry's concerns related to "unfair" competition from "backyarders" and certain small operators who, it was claimed, lacked competence, generally had insufficient or inappropriate equipment and often did not comply with other legislative requirements.

Whilst the stated objective was to raise repair standards, the introduction of licensing in New South Wales has restricted the number of workshops and

tradespersons and may have increased returns (either business profits and/or wage rates) for those in the industry.

The requirement under the MVRIC arrangement that all repair establishments comply with minimum skill and equipment levels represents a barrier to entry for small operators. Its effect is likely to be marginal in terms of competition in the industry as a whole, although it has clearly reduced competition in some market segments (eg repairs to older vehicles).

Other aspects of the MVRIC scheme are considered in Section 4.3.

Quoting systems

There are essentially two types of quoting systems employed by insurers. The two-quote (or "competitive quote") system as used by many insurers for driveables, and a relatively small number of insurers for non-driveable vehicles, was discussed in the previous chapter. The other approach is referred to as the "one-quote" system. It is used by the majority of insurers for non-driveable vehicles. Some insurers also use this system for driveables. The use of one-quote systems is seen by some as indicative of limited competition within the repair industry.

Under the one-quote system, repair work is generally undertaken by the repairer to whose yard a vehicle has been towed. This means that there is no competition between repairers for individual jobs once vehicles have been "secured" or "captured", although there is competition between repairers to attract the vehicle in the first place (eg inducements are offered to drivers of damaged vehicles and drop-fees are paid to tow truck drivers). This appears very different from the situation in other industries where the distribution of sales between suppliers is mainly determined by competition on the basis of price, quality and other attributes of the product/service valued by users.

In the absence of direct price competition, the major concern is that once a vehicle has been "captured" a repairer will be able to inflate prices to the detriment initially of insurers, but also policyholders (via higher insurance premiums). There is some evidence of "overpriced" repairs. AAMI claimed that the absence of price competition between repairers can add up to 30 per cent to the cost of repairs.

However, the use of assessors by insurance companies constrains the ability of repairers to exploit any market power arising from the one-quote system. Indeed, many repairers were scathing in their criticism of assessors and of their role in cutting repair costs. As discussed earlier, many considered that assessors

reduce repair costs to a level which results in unacceptable quality and which threatens the viability of the repair industry.

On the other hand, the Commission was provided with evidence of substantial variation in quotations for the same insurance job and was told that assessors are not always effective in controlling costs. In some cases, the variation in quotes was more than 250 per cent and amounted to several thousand dollars. This partially reflects the degree of subjectivity involved in determining appropriate repair methods. Indeed, one large insurer suggested that its own assessors' estimates on the same job can vary by up to 20 per cent. Thus, even with the benefit of two quotes, assessors may not be able to accurately determine the appropriate repair cost.

Another constraint on prices is the desire of repairers to retain a share of the business available through insurance companies. It is to their advantage to quote competitively and perform good quality work as they are then more likely to establish good working relationships with insurers and to have repair work referred to them (eg repair of driveable vehicles).

Different repair businesses can have different costs. Indeed, the same business can face different cost levels at different times depending on levels of capacity utilisation. One-quote systems can deprive insurers of the opportunity to benefit from these differences at any point in time. For example, a particular workshop may be working well below capacity and be willing to put in a lower bid for a job than another repairer who is relatively busy.

If insurers using the one-quote system are at a cost disadvantage relative to other insurers, there could be pressure on them to move to a two-quote system or to make offsetting cost savings elsewhere in their operations. Indeed, the Commission understands that a number of insurers are investigating the value of a two-quote system. They may retain one-quote systems if, in their assessment, any benefits from the two-quote system (in the form of lower repair prices) are outweighed by various costs (eg removing vehicles from repairers' yards or operating holding yards). There are also the perceived commercial benefits in allowing their customers the choice of repairer.

The different approaches adopted by insurance companies with respect to the number of quotes reflect their assessment of commercial trade-offs. Governments should not interfere in these arrangements.

4.3 Concerns about cost and quality

In any service industry of this type, quality will vary from firm to firm and it is to be expected that there will be some substandard repairs and unscrupulous

operators. Hence, any assessment of complaints about cost and quality must have regard to the totality of the industry's operations and the views of all consumers, not just those who register complaints.

While the majority of participants who commented on this matter were critical of the quality of repair work, some were quite supportive. For instance, the MTAA (sub. 27, p. 2) stated:

> We are not aware of any widespread consumer dissatisfaction with the routine maintenance and repairs carried out in dealer or garage based workshops nor with the variety of services provided by specialist workshops. This is not surprising as there are many thousands of these workshops, all in competition for the consumer's dollar. While there are no doubt some rotten apples in the trade, car owners generally manage to find among these competing firms one that suits them.

And the AAA (sub. 41, p. 3), representing major users of repair services, commented:

> In general terms, it is considered that the motor vehicle repair industry provides a reasonable level of service to consumers, both in terms of quality of work and price ... There will of course always be exceptions. Unsatisfactory repair work, overcharging and overservicing certainly occur.

Level of complaints

Complaints about motor vehicle repairs are received mainly by motoring organisations, trade associations, Consumer Affairs Bureaus and, in New South Wales, the Motor Vehicle Repair Industry Council. The following examples illustrate the extent of complaints:

- In New South Wales, the MVRIC received 1482 written notices of dispute in 1993–94, virtually the same as 1992–93 (1 489), but down significantly from 1990–91 and 1991–92 (1761 and 1610 respectively). Its Technical Enquiry Officers received approximately 16 000 telephone queries in 1993–94, mainly about the standard or cost of repairs. Most of these were resolved without the need to resort to a formal investigation.
- In the ACT, the Consumer Affairs Bureau has received 800 written complaints against motor vehicle repairers since 1985 (ie an average of around 100 per year). The ACT has about 600 repairers.
- In 1992–93, the South Australian Commissioner for Consumer Affairs reported that 352 complaints about automotive repair services were investigated. This represented 24 per cent of complaints relating to "motor vehicles and other transport equipment" and around 2 per cent of all complaints investigated. By comparison, complaints investigated relating

to the purchase of used motor vehicles, household appliances and furniture numbered 722, 526 and 357 respectively.

- In Queensland, the Department of Consumer Affairs handled an average of 328 complaints per year about the motor vehicle repair industry between 1988 and 1991. In 1991, repair complaints comprised around 4.5 per cent of all industry complaints received by the Department and about 32 per cent of all motor vehicle industry complaints.

The level of complaints needs to be put in the context of the number of repairs performed. The MVRIC estimated that approximately 14 million services/repairs were performed in New South Wales during 1992–93. Thus, the number of formal dispute notifications in 1992–93 represented only one-tenth of one per cent of the total number of repairs undertaken.

The Commission is not aware of equivalent estimates for other states. However, it is possible to use comparative motor vehicle registration data to derive a rough estimate for other jurisdictions. Based on the number of repairs estimated using this methodology, the total number of repair complaints investigated in other jurisdictions represents a similar proportion of total repairs to that reported for New South Wales — about one-tenth of one per cent.

It is possible that these estimates do not accurately reflect the extent of concerns in relation to the quality of repairs. In many instances, consumers are not well enough informed to identify overservicing or poor standard repairs. Complaints are also likely to be the "tip of the iceberg," since only a small proportion of customers who are dissatisfied actually complain, either because they are not aware of the avenues available for making complaints or because they consider it would not be worth the time and effort to pursue the matter. On the other hand, it is also likely that some complaints result from consumers' lack of knowledge or, in some cases, they may be deliberately frivolous or vexatious. However, similar reservations apply to complaint statistics for other service sector activities.

Overall, the standard of motor vehicle repairs appears to be satisfactory. Consumer dissatisfaction with repairs is not high when considered in the context of the number of repairs performed, or by comparison with similar service industries.

Nature of complaints

A substantial proportion of complaints relate to mechanical repairs. For instance, of all the MVRIC Disputes Committee's determinations (where the repairer was found to be at fault) over the two years to the end of June 1994,

disputes relating to engine and transmission repairs averaged 25 per cent and 20 per cent, respectively.

Disagreements about smash repairs generally account for a small proportion of complaints to state/territory consumer bodies. For example, the South Australian Commissioner for Consumer Affairs reported that, in 1992–93, only 8 per cent of complaints about automotive repair services — less than one-fifth of one per cent of all consumer complaints investigated — related to panel beating, bodywork and painting. However, this largely reflects the fact that most body repairs are completed under insurance claims. Vehicle owners with a complaint about the quality of an insurance repair would normally complain to the insurance company or one of the special dispute resolution mechanisms for insurance claims.

On the other hand, 23 per cent of the MVRIC Disputes Committee's determinations (where the repairer was determined to be at fault) in 1992–93 and approximately 30 per cent in 1993–94 related to panel and paint repairs. The data suggest that problems with *private* smash repair work account for a disproportionate share of total disputes in New South Wales, since repairs under insurance claims are not within the jurisdiction of the Committee.

Whilst a number of repairers participating in the inquiry raised concerns regarding the quality of *insurance* repairs, other participants suggested that the incidence of poor quality repairs is low. The SIO Consumer Appeals Centre said that disputes about the quality of insurance repairs are rare, but a significant number of complaints are received about the use of non-genuine or second-hand parts in accident repairs.

Separate information on safety related complaints is not available. However, evidence presented to the Commission suggests that the incidence of safety related problems resulting from substandard accident repairs is low. Safety aspects of repairs are discussed in Section 4.5.

Causes of complaints

Complaints may arise for a number of reasons including: unsatisfactory workmanship (including faulty diagnosis); lack of communication; excessive charges; charging for work not performed; overservicing; failure to complete repairs in a suitable time (and other customer service issues); and the standard or type of replacement parts used.

Unsatisfactory workmanship can be the result of many factors including the competency, integrity or conscientiousness of tradespersons, as well as the standard of equipment available. Practices such as overservicing and charging

for work not performed would generally be more closely related to the honesty of the repairer than to the competency of the tradespersons or the standard of equipment used. Dishonest and fraudulent practices are less likely to be detected by the average vehicle owner than are poor quality repairs.

Participants did not consider misleading quoting, overcharging and overservicing to be widespread in the *general mechanical* repair sector. In relation to Victoria, the RACV (sub. 10, p. 17) commented:

> Misleading quoting is much less prevalent than some years ago. This is generally a function of the improving standards in the industry. Misleading quoting is probably no more or less prevalent than in other industries that have an equal opportunity for unscrupulous activities.

Participants raised some concerns about malpractices in insurance repairs. It was claimed that some repairers engage in fraudulent practices such as: parts (and paint) substitution; claiming for work not conducted; cover quoting; and quoting on old damage.[4] In turn, some participants representing the repair sector consider that these practices largely arise because insurers force body repairers to "cut corners". For example, the MTAA (sub. 27, p. 11) stated:

> In many instances the insurance company does not take into account the quality of the repair — that is, whether or not second-hand parts or new parts are used, whether genuine or non-genuine parts are used, or whether a particular method of repair is chosen to restore the asset value of the vehicle.

Whilst some participants also identified poor skills and inappropriate equipment as contributing to substandard repairs, others considered that competency and equipment standards are generally relatively high. For example, the Society of Automotive Engineers of Australia (sub. 4, p. 2) claimed that:

> ... there can be no doubt that most tradespersons in Australia are as competent as any in the world, and many of our workshops compare more than favourably with any overseas. We also have in our shops generally, a high standard of finish and detail. It is common knowledge that the average Australian car owner expects a standard and quality of repair rarely seen overseas, except in specialist workshops, ...

Nevertheless, several participants noted that apprenticeship numbers have been declining and expressed concern that, as the demand for repair services increases with economic growth, shortages of skilled tradespersons may develop. Car Craft (sub. 5, p. 16) suggested a shortage of qualified tradespersons had already developed in Western Australia. AAMI (sub. 95, p.8) considered that a current shortage exists and that it will worsen.

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[4] Cover quoting, which can occur in a two-quote system, involves repairers providing the second quote by improper or collusive means. For example, the first repairer may contact a friendly competitor or allied business to provide a higher priced second quote, or simply prepare the second quote using a different quote sheet under another business name.

Nevertheless, several participants noted that apprenticeship numbers have been declining and expressed concern that, as the demand for repair services increases with economic growth, shortages of skilled tradespersons may develop. Car Craft (sub. 5, p. 16) suggested a shortage of qualified tradespersons had already developed in Western Australia. AAMI (sub. 95, p. 8) considered that a current shortage exists and that it will worsen.

The Automotive, Food, Metal and Engineering Union (AFMEU) (sub. 14, p. 2) stated:

> ... many of the current difficulties ... arise from the traditional *absence* of an appropriate framework to regulate vocational standards, and an over-reliance on market conditions to determine the availability of skilled labour.

Whilst praising some recent developments such as broad banding of job descriptions in the relevant federal award and moves toward competency based training, the AFMEU (sub. 14, p. 3) called for reforms to training arrangements to make training opportunities and the supply of skilled tradespersons "less vulnerable to the caprice of swings in the business cycle".

The AFMEU supported the introduction of a Repair, Services and Retail (RS&R) Industry Certificate being developed by the Victorian Automotive Industry Training Board. The certificate would not replace traditional trade qualifications, but would provide non-trade employees with a nationally recognised qualification. The RS&R Certificate would be accessible to three broad occupational groups — clerks, sales and automotive non-trade specialists — giving these workers the opportunity to "cross-skill". The Australian Manufacturing Workers' Union (AMWU) (sub. 114, p. 3) considered that:

> ... the RS&R Certificate will give people already employed in the industry the opportunity to build on their existing skills and thereby move through a career path. Thus, skill formation should be less exposed to the fluctuations of the business cycle ...

In some jurisdictions, the industry has tried to address shortcomings in current training arrangements through the establishment of industry based group apprenticeship training schemes (see Box 4.1).

AAMI (sub. 95, p. 8) suggested that there may also be scope for individual insurers to fund apprentice training schemes. AAMI is currently considering this possibility.

A number of participants supported wider use of schemes such as MVRIC to address perceived problems with the competency of tradespersons and the standard of equipment and premises.

Box 4.1: Group apprenticeship training schemes

These schemes provide firms with the flexibility to train apprentices without having to meet the on–costs and contractual obligations associated with long term training. At the same time, they enable apprentices to gain experience across a number of different firms in the industry.

The schemes originated in the automotive and building industries during the 1970s. They are typically administered by incorporated bodies and sponsored by either industry associations or regional bodies such as local government. Funding is also provided by state and/or Commonwealth governments.

The group training company indentures apprentices and "hires" them out to individual firms for both long and short term employment. The hiring fee typically covers wages and administrative costs. Sick pay, holiday pay, superannuation and workers compensation is provided by the group training company.

Currently, there are 103 group training companies in Australia employing over 13 000 apprentices across most trades. One example of a group training scheme operating in the automotive industry is the scheme run by the Motor Industry Training Association Inc. (MITA) in Queensland. MITA is a non–profit employer organisation, controlled by a board of directors representing the industry and a representative from both the state and Commonwealth Governments. At the beginning of 1995, the MITA employed 110 automotive apprentices.

The MVRIC scheme

According to many participants, the standard of repair work in New South Wales has improved since the MVRIC scheme was introduced. In the view of the MVRIC (as quoted by the MTAA, sub. 27, p. 32):

> ... the gross incompetence in relation to work that was recorded during the first few years of the existence of the Disputes Committee is no longer evident. Clearly, the standard of repair work has improved.

According to the MVRIC (1993, p. 38), the proportion of disputes relating to the standard of work fell from 75 per cent in 1985–86 to only 11 per cent at the end of 1992–93. In 1993–94, the share of disputes relating to the standard of repairs fell further, representing less than 7 per cent of disputes (MVRIC 1994, p. 64). The NRMA suggested that the Motor Vehicle Repairs Act had resulted in a considerable change in the number and nature of

complaints received from its members. The NRMA's Chief Engineer (as quoted by MVRIC (1993, p. 38)) stated:

> Prior to (the Motor Vehicle Repair Industry Council) being set up we received many calls from members involving poor and even dangerous repairs. In recent years we have received many fewer calls about poor repairs. The majority of complaints now are about the cost of repairs. In many cases it has been found that the consumer has not realised that costs have increased.

Advocates of MVRIC type regulation argue that two of the most important factors determining the quality of repairs are the skill of the tradesperson and the provision of adequate equipment. The Institute of Automotive Mechanical Engineers (sub. 8, p. 2) stated:

> A skilled tradesman cannot perform quality work in many situations unless proper equipment is available. Nor can an unskilled person produce quality work without appropriate knowledge irrespective of the equipment provided.

Whilst governments outside New South Wales have so far chosen not to regulate the repair industry, industry self-regulatory schemes designed to improve repair standards operate in all jurisdictions. Most of these self-regulatory codes of practice incorporate minimum standards for tradesperson competency and equipment/premises. These voluntary schemes are operated by motoring organisations (eg NRMA) and trade associations (eg IAME and VACC). In addition to meeting minimum standards, repairers are typically required to abide by a code of ethics/conduct to gain accreditation. These schemes cover both general and specialist repairers. Similar approaches are common in other industries (eg residential construction).

A number of participants suggested the use of "binding" or "mandatory" self-regulatory codes. AAMI outlined an approach which it was developing with the VACC in Victoria with a view to improving the performance of the repair industry and relationships with the insurance industry. The proposed scheme has several features in common with MVRIC. An independent body would: licence repairers; oversee compliance with a code of practice; and provide a disputes resolution tribunal. The body would have the power to revoke licences. AAMI envisages that insurers and assessors would be subject to the code of practice and the tribunal would be available to resolve disputes between repairers, insurers and/or consumers. The approach has received in-principle support from the MTAA, and the parties are now consulting with the Trade Practices Commission. The MTAA (sub. 27, p. 3) commented that it supported:

> ... the development of self-regulatory codes binding on all parties in the industry — repairers, insurance companies and assessors.

Assessment

The Commission accepts that the repair of modern vehicles increasingly requires high skill levels and specialised equipment. However, several points should be made:

- Tradespersons with extensive on-the-job training (but without formal qualifications) may be just as competent as those with formal training — at least to work on less sophisticated vehicles or to perform less complex repairs.
- For many repairs, especially to older vehicles, highly sophisticated equipment may not be required to achieve a suitable standard of repair.
- Having highly trained technicians and a well equipped workshop does not guarantee quality repairs.
- Not all consumers want repairs of the highest possible quality. For example, it is likely that a proportion of uninsured individuals (and some insured individuals having minor damage to their vehicle) would prefer a lesser quality repair at a lower cost.

This last point is supported by an NRMA survey (sub. 54, appendix 5, pp. 2–4) which reported that, while there was a high degree of consumer satisfaction with the quality of repairs in New South Wales, nearly 30 per cent of respondents expressed dissatisfaction with the "value for money" of repairs. Dissatisfaction was highest for repairs undertaken by franchised dealers (which generally have the best equipped workshops and the most highly trained technicians). Franchised dealers also recorded the lowest ratings on "quality of workmanship", "repairs requiring rectification" and "helpfulness, courteousness and knowledge".

Substantial demand still exists for lower cost repairs to older and/or less complex vehicles. However, regulated minimum standards of the type employed in New South Wales exclude some smaller repair establishments from the industry, even though they may be capable of performing adequate repairs to most vehicles, simply because they lack the equipment or training to cope with modern vehicles or more complex repairs. Many consumers may therefore be worse-off because of the reduction in the variety of services available. As the RACV (sub. 10, p. 25) pointed out:

> ... even some unlicensed panel beating premises operated in the owner's "backyard" do adequate work. Also, some people will seek out the "backyarder" in the belief that they will get adequate service for a cheap price.

Similarly, AAMI (sub. 95, p. 7) did not support input regulation stating:

> ... owners of ... [older] vehicles and other private consumers should have the choice of having their vehicles repaired less expensively at more basic shops which do not operate with the high overheads applicable to repair shops kitted out in accordance with the need to repair more modern motor vehicles.

The MVRIC scheme has almost certainly raised skill levels and increased the average quality of repairs in New South Wales. Many consumers, particularly owners of newer vehicles, will have benefited from the greater certainty provided by minimum standards. On the other hand, MVRIC also restricts users' choices and disadvantages many owners of older or less sophisticated vehicles. It is not possible based on the data available to draw firm conclusions regarding the overall impact of MVRIC on repair charges. However, as acknowledged by MTAA (sub. 93, p. 5) "... input requirements may increase costs for some segments of repair work ...". Similarly, GIO (sub. 36, p. 4) noted:

> ... New South Wales mandates the equipment that repairers will possess, and this does push up repairers' costs.

While there are clearly some substandard repairs performed in all jurisdictions, the earlier discussion suggests that the proportion of such repairs is relatively low. Also, notwithstanding participants' concerns that a shortage of qualified tradespersons may develop, there is no evidence of significant problems with the general level of skills or equipment.

In other industries, prescriptive input regulations or regulations that specify operating methods have frequently been found to reduce the incentive to innovate and to develop better alternatives. For example, in a recent review of food standards, the National Food Authority (1994, p. 11) considered reducing "... the level of prescriptiveness of standards to provide wider permissions on the use of a range of ingredients and additives to facilitate innovation ...". Where technology is changing rapidly — as in the repair industry — such problems can be magnified.

It is not necessary for governments to prescribe minimum input standards for the repair industry. Even if it could be demonstrated that a quality problem exists, the regulation of inputs (ie the qualifications of tradespeople and the level of equipment) will not guarantee output standards. On the other hand, regulation can reduce competitive pressures, increase average repair costs and constrain consumer choice.

While the Commission has not identified problems with the cost or quality or repairs which would warrant government intervention, it recognises that governments in Queensland, Western Australia and the ACT have been giving consideration to the adoption of regulatory arrangements similar to the MVRIC system. If governments believe some form of intervention is required, random

inspections and performance audits (output monitoring) by government officials is likely to be a more cost-effective option. Checks of work in progress and audits of recently repaired vehicles could be undertaken. In addition, inspectors could use prepared vehicles with known faults to test the competency and integrity of repairers.

For output monitoring to be most effective in raising repair standards it would need to be introduced in conjunction with a system of compulsory registration of repair workshops. One option would be an arrangement whereby all existing repairers would initially be registered, but would face the threat of deregistration for serious and/or frequent misconduct. This could be implemented through a demerit point system whereby repairers guilty of fraud, other malpractice or performing unsafe repairs would lose points, leading to eventual suspension or revocation of the repairer's registration. With an effective sanction of this type, inspections need not be frequent as there would be a substantial incentive for repairers to act responsibly. With respect to repair charges, sanctions would only apply to misleading and deceptive conduct. It would be inappropriate for inspectors to make judgments on whether the repair services constituted reasonable "value for money".

If governments see a need to intervene, a system of output monitoring implemented in conjunction with compulsory registration of repair establishments and embodying a demerit point system is likely to be a more cost-effective method of raising repair standards than an approach that relies on the specification of minimum training and equipment standards. Such a system would also be a more appropriate mechanism for addressing commercial misconduct and fraudulent practices.

A case for introducing a registration system can also be made on the grounds of enforcement of safety, environmental and other government regulations and is discussed in later sections. The case for registration is summarised in the final section of this chapter.

4.4 Dispute resolution mechanisms

As with insurance complaints, dispute resolution procedures in relation to vehicle repairs are usually based on a multi-tiered process, starting with direct negotiation and then involving some form of low level conciliation/mediation and, finally, arbitration where necessary. The point of entry into the resolution hierarchy varies. Amongst other things, it depends on whether the repairer has any form of accreditation, whether the repairs are carried out under an insurance claim and consumers' awareness of the various options.

Usually the first step is for a consumer to try to resolve the dispute directly with the repairer or, if it is an insurance repair, with the insurance company. Like insurers, some large repairers have quite sophisticated internal dispute resolution mechanisms and place a strong emphasis on "in-house" resolution to protect their reputations.

Repairers accredited with motoring organisations or trade associations normally have a system for resolving disputes incorporated in their codes of practice. In relation to its own accredited repairer scheme, the NRMA (sub. 54, p. 44) stated:

> Under the terms of the Approved Repairer Agreement, repairers are obliged to accept NRMA arbitration in the event of a dispute. In these cases qualified NRMA staff facilitate a resolution of the matter by negotiation with the repairer on behalf of the member.

Motoring organisations sometimes provide technical assistance/advice for members who have dealt with non-approved repairers. They may also become involved in negotiating settlements where disputes arise with these repairers.

Owners of vehicles insured by an ICA member company (and now also the GIO) with a complaint about the quality of an insurance repair also have the option of having their grievance heard by the Claims Review Panel (see Chapter 3).

There is a duty of care owed consumers under Common Law and legal remedies are available for breach of contract. As discussed in the previous chapter, Trade Practices and State Fair Trading Legislation also protect consumers and impose disciplines on repairers. Consumers with a complaint against a repairer can seek the assistance of state/territory Consumer Affairs Bureaus, Ministries of Consumer Affairs/Fair Trading or progress the matter through the courts.

The majority of complaints regarding the repair industry dealt with by the Queensland Department of Consumer Affairs in 1991 were either resolved to the satisfaction of the complainant (36 per cent) or the situation was clarified with no further action required (22 per cent). The Commission understands that these redress rates are comparable to those achieved by the Department across all product/service classifications.

In New South Wales, there is the additional option of utilising the specialist dispute resolution procedures that form part of the operation of the MVRIC. Initial contact is with a Council Technical Enquiry Officer. A high proportion of complaints are settled by negotiation at this point. If the complaint cannot be resolved, a formal dispute is notified. Attempts are then made to resolve the conflict through conciliation. If these are unsuccessful, the complaint is referred to the Council's Disputes Committee for determination. The Disputes

Committee is chaired by the Chairman of MVRIC and includes two consumer representatives and two industry representatives (one representing employees and the other employers).

The Committee has the power to order that rectification work be carried out and/or the payment of money to a consumer up to $3000. These orders are enforceable through the local court. If the orders cannot be enforced (eg if the business has been declared insolvent), compensation can be provided through the MVRIC contingency fund. Although most participants familiar with the MVRIC scheme were supportive of it, some consider that the current ceiling of $3000 — which has applied since the schemes inception — is too low.[5]

Concerns about existing procedures

Participants were generally supportive of self-regulatory codes and other schemes which avoid the costs and delays frequently associated with claims pursued through the courts. Nonetheless, there was some criticism that procedures forming part of repairers' self-regulatory codes of practice lack independence and often do not include consumer representation. The SAEA (sub. 4, p. 3) stated:

> We favour the self-regulatory system of the VACC, although one must question the continuing effectiveness of a Dispute Resolution Committee composed solely of their peers, surely an independent chairperson to such a committee would give more confidence to the community, and would remove any stigma of bias.

Participants were also concerned that self-regulatory schemes lack appropriate and enforceable sanctions. For example, the MTAQ (sub. 59, p. 7) argued:

> The MTAQ is called upon to arbitrate in disputes, however, with no real penalties involved it is difficult in the case of a recalcitrant repairer to achieve a good result.

In light of this deficiency, the binding self-regulatory schemes being developed by AAMI and the VACC encompass the establishment of an independent tribunal for resolving disputes involving repairers, insurers and/or consumers.

The TPC (sub. 110, p. 9) suggested that industry operated dispute resolution schemes could achieve an even greater degree of independence if they were made accountable to an independent body (as is the case with insurance and banking industry schemes) rather than to the board of the industry association.

Consumer affairs and small claims procedures were mainly criticised for delays and lack of technical expertise. Having a vehicle off the road whilst disputes

[5] The Commission understands that, in a small proportion of cases, the Council has authorised claims in excess of this amount. The ceiling is currently being reviewed as part of the New South Wales Government's Review of Motor Trade Regulation.

are resolved can impose a major inconvenience and cost on consumers. The MTAQ (sub. 59, appendix A) stated:

> ... the Small Claims Tribunal is time consuming and the referees in question may not have the technical expertise necessary to assist them with their determinations (p. 2).
>
> A percentage of the complaints/consumer inquiries received by the Association are the result of the time consuming procedure required by Department of Consumer Affairs ... (p. 9)

The TPC (sub. 110, p. 9), whilst supportive of most aspects of the MVRIC scheme, considered that:

> ... consumers might be better served if consumer representatives on the scheme were appointed from recognised consumer organisations such as AFCO and ACA [rather than by the NRMA as currently].

Assessment

Effective dispute resolution mechanisms don't just overcome existing problems. They can also help improve quality and reduce the number of future complaints. Because formal dispute resolution procedures are costly to operate, it is important that the systems in place create an appropriate culture that encourages parties to utilise lowest cost procedures wherever possible (ie internal mechanisms or low level mediation) and to avoid pursuit of unreasonable claims.

Dispute resolution mechanisms will be most effective in raising the standard of repairs if penalties/sanctions for inappropriate behaviour are significant. An advantage of the MVRIC scheme is its ability to enforce commercially significant sanctions. The licensing/registration arrangements which are integral to the scheme provide authorities with the option, in extreme cases, of suspending or revoking a repairer's right to operate.

Redress mechanisms are likely to be more effective in raising industry standards if information about repairers who have had determinations against them is made public. In this regard, the RACV (sub. 10, p. 35) suggested:

> ... proposed systems should also be able to establish a list which should provide some data on the complaints history of repairers. This data should be available to the public so that any person could review the complaints history of their proposed repairer.

To protect the interests of repairers that are subject to complaints which are dismissed or have had determinations against them for relatively minor disputes, publicly available information could be limited to repeat offenders and those repairers found guilty of more serious fraud or malpractice.

An independent dispute resolution mechanism structured along the lines of the MVRIC scheme would rank highly in terms of the desirable characteristics of a dispute resolution mechanism outlined in Chapter 3. Based on the MVRIC experience, transaction costs for consumers using the procedures would be comparatively low, industry would be supportive and consumer awareness of this avenue for resolving disputes high. Indeed, MVRIC reported that a third of vehicle owners using its dispute resolution procedures were made aware of its existence by a repairer.

The benefits for consumers and the industry of a MVRIC type scheme need to be balanced against the administrative costs which are currently borne by the industry. All repairers contribute to the funding of the operation of the Disputes Committee through license fees, irrespective of the number of disputes they generate. Consideration could be given to levying a charge on repairers that go before the Dispute Committee. This approach would be similar to that adopted elsewhere (for example in many private Ombudsman schemes and the General Insurance Claims Review Panel). This alternative funding arrangement would increase the incentive for parties to resolve disputes between themselves and would benefit those repair firms with the lowest levels of disputation.

The disputes resolution service is currently provided free to consumers. It is likely that this results in some unreasonable complaints being pursued. The approach discussed in relation to the insurance industry Claims Review Panel could be considered by MVRIC. Consumers would be given preliminary advice about whether their complaint is considered reasonable. If it is considered unreasonable and the consumer chooses to proceed, a small fee could be levied and refunded in the event that the Disputes Committee finds in favour of the consumer.

Given that general mechanisms for resolving complaints already exist, one option would be to improve them by incorporating some of the desirable features of a MVRIC type model. These features include reliance on independent technical expertise; fast resolution times; and the enforcement of appropriate sanctions. However, unless a system of registration/licensing of repairers also operated, general schemes would lack one important feature of MVRIC — the ability to "de-register" a repairer for inappropriate behaviour.

At the same time, the repair industry should be encouraged to improve self-regulatory schemes by developing dispute resolution mechanisms that have a greater degree of independence. Like insurers, repairers should consider consumer representation on their industry dispute resolution panels. This would increase consumer confidence in the "fairness" of the process. AAMI suggested the dispute settling procedure operated by the MTA of Western Australia

Approved Body Repairer Scheme provides a useful model of an independent industry mechanism. The Scheme incorporates a Disputes Committee that includes a member nominated by the Western Australian Minister for Consumer Affairs and a member nominated by the Insurance Council of Australia.

The independence of dispute resolution committees operating as part of industry self-regulatory codes could be further enhanced by making them accountable to a separate independent body (as is the case with the general insurance and banking industry schemes) rather than to the board of the industry association. Such a body, which could have equal consumer and industry representatives, should have the capacity to impose significant sanctions on recalcitrant or unreasonable repairers.

4.5 Safety issues

Many participants representing the repair industry expressed concerns about the safety implications of poor standard repairs. This concern, which focused almost entirely on accident repairs rather than mechanical repairs, is illustrated by the following comment by Car Craft (sub. 5, p. 13):

> The insurance companies continue to exert control over the repairers ... This inevitably leads to the repairer looking to reduce repair time and in the process make short cuts to save cash on the repair job. The net result is often shoddy workmanship, poor customer service and questions about the structural integrity of the vehicle and the safety of the occupants.

A number of repairers provided the Commission with examples of unsafe repairs, involving both poor workmanship and defective components. Concerns related to insurance and non-insurance work, and were not confined to repairs performed by smaller less well equipped establishments or "backyarders".

The Commission received little evidence of safety concerns on the part of vehicle owners. The NRMA (sub. 54, p. 23) reported that in 1993–94:

> No incidences of safety related problems post repair have been recorded ...

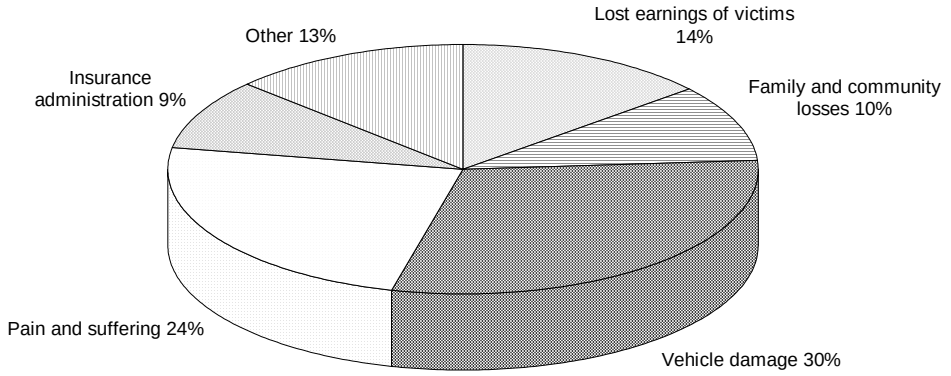
Cost of accidents

Road accidents impose substantial suffering and economic costs. Two recent studies by the BTCE (1993) and Andreassen (1993) have attempted to estimate the cost to the nation of road accidents.

The total cost to the community was estimated by the BTCE to have been $6.1 billion in 1993. Of this amount, around 30 per cent ($1.86 billion) was estimated to relate to vehicle damage costs (see Figure 4.2). The calculations

were based on estimates of the number and type of road accidents, the number of casualties, their ages, gender and the number of vehicles involved in the accidents.

Figure 4.2: Cost of road crashes in Australia, 1993 (per cent)



Total cost $6.1 Billion

Note: The 'other' category comprises: costs relating to hospitalisation, medical treatment and rehabilitation; crash investigation; travel delay; losses to non–victims; and ambulance and legal services.

Source: BTCE (1993)

The Andreassen (1993) study put the cost of accidents reported to police over a three year period to 1991 at more than $25 billion. This study, based on detailed insurance company data from accident claim forms, found that in 1991 the cost of accidents was $7.6 billion, with vehicle repair costs accounting for approximately 35 per cent ($2.66 billion).[6] Unreported accidents would impose additional costs.

Even if allowances are made for different methodologies and estimation errors, it is evident that road accidents impose a substantial cost on the nation. However, it is exceedingly difficult to ascertain to what extent this cost is attributable to faulty repairs.

6 Andreassen's estimates are higher than the BTCE's principally because he was able to make a more detailed estimate of costs related to disabilities. Also, the BTCE study does not include the value of lost wages for persons involved in non–injury accidents.

Vehicle defects and accidents

There has been little detailed research into the role of vehicle defects in road crashes in Australia, and even less information is available on the relationship between substandard repairs (defective components or workmanship) and the defects thought to have contributed to accidents. Even though defects are found to occur frequently in vehicles involved in accidents, the data available suggest that it is uncommon for a vehicle defect to be the primary causal factor in crashes.

An in-depth Australian study conducted in Adelaide between 1975 and 1979 (McLean 1979) found that defects were highly causative in 1 per cent of accidents and in 5.4 per cent of accidents defects were possibly causative. Similar results have been reported in more recent studies. Studies of road accidents in Queensland between 1991 and 1993 found vehicle defects to be *one* of the causal factors in 4 per cent of all major accidents and 6 per cent of all fatal accidents (Queensland Transport 1992, 1993b and 1994). An analysis of police statistics in Victoria suggests that around 5 per cent of accidents involving fatalities have defects as a contributing factor (ACA 1994, p. 30).[7] Studies have generally found other factors to be more important contributing factors (see Box 4.2).

Those overseas studies available to the Commission suggest that the condition of the vehicle accounts for between 8 and 13 per cent of accidents. It is, of course, difficult to relate these results to Australia because of differences in factors such as registration requirements, design requirements and driving conditions.

Even where vehicle condition is found to have been a factor contributing to an accident, the presence of defects is not necessarily a result of faulty repairs. Defects in vehicles may also be caused by: poor maintenance; vehicle modification; pre-existing damage to the vehicle; or by a "chance" event. Certain types of defects (eg structural defects) are more likely to be due to poor standard repairs than other defects (eg headlight failure). In its accident studies, Queensland Transport found that, over a two and a half year period to June 1994, pre-existing structural defects were a contributing factor in only 2.5 per cent of all major accidents reported involving vehicle defects and in 2 per cent

[7] It is possible that these estimates understate the level of accidents caused by substandard repairs. Studies based on police statistics assume that police attending accidents have the technical competence and suitable equipment to identify mechanical and structural faults. Also, in many serious accidents, damage to vehicles is too extensive to determine causal factors. On the other hand, other factors tend to result in the estimates overstating the importance of vehicle defects. For instance, some drivers may attempt to attribute an accident to a vehicle defect rather than acknowledge driver error.

of fatal accidents where defects were a contributing factor. In-depth accident studies in Australia and overseas have generally found brake system defects to be the most important type of defect as a causal factor in accidents, with tyres, steering and suspension faults also significant. These types of defects are generally attributable to wear and tear and poor maintenance rather than to defective fitting/repair.

Box 4.2: Factors contributing to vehicle accidents

Studies of accident data generally indicate that human factors and road conditions are far more important contributing factors to accidents than vehicle roadworthiness.

Table 16 in Appendix B provides an indication of the relative importance of all the major causal factors based on Queensland Department of Transport studies. These studies found that, between 1991 and 1993, traffic rule breaches were a contributing factor in 41 per cent of all reported crashes and 35 per cent of fatal crashes, while road conditions were a contributing factor in 19 per cent of fatal crashes and 17 per cent of all reported crashes. Alcohol/drugs were a contributing factor in 8 per cent of all reported accidents and 28 per cent of accidents involving fatalities. Driver inattention was important in the context of all reported crashes (24 per cent), but a less significant causal factor in fatal accidents (6 per cent). Vehicle defects were found to be one of the causal factors in 4 per cent of all reported accidents and 6 per cent of all fatal accidents.

However, according to the Roads and Traffic Authority of New South Wales (1994), vehicle defects are four times more likely to be a causal factor in heavy vehicle accidents than in accidents involving light vehicles.

In summary, Australian studies suggest somewhere between 1 and 6 per cent of all accidents may be attributable to defects. However, the available data shed little light on the link between substandard repair work and accidents. Based on the range of between 1 and 6 per cent and assuming, arbitrarily, that 20 per cent of vehicle defects were the result of poor repairs, this would suggest that substandard repairs were implicated in between 0.2 per cent and 1.2 per cent of reported accidents.

Mechanisms for maintaining safety

In an ideal world, defective repairs would not pose a significant safety problem. Consumers would be able to identify and reject substandard work by repairers,

and would not seek to reduce costs by authorising repairs which compromise vehicle safety. Of course, in practice, this does not eventuate.

Consumers of vehicle repair services are typically poorly informed and not in a position to compare easily the quality or safety of competing repair services. A car which is poorly repaired could look perfect to many consumers. In this context, Car Craft (sub. 5, p. 21) commented:

> Most consumers would not normally be aware how the repairs have been completed or how safe the vehicle is to drive after the accident. In some cases this consumer ignorance coupled with a lack of standards provides the catalyst for the evolution of unsound and unsafe repair practices.

Even with "perfect knowledge" there is no guarantee that the decisions taken by individual consumers will be consistent with the interests of the broader community. Where an insurance claim is not involved, individuals making decisions about smash repairs will often make trade-offs between lowering the costs of repairs and decreasing safety levels. Naturally, risk preferences — and the trade-offs made — vary between individuals. While an individual may judge that it is better to save on maintenance or repair costs by not having all safety defects rectified, the increased risk to which other motorists (or subsequent owners of the vehicle) are exposed could make that decision contrary to the interests of the community.

These two factors — consumers' lack of information and the likelihood of individuals' decisions on safety adversely affecting the community at large — provide the main justification for government involvement in maintaining minimum safety standards. This rationale for government intervention is aptly summarised by the following quote from a study by Queensland Transport (1993, p. 13):

> In regulating industry, Government must balance the cost of adherence to safety design, construction and repair standards with the general level of risk the community is prepared to accept. The cost of accident prevention and amelioration measures should not exceed the expected reduction in accident costs.

At present, the repair industry in Australia is not specifically regulated with respect to safety requirements. No *mandatory* technical safety standards need be adhered to when repairing vehicles. However, some codes and standards have been developed to *guide* repairers. These include:

- codes of practice (incorporating standards) developed by Standards Australia which apply to some repairs (eg engine reconditioning, chassis and windscreen repair);
- the AAAA's code of practice for brake repairs and maintenance for cars and light commercial vehicles; and

- Australian Design Rules (ADRs) for motor vehicles and trailers with which all vehicles must comply when first supplied to the Australian market. Although ADRs mainly apply to the performance of the car as a whole, they also prescribe standards for some specific parts (eg seat belts and headlights). While they apply directly only to new vehicles, owners are responsible for ensuring that their vehicles continue to comply with ADRs. (ADRs and the role of the Federal Office of Road Safety in developing, administering and enforcing these standards are discussed in the following chapter.)

Governments in Australia do not systematically check that repaired vehicles are returned to the road in a safe condition, though most attempt to ensure that vehicles are maintained in a safe condition over their working life. This objective is mainly pursued by vehicle inspection procedures. Some random roadside vehicle inspections are undertaken in all jurisdictions. New South Wales, the ACT and the Northern Territory also have periodic inspections as a pre-requisite for registration renewal. In Victoria and Queensland, inspections are required on transfer of ownership (see Table 4.1).

The relatively high numbers of vehicles detected with safety related defects by periodic inspection systems could imply that they are an effective means of improving roadworthiness. For example, data supplied by FAPM show that, of 260 vehicles tested on a "typical day" in the ACT, 53 per cent failed.

What is more relevant from the viewpoint of this inquiry, however, is the lack of information on the proportion of defects identified in inspections which can be attributed to substandard work by the repair industry. The information which is available suggests the overwhelming majority of vehicles fail inspection tests because of poor maintenance (for example, because of brake wear, worn tyres and poor headlight alignment). Furthermore, some participants questioned the ability of inspection procedures to detect certain types of safety defects due to substandard repairs. Bemak (sub. 28, p. 3), for instance, expressed the following concern:

> At present there does not appear to be a roadworthy certification facility who can accurately assess body alignment or evaluate what repairs may have been done or still need to be done to a body of a vehicle.

Table 4.1: Vehicle roadworthiness testing in Australian states and territories

State/Territory	*Regular periodic inspections*	*Random inspections*
New South Wales	Annual inspections (with renewal of registration)	Police and Roads and Traffic Authority carry out about 600 000 random inspections per annum (approximately 15% of total inspections).
Victoria	On transfer of ownership and re-registration of second hand vehicles.	Specific Vic Roads on-road operations.
Queensland	On transfer of ownership. On registration renewal for vehicles over 4 tonnes, taxis, light buses and tow trucks.	A major program of on-road inspections is being implemented.
Western Australia	Annual inspections for special vehicles only (eg buses and driving instructors' vehicles). Inspection if transferred from another jurisdiction, or if registration expired by more than 30 days, or if a new vehicle not complying with vehicle standards regulations.	Performed by police.
South Australia	Inspection for vehicles transferred from another jurisdiction and for vehicles over 4.5 tonnes, or non-standard vehicles. Buses inspected on registration renewal.	Performed by police.
Tasmania	Inspection for vehicles transferred from another jurisdiction, new vehicles without type approval, and if registration expired by more than 30 days.	On-road testing has recently been implemented.
Northern Territory	Annual inspection for passenger vehicles and twice yearly for commercial vehicles	Performed by Transport and Works Dept in conjunction with police.
ACT	Annual inspection for vehicles over 6 years old	Performed by ACT Government inspectors and police.

Source: Solomon, McKay, Laidler and Richardson (1994) and information supplied by state and territory governments.

Even if information were available on reductions in vehicle defects as a result of inspection procedures, it would be extremely difficult to quantify the likely reduction in accident costs, since the importance of vehicle defects as a contributing factor in accidents cannot be determined with any degree of precision.[8] These shortcomings bring into question any sort of cost-benefit analysis of inspection systems.

It is likely that most vehicle defects which contribute to accidents are the result of poor maintenance and that only a small proportion are the result of substandard repairs. It can also be difficult to detect unsafe repairs. For these reasons, it is hard to justify compulsory vehicle inspection procedures purely as a mechanism for detecting defects due to poor repairs.

This is not to deny the value of vehicle inspections in meeting their primary objective of identifying unroadworthy vehicles, including the detection of vehicles that do not comply with emission standards. Environmental issues are discussed in the next section, together with some suggestions for improving the cost-effectiveness of vehicle inspection procedures.

Although not promulgated to meet safety objectives, the state government regulations applying to the repair industry in New South Wales could also have a positive impact on safety levels. The oversighting authority — MVRIC — considers this to be the case. In a submission to the Vocational Education Employment and Training Advisory Committee's (VEETAC) "Review of the Partially Registered Occupations", MVRIC claimed that the licensing of tradespersons (and of repair establishments) had reduced defects due to faulty repairs and, having regard to other relevant factors, had also reduced the casualty rate in New South Wales. The submission noted that, since the regulations were introduced, there had been a greater reduction in the number and rate of motor casualty accidents in New South Wales than in any other state.

The majority of the VEETAC Working Party (1993, p. 395) disagreed with this contention stating that the submission:

> ... did not demonstrate that a link existed between the claimed reduction in casualty accidents and registration of these occupations.

The Working Party (p. 396) claimed that the submission:

> ... did not adequately reflect a combination of other significant factors which have contributed to a reduction in accident rates in the last 15 years.

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[8] There are, of course, also difficulties associated with estimating the costs imposed on the community by accidents and, therefore, the benefits of any reduction, although all studies suggest that existing costs are very large.

VEETAC recommended that the occupations of motor mechanic and other vehicle trades be deregistered in New South Wales on the grounds that it was not satisfied that the key criterion for retention — that removal would pose a significant risk to public health and safety — was met. VEETAC did not specifically consider the impact of other aspects of the regulation (eg the specification of minimum equipment standards) on safety levels.

If governments consider that substandard repairs are posing a significant safety risk, consideration could be given to the introduction of a system of output monitoring as described in the previous section. Random inspections and performance audits (in conjunction with compulsory registration of repair workshops and a demerit point system) would address the problem of unsafe repairs more directly than input regulations.

However, in evaluating the case for new measures (or in reviewing existing safety measures), governments need to consider the likely reduction in risk and savings to society as a result of the measures and whether there are less costly or more effective ways of achieving the desired outcome. The available information suggests that factors other than the roadworthiness of vehicles are far more significant as causal factors in vehicle accidents. Thus, if the objective of government intervention is to reduce injuries and fatalities from road accidents, it is likely to be more efficient to target these other causes rather than introduce measures directed toward eliminating vehicle defects.

The ARRB (sub. 108, p. 3) suggested greater use could be made of the information in police accident reports and data collected by insurance companies concerning the circumstances of accidents and details of persons injured and vehicles damaged in order to gain "... a better understanding of the characteristics of accidents". The ARRB (p.1) argued that:

> It is highly desirable that insurers adopt common definitions and terminology if their information is to be of any value within the industry or for wider community concerns.

An independent review of the scope for greater harmonisation of accident data bases should be conducted. The review should consider community wide costs and benefits, including the extent to which these data bases could be used in the evaluation of the cost-effectiveness of alternative road and vehicle safety measures.

4.6 Environmental issues

There are a number of concerns about the way in which the motor vehicle and marine craft repair industries interact with the environment. These include: the release of environmentally hazardous substances during repairs (eg CFCs, paint

and other vapours); waste disposal (eg lubricants and coolants, solvents, tyres and batteries); and the implications of substandard servicing and repair (eg poor engine tuning may result in excessive exhaust emissions). In the absence of some form of government intervention, these environmental impacts may not be fully accounted for (ie repairers and vehicle owners would tend to overlook the wider costs that their actions impose on others).

As in the case of safety, there are difficulties in relating environmental shortcomings in vehicles to the performance of the repair industry. Even where it is possible to identify vehicle faults that have implications for the environment, it is extremely difficult to determine the extent to which these are attributable to inadequate maintenance by vehicle owners or poor workmanship by repairers. However, the South Australian Government (sub. 106, pp. 8–9) stated that:

> The general deterioration in performance of vehicles, in terms of emissions and noise, largely reflects the increasing age of the car fleet and is not necessarily a function of the quality of servicing.
>
> Experience in Victoria, and from a survey carried out by the Federal Office of Road Safety, indicates that vehicle emissions tend to improve little after tuning, except for those with mechanical failures (eg catalysts or piston ring wear). The repair industry is not the cause of these problems nor is it apparently adding to them.

Codes of practice have been developed by the repair industry, or the industry in conjunction with government agencies, to guide repairers in minimising the harmful impact that particular procedures may have on the environment. Some participants suggested greater efforts were required to formulate such codes. For example, the Australian Paint Manufacturer's Federation (sub. 65, p. 2) called for the National Occupational Health and Safety Commission (Worksafe Australia) to expedite the completion of a draft national standard for spray painting " ... which has been on the drawing board for over two years".

Whilst some environmental regulation is specific to the repair industries (eg marine craft repairers must be registered in some states), most environmental legislation is general in application. However, some general legislation/regulations (eg state clean air Acts and ozone protection regulations) have specific provisions relating to the repair industry (eg requirements for spray booths to be installed or for persons engaged in automotive air-conditioning work to be authorised). Participants generally considered that these measures are adequate to address environmental impacts. The MTAA (sub. 27, p. 38), for instance, commented that:

> ... environmental standards for the operation of repair facilities are sufficiently and appropriately addressed by state and local authorities ... no change is required in these arrangements.

However, several participants were concerned that the enforcement of environmental regulations is inadequate and that "irresponsible" repairers can abuse the environment with little prospect of prosecution. The RACV (sub. 10, p. 36) stated:

> Most legislation relating to environment protection issues is not enforced. In reality it only affects the people willing to abide by the law. In the case of CFCs, for example, there is little or no enforcement of the regulations.

Car Craft (sub. 5, p. 31) suggested that, while most repairers are unaware of damage being done to the environment, others are aware but don't care:

> Some let Chloro Fluoro Carbons (CFC) directly into the atmosphere, others pour materials, solvents and oil into the ground or the storm water drains. ... all too often repairers take the view that ... "the crime is in getting caught".

The South Australian Government (sub. 106, p. 7) on the other hand argued that generally the enforcement of environmental regulations is adequate in that state. Reductions in the use of CFCs, for example, have been achieved through a combination of "... consultation with industry users, inspections of premises, and providing information by way of newsletters and seminars". The South Australian Government (sub. 106, p. 7) added:

> Since specific legislation came into operation on 1 June 1990, there have been approximately 1 000 inspections of automotive repairers' premises. There have been four successful prosecutions for non-compliance of ozone protection regulations, and numerous warnings have been issued. This number of inspections and the successful prosecutions have had a deterrent effect for other repairers in the industry to operate within the legislation.

However, disposal of certain types of waste from the vehicle and recreational marine craft activities continues to be an environmental problem in South Australia, particularly in centres where recycling is not financially attractive.

The enforcement of environmental and other regulations that apply to repair workshops would be enhanced through compulsory registration. In the absence of compulsory registration, it is difficult for authorities to identify all repair establishments.

Because the extent and effectiveness of current enforcement efforts appear to vary, the case for registration is likely to be stronger in some jurisdictions than others. The benefits of registration in safeguarding the environment and the health and safety of those employed in the industry, when considered in isolation, may not outweigh the administrative, compliance and enforcement costs associated with a compulsory scheme. However, any benefits, over and above those associated with enforcement of environment and other regulations, must be considered when evaluating such a measure. These are discussed in Section 4.7.

Vehicle inspections

Given that so much effort is made to ensure that new vehicles conform to specific environmental standards, it is somewhat incongruous that little or no effort is currently made to ensure that vehicles continue to operate "cleanly".

A number of participants called for a national system of regular roadworthiness inspections. However, at the present time, the ability of inspection procedures to evaluate emissions may be limited. The AAA (sub. 41, appendix E, p. 6) reported:

> The technology and equipment for detecting ... high polluting vehicles is still under development.

The Environment Protection Authority (EPA) of New South Wales (sub. 101, p. 1) stated that the New South Wales Government is progressively introducing programs to ensure that in-service vehicles continue to meet the emission standards applicable to them. The Roads and Traffic Authority (RTA) is conducting noise testing on heavy vehicles as part of the registration process. In conjunction with the EPA, the RTA is currently implementing a motor vehicle maintenance program which will result in cars also being subject to regular emissions testing as part of the registration process.

The final decision on the form of the emissions testing in New South Wales is yet to be made, but will be influenced by the results of a study of motor vehicle emissions. The New South Wales EPA (sub. 63, pp. 2-3) reported that the study — being conducted in conjunction with the Federal Office of Road Safety, the Victorian EPA and Ford Motor Company — involves a large scale test program and focuses on the potential for engine and exhaust system maintenance and repair to reduce emissions from in-service motor vehicles.

On the evidence presently available, it is not possible to determine whether the benefits of regular vehicle inspections to check emissions would outweigh the costs. The case for vehicle inspections is likely to be stronger in some jurisdictions (for instance Australia's largest cities, where pollution problems are most severe) than in others.

All governments are committed to some form of vehicle roadworthiness checks. In some jurisdictions, consideration is being given to extending inspection programs to include emissions testing.

Governments should seek to maximise the cost-effectiveness of any inspection procedures. Random roadside checks can be more cost-effective than registration based inspection systems. An inherent disadvantage of the latter is that owners only have an incentive to ensure that vehicles comply with roadworthiness requirements at a designated time (usually coinciding with

registration). However, it may be necessary to complement random roadside checks with a system of periodic emission checks at inspection stations. For example, if appropriate technologies do not exist for adequately testing "on-road" vehicle emissions at roadside checks, then periodic testing, say every five years, at appropriately equipped checking stations could be considered. The complementary use of random roadside and periodic checks is also likely to be a more cost-effective strategy for detecting *safety* defects than the use of roadside inspections in isolation.

Inspections should target vehicles most likely to offend. This could involve more frequent checking of older vehicles (as is currently the case in New South Wales and the ACT) and vehicles which are used extensively (eg delivery vehicles).[9]

Inspection systems — and random inspections in particular — are most likely to provide an effective incentive for individuals to appropriately maintain vehicles if there is the potential to impose penalties on owners of defective vehicles. This could involve fines and/or refusing to register a vehicle.

Given that excessive vehicle emissions are more likely to be the result of poor maintenance than substandard repairs, vehicle inspection procedures could not be justified solely as a mechanism for detecting excessive emissions caused by poor repairs. However, vehicle inspections currently utilised in some jurisdictions to meet broader roadworthiness objectives should, where feasible, include checks of emission levels. Well targeted periodic checks at inspection stations could be made more effective through the complementary use of random inspections. The incentive for owners to ensure on-going compliance of their vehicles would be increased by providing for appropriate sanctions for breaches.

4.7 Registration of repair establishments

The possibility of compulsory registration of repair establishments has been raised several times in this chapter. It was mentioned as one component of a possible system to address participants' concerns about the cost, quality and safety of repairs. And it was discussed in relation to the enforcement of environmental and other government regulations.

The Commission considers that problems with repairs (either cost or quality) do not warrant any additional government involvement in the industry. Overall, the

[9] Most jurisdictions currently target public transport vehicles (eg buses, taxis and hire cars) for more frequent inspections, but usage is not a criteria that determines frequency of inspection for private vehicles.

standard of motor vehicle repairs appears to be satisfactory and the level of consumer dissatisfaction is low in relation to the number of repairs performed. Given the minor importance of vehicle defects as a contributory factor in accidents, compulsory registration is also not considered warranted on safety grounds. The previous section concluded that registration is possibly not justified solely as a measure for enhancing enforcement of environmental and other government regulations.

However, taken collectively, the possible benefits of registration provide a stronger case for compulsion. The benefits would vary between jurisdictions, but if governments identify significant problems, then a system of registration could be appropriate.

Compulsory registration of repair establishments would allow for sanctions to apply where repairers are guilty of misconduct, have breached environmental or safety standards, or fail to comply with other government regulations. Registration could be linked with a demerit point system whereby repairers lose points, leading to eventual suspension or revocation of the repairer's registration. Such a system could provide an effective discipline on repairers. Whilst industry self-regulatory codes currently incorporate sanctions (in the form of loss of accredited repairer status), they are rarely enforced. AAMI (sub. 30, p. 65) commented:

> ... the trade associations through conflicts of interest and administrative law issues find the codes of practice difficult to enforce.

Any registration system implemented should not involve input standards (eg minimum standards for equipment or tradespersons' qualifications) or any other prerequisites which establishments must satisfy in order to be eligible for registration.

The compulsory registration of repairers, in conjunction with a demerit point system, may bring net benefits in some jurisdictions. Compliance with minimum input standards should not be a requirement of registration. Concerns about the quality/safety of repairs or the integrity of repairers would be more directly addressed by a system of output monitoring.

5 REPLACEMENT PARTS

There are a number of sources of replacement parts, sometimes referred to as "spare" or "aftermarket" parts. These include local and overseas vehicle manufacturers and their component suppliers, companies that produce replacement parts only, and sellers of second–hand and reconditioned parts. The terms of reference require the Commission to examine the use, cost and effect of parts from different sources. These issues, as they relate to passenger motor vehicle parts — which were the focus of participants concerns — are considered in this chapter.

5.1 Role of vehicle manufacturers in the replacement parts market

Motor vehicle manufacturers (including importers) play a pivotal role in the replacement parts market. They determine the design and sourcing of key components and their pricing decisions influence the pricing and supply of parts from all sources.

Replacement parts produced by vehicle manufacturers, or produced on their behalf by specialist component manufactures, usually conform to the vehicle manufacturer's original equipment (OE) specifications and are commonly referred to as "genuine" parts. Alternative ("non-genuine") parts include those produced by the OE suppliers, but marketed under a different brand name, and also parts produced by other suppliers.

Vehicle manufacturers have a range of options for sourcing OE parts. They produce around 30 per cent (by value) of the OE parts themselves, with the remainder being produced and supplied by subcontractors. Where the parts manufactured by subcontractors are unique to the vehicle (eg body panels and trim), it is not uncommon for the tooling to be supplied and owned by the vehicle manufacturer. For standard parts, which are often designed by the subcontractor (eg spark plugs and oil filters), the tooling is usually owned by the subcontractor.

The design and production of parts — and the vehicle itself — are influenced by government regulation, in particular Australian Design Rules (ADRs) which impose safety standards on the design of new motor vehicles. Local manufacturers and importers of vehicles must meet ADRs in order for the vehicle to qualify for registration in any Australian state or territory.

After sales service

After sales service is seen by motor vehicle manufacturers as critical to maintaining and enhancing the reputation and attractiveness of their vehicles in the market place. A key element of after sales service is easy access to parts. Toyota (sub. 31, p. 2) commented that:

> We believe that it is important for customers to have the assurance that vehicles can be repaired in a timely manner. Prompt parts availability is one of our most important priorities, because it supports the development of customer goodwill, leading to repeat vehicle sales.

In addition to a commercial desire to uphold and enhance product reputation, Section 74F of the Trade Practices Act requires that manufacturers provide replacement parts and service for their vehicles for a reasonable period of time. In practice, parts availability policies vary from company to company. However, the industry has collectively agreed that, following the end of production of a model, parts categorised as "functional" (ie essential to maintaining legal and mechanical mobility and ensuring structural integrity and appearance) are stocked for 10 years. Non-functional parts, soft trim and accessories are usually stocked for 5 years, 2 years and 1 year respectively.

The commitment to parts availability necessitates large stock holdings. For example, between them, Ford, GMH, Mitsubishi and Toyota carry approximately 550 000 replacement part lines. The large number of parts held reflects the large number of vehicles (10.5 million) and vehicle models (480) on the road, as well as the many components that make-up motor vehicles. The vehicle manufacturers therefore have a large investment in stocks. For example, Ford's total replacement parts inventory (company and dealers) is valued at $123 million. As the Prices Surveillance Authority (PSA 1988, p. 22) stated:

> Capital investment in such comprehensive parts inventory and suitable warehousing facilities is substantial. ... this situation is exacerbated for importers, because of the larger inventory necessary to offset the protracted supply lead times from overseas sources.

One local vehicle manufacturer indicated that the value of its replacement parts inventory was equivalent to approximately 45 per cent of its annual revenue from the sale of replacement parts. In comparison, for the motor vehicle industry as a whole, stocks accounted for only around 12 per cent of turnover in 1989–90.[1]

The bulk of replacement parts stocked by manufacturers are produced while the model is current. This enables vehicle manufacturers to take advantage of scale economies and avoid the costs of small production runs and retooling (where

[1] ABS Cat. No. 8221.0, ASIC Industry Class 3231

required) at a later date. Manufacturers generally base their stock holdings on the expected demand for the parts over the life of the vehicle, taking into account the prospective availability of parts from other sources. In its review of the prices of motor vehicle replacement parts, the PSA (1988, p. 22) stated:

> A high incidence of obsolescence in inventory is associated with this approach ... subject as it is to difficulties in predicting demand for replacement parts, in particular for medium and slow moving parts.

In the area of "fast moving parts" (eg maintenance parts such as filters and spark plugs for which demand is high), there is considerable competition and generally a range of alternate parts is available. The main exception appears to be in the area of accident repair parts.

"Slow moving" parts comprise a substantial proportion by number and value of the stocks held. The Commission was told by one vehicle manufacturer that slow moving parts account for around 60 per cent of the total value of its parts inventory.[2] The costs associated with the investment in slow moving stock are therefore considerable.

Distribution process

Speed and service is also an important element of after sales support. GMH (sub. 21, p. 3) said that:

> ... when a car is lodged with a dealer for service, the owner usually expects that it will be repaired and returned promptly. This implies that either the servicing dealer will keep a very large stock of parts, or he will be able to access a large stock within say two hours of making a request.

A multitiered network has evolved to distribute replacement parts. The distribution network used by vehicle manufacturers typically involves:

- a national warehouse (or warehouses) operated by the vehicle manufacturer or vehicle importer;
- parts distributors that purchase parts from the national warehouse(s);
- wholesale parts dealers that purchase from the parts distributors; and
- franchised retail dealers that sell to the trade and to the public.

The configuration employed varies between vehicle manufacturers. For example, Mitsubishi's distribution network consists of two national parts distribution centres that supply 25 000–30 000 line items to five parts distributors who, in turn, supply Mitsubishi's 316 dealers with 2000–8000 line

[2] Slow moving parts were defined by this manufacturer as parts with sales of less than 120 per annum.

items. On the other hand, Ford's network consists of a single national parts distribution centre supplying 37 parts distributors. The distributors supply 50 wholesale parts dealers who, in turn, supply 236 retail dealers. This approach ensures that consumers' demands for minimum vehicle down-time are met — but at a high cost. Distribution costs typically account for 60–65 per cent of the final cost of genuine replacement parts.

In the main, vehicle manufacturers have opted to own and operate national or central warehouses. Most distributors, wholesalers and dealerships are independently owned and operated under franchise-type arrangements. Because they are owners, operators have strong commercial incentives to function efficiently.

Manufacturers play an active role in the operation of the network. For instance, new dealerships are established only after consideration of the implications for the profitability of surrounding dealerships. Prospective dealership owners also have to meet the manufacturer's criteria in order to secure a dealership.

The pricing structures used by manufacturers are intended to encourage distributors, wholesalers and dealers to hold slow moving parts. Toyota (sub. 31, p. 4) noted that:

> ... differing margins are designed to encourage dealers to purchase parts from Toyota to hold in stock or discourage them from purchasing only when they have a retail or trade demand ... This supports our policy to ensure immediate availability to the customer, wherever possible.

Most vehicle manufacturers provide distributors and dealerships with recommended price lists. They equalise freight rates in order to supply parts and accessories to distributors, wholesalers and dealers across Australia at a uniform price. For instance, under Ford's freight equalisation program, a dealer in Perth is charged the same freight cost for the delivery of a part as a Ford dealer in the suburbs of Melbourne, even though Ford's national distribution warehouse is located in Melbourne.

The effect of freight equalisation on parts prices varies according to the cost of freight. The Commission understands that freight costs on average account for about 1 per cent of the total cost of parts. The cost of freighting a typical container of parts from Melbourne to Perth is around 3.5 times (and Melbourne to Brisbane around twice) the cost of freighting the same container between Melbourne and Sydney. The implied subsidy to users in more distant locations will be larger for those parts for which the volume/value ratio is high.

5.2 Concern about the cost of parts

A number of participants raised concerns about the price of replacement parts. This section examines these concerns and then discusses the reasons for observed price levels and price movements. These factors are discussed under two broad headings, namely cost factors and factors impinging on the level of competition.

Participants' concerns

There is a perception that once a vehicle is purchased, the owner is, in a sense, captive or locked-in to obtaining parts from the manufacturer's franchised dealers. Motor vehicle manufacturers have been characterised as exploiting this situation — overpricing parts to make excess profits or to compensate for poor profits from the sale of new vehicles. The GIO (sub. 36, p. 5) commented:

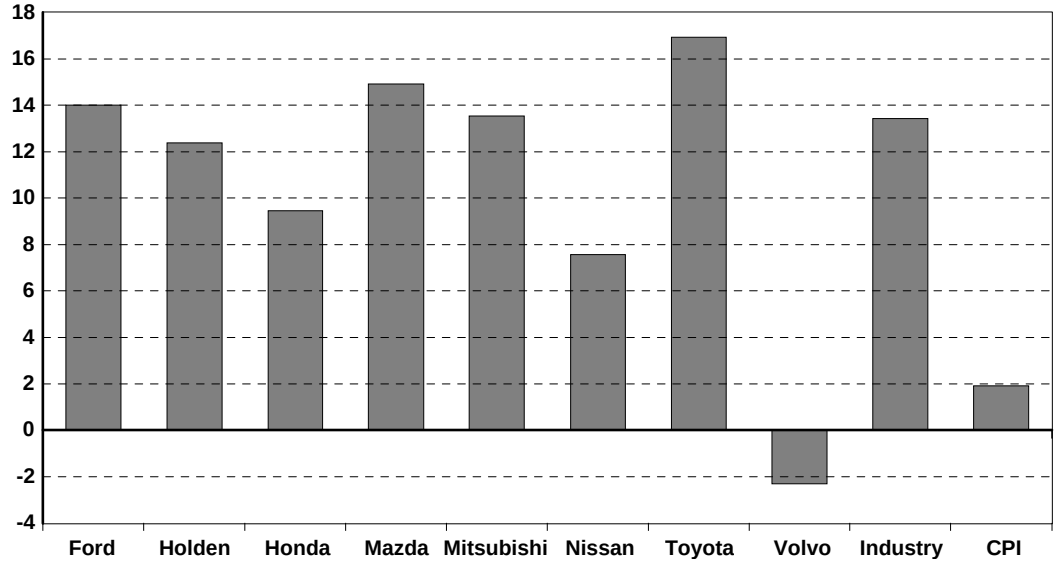
> ... car manufacturers appear to keep the sale price of a new vehicle low because they are in competition with other manufacturers; it is claimed that they recoup the discount on the sale price by charging inflated prices for spare parts.

Motor vehicle insurers have also voiced concerns about the prices they are charged for genuine parts. The pricing policies of the vehicle manufacturers have a significant impact on insurance premiums because about 95 per cent of the parts used for insurance repairs are genuine, and replacement parts typically comprise around 50–60 per cent of repair costs.

A number of observations have been advanced in support of the view that motor vehicle manufacturers "overprice". These include:

- *General increases in the cost of genuine parts.* Based on a sample of over 100 000 parts and the recommended price lists of vehicle manufacturers, the NRMA claimed that, in 1993, 58 per cent of parts increased in price, 3 per cent decreased and 39 per cent remained unchanged. According to the NRMA, the overall average price increase for genuine body repair parts in 1993 was 13.4 per cent compared with around 1.5 per cent for the CPI. Average body repair parts price changes for selected manufacturers are shown in Figure 5.1.
- *Increasing cost of parts used in insurance related repairs.* The NRMA compared the cost of repairing a Honda Civic in March 1994 with the cost in November 1991. Labour costs were shown to have increased by 5 per cent, whereas parts costs increased by 23 per cent. Overall, repair costs increased by 15 per cent.

Figure 5.1: Average changes in body repair parts prices, 1992–93 (per cent)



Source: NRMA

- *Differences between the price of genuine parts and parts manufactured by the same supplier, but marketed under a different brand name*. Examples include genuine wheel bearings and brake pads costing up to 500 per cent and 190 per cent more, respectively, than the same parts marketed under different brand names (*Wheels* 1993, p. 101); and
- *Differences in the price of similar (or identical) parts for badge engineered models.* For instance, the price of a drive shaft for a badge engineered model can vary by up to 100 per cent from the price of the same part charged by dealers of the "original" model (*Wheels* 1993, pp. 101–2).

A number of cost factors may have contributed to the price movements and price differentials cited above. However, it is important to recognise that production of many motor vehicle parts (in particular common smash repair parts such as panels) is characterised by large fixed costs and relatively low marginal costs.

For their parts operations, manufacturers will seek, at a minimum, to cover all fixed costs (including overheads) and variable costs. Indeed, some may also seek to cover certain overhead costs which are more closely related to their vehicle production activities. In recouping these costs, manufacturers will not necessarily aim to allocate costs precisely in accord with the actual costs associated with each part. Generally they will take account of the varying

degrees of competitive pressure which characterise the replacement parts market in Australia (eg they will understate costs for parts where competition is intense) and tend to recover a higher proportion of costs from parts where there may by only limited competition (eg body panels). This means that there is some degree of arbitrariness in cost allocation, and it implies that there could be a degree of cross-subsidisation between some parts.

The following sections discuss, first, cost factors which place upward pressures on prices and, second, the extent of competition in the market for replacement parts.

Cost factors

Movements in the exchange rate have a significant impact on prices, in particular the depreciation of the $A against the Japanese Yen over the past three years. Japanese sourced parts account for approximately 50 per cent of all imported parts and accessories. Mitsubishi said that the depreciation of the $A had added over 30 per cent to the cost of importing parts from Japan over the past three years. Toyota commented that this had increased component costs by 38 per cent between December 1991 and September 1993, although selling prices had only increased by 22 per cent.

Other cost factors help explain the increasing cost of parts as a proportion of the total cost of accident repairs:

- Vehicles are now being designed to "crumple" more easily, this can increase panel damage and, hence, the costs of parts required to repair the vehicle.[3]
- With greater use of integrated assemblies, whole components may need to be replaced when only a sub-component is damaged.
- In modern vehicles it is also often necessary to replace or reinstall relatively costly high-tech components and control systems which are located in vulnerable positions (eg air bags, engine management control units and anti-skid braking systems).

The disparity between prices of genuine and non-genuine parts may, to some extent, reflect differences in the cost structures between suppliers of genuine and non-genuine parts. For example, Mitsubishi (sub. 34, p. 5) commented that:

> The non-genuine parts suppliers ... do not have to undertake the initial design and testing of the parts, do not have to ensure that the parts meet any ADRs, do not have to

[3] One offsetting design feature that tends to reduce the extent of damage in low impact collisions is the improvement in the impact absorbing capacity of modern vehicle bumpers.

> stock slow moving parts, do not have to maintain supply over an extended period after the demand falls away, do not have to ensure that parts are available throughout Australia, and do not have to support the Repair Industry in skills and knowledge to repair vehicles.

Variations in warranties and quality, including performance and life expectancy, and the freight equalisation policies of the vehicle manufacturers can also contribute to differences in the prices of genuine and non-genuine parts.

The observed variations in prices between genuine parts for badge engineered vehicles cannot be readily explained in terms of cost factors. They could partly reflect differences in marketing strategies. For instance, some companies (eg Toyota) indicated a preparedness to cross-subsidise the sale of certain parts. One corollary is that losses on the sale of parts have to be recouped elsewhere in the business, including the sale of other parts.

While cost factors undoubtedly help explain some price levels and changes in prices, the level of competition faced by parts suppliers is likely to be a more important factor. This is discussed below.

Competition in the replacement parts market

Vehicle manufacturers presently face competition in some segments of the replacement parts market from a range of sources including: OE manufacturers selling parts under their own brand name; other component manufacturers; and importers. Wrecking yards selling second-hand parts and parts reconditioners provide other sources of competition.

Vehicle manufacturers indicated that they consider the prices of competing parts in setting prices. For example, Ford (sub. 20, p. 11) commented that it:

> ... continually monitors the market utilising market information from its dealers and customers on competitive price positions and, where appropriate, adjusts prices to ensure its parts are competitively priced.

The Australian Automotive Aftermarket Association (AAAA) (sub. 64, p. 1) considered that Australia has "... a very competitive automotive replacement parts industry ...", as reflected by the fact that the vehicle dealer network accounts for less than 50 per cent of replacement parts sold in Australia, compared with levels as high as 80 per cent in other countries.

However, competition in the market for replacement parts varies between market sectors. Competition is most intense in the area of fast moving maintenance parts. The PSA (1988, p. 35) commented:

> Competitive pricing is apparent where alternative choices of supply are available, for example in relation to fast-moving parts which are often sold by large stores and

> chains, being items such as spark plugs, filters and accessories, and some standard repair packages.

In contrast, some participants considered that competition in the supply of accident repair parts (in particular panels) is limited. The ICA (sub. 23, p. 28) stated that:

> The vehicle manufacturer/importer either manufactures the panels or imports them from their own sources. Accordingly, no competitive market exists in supplier brand name panels as it does, for example, in shock absorbers, filters or spark plugs.

The scope for substitution between genuine and non-genuine parts is sometimes limited. For example, where an insurance claim is involved, consumers have a strong preference for genuine parts. As AAMI (sub. 30, p. 30) said:

> Although consumers when buying accessories or other such aftermarket parts from retailers are often content to use a non-genuine part, their view is very different on an insurance claim for smash repair parts when the insurer is paying.

Notwithstanding their reluctance to use non-genuine parts, the high prices of genuine parts have, in some instances, encouraged insurers to search for alternative parts, including new and second-hand parts sourced domestically and off-shore. This has placed some pressure on vehicle manufacturers' prices. In this context, Suncorp (sub. 38, section D) stated:

> ... this is a huge deterrent against the vehicle manufacturers. As an example in 1990 we decided to use exchange plastic bumper bars and within a month Ford had contacted us and reduced the price of their genuine new bars to match the price of the exchange bars which were half the price of the new ones.

Even where the competition for certain parts is limited, vehicle manufacturers could be expected to consider the implications of parts pricing for the image and saleability of their new vehicles. As Mitsubishi (sub. 34, p. 5) commented:

> With the maintenance costs of vehicles being an increasingly important factor in the car-buying decision, each company must continually be looking for ways to reduce the costs and prices of replacement parts.

Competition clearly imposes some pressure on the prices that vehicle manufacturers can charge for parts. Nevertheless, participants had a number of concerns regarding the scope for effective competition in the replacement parts market. These concerns are considered below and include: the distribution arrangements used by vehicle manufacturers; dealer practices; assistance arrangements; tooling and supply arrangements; information shortcomings; and design protection of vehicle manufacturers' parts.

Distribution arrangements

Insurance companies and other large consumers of spare parts (including groups or cooperatives of repairers) can negotiate with dealers to obtain volume discounts. However, a number of insurers expressed concern that they cannot reduce costs by purchasing parts direct from vehicle manufacturers. For instance, the RACV (sub. 10, p. 20) stated that it:

> ... approached vehicle manufacturers with a proposition that its ... Insurance Crash Repairers be permitted to purchase replacement parts direct from the vehicle manufacturer. This was not permitted because it would take market share away from the new car dealer network.

Manufacturers could opt to sell direct to insurance companies and appropriate some of the margin which would otherwise accrue to the dealer network. However, the vehicle manufacturers consider that, if their distributors/dealers are not able to make up any revenue shortfall from the loss of these margins on other parts sales, their capacity to support an extensive service network to their customers could be undermined. Ford (sub. 20, p.10) stated:

> If Ford Australia were to deal directly with large retail 'chains' or insurance companies, this would in turn reduce the distributors/wholesaler sales opportunities in the local area, and thereby reduce the viability of the dealer's parts business and result in the dealer being unable to stock the wide range of parts necessary to provide the optimum level of service to the customer.

This concern was acknowledged by AAMI (sub. 30, p. 28):

> By dealing direct with AAMI, manufacturers would cause dealers to lose their sales of "crash and bash" parts, which are fast movers. They argue that dealers would be left with stocks of slow moving parts that must be kept to provide clients with adequate service.

From the consumer's perspective, there is a trade-off between lower insurance premiums (because of reduced parts costs) and proximity to dealers. It is not clear where this balance would lie. Nevertheless there is an incentive for insurers to seek alternative sources of parts for accident repairs. To the extent that they are successful, this places additional pressure on the motor vehicle companies and their dealers to lower prices.

The TPC (sub. 110, p. 11) suggested that the decision by a manufacturer not to sell parts direct to insurance companies is unlikely to raise trade practices problems. In its opinion, it is a legitimate commercial decision reflecting the manufacturer's view that the most efficient means of serving the overall market involves supplying parts exclusively through its distributor network.

Dealer practices

A number of participants were concerned that the use of recommended price lists by distributors and dealers limit price competition on parts. The NRMA (sub. 54, p. 35) commented:

> Dealers are sometimes classified by the car companies as wholesalers or distributors if they sell very high volumes of parts. The discount received by these special dealers is greater due to their higher volume yet their selling prices are often the same as the regular dealers because they stick to the same recommended prices.

For distributors and dealers, recommended price lists provide a useful managerial tool, acting as a guide or price reference for the many thousands of parts they stock. However, this does not prevent them departing from price lists and offering discounts on parts either across the board or to volume buyers. Indeed, most dealers and distributors offer discounts to some large customers (including insurers). Mitsubishi (sub. 34, p. 6) commented that:

> Parts Distributors/Dealers do not necessarily follow the Recommended Price List or Discount Schedule. Certainly additional discounts are offered to attract business and maintain customer satisfaction.

Another area of concern relates to the perception that genuine parts have to be used in order to ensure the validity of new vehicle warranties. This, in turn, acts as a barrier to the sale of non-genuine parts during the warranty period which, on most cars, now extends beyond 12 months/20 000 kilometres. Whilst vehicle manufacturers are free to make the use of genuine parts a condition of their voluntary or *express* warranties, the Commission understands that generally new vehicle warranties do not include such conditions.[4] Alternate parts can therefore be used without voiding a new vehicle warranty, although failure of the alternative parts or any system related to the use of an alternative part would not be covered by the vehicle manufacturer's warranty.

Some participants were also concerned that, under the streamlined sales tax system which was introduced on 1 January 1993, they cannot determine the sales tax payable and, therefore, whether a competitive price is being paid for parts. Under this new sales tax system, sales of parts to repairers (including dealership workshops) are classified as retail sales. Sales tax is calculated on prices paid by dealers rather than selling prices. According to the NRMA (sub. 54, p. 36):

> It is impossible for us to calculate the true amount of sales tax paid on any given part, because dealers' sales tax payments vary depending upon the cost price of parts from the manufacturer. For instance, dealer cost prices and sales tax paid will always be

[4] Use of alternate parts would not void any statutory warranty implied by the Trade Practices Act unless the fault occurred in, or was related to, the non-genuine part itself.

> cheaper for monthly stock orders than for overnight emergency orders. Most dealers elect to show tax-inclusive trade prices on their supply invoices, disguising the true amount of sales tax paid.

The NRMA (sub. 54, p. 36) went on to say that:

> ... many dealers continue to add the applicable tax rate to their selling prices. This effectively increases their gross profits at the expense of the repair industry and consumers in general.

It is understandable that insurers are concerned about the prices paid for parts. However, dealers are prepared to offer discounts to large users of parts such as insurers and it is the bottom line price that is relevant rather than the way in which sales tax is calculated. The ability to negotiate with dealers in a competitive fashion provides insurers with the capacity to obtain parts at the most competitive price.

Assistance arrangements

Tariffs on imports are the main form of protection for local production of replacement parts for vehicles and recreational marine craft. A range of general budgetary measures also provide some assistance, although these schemes increase the returns to parts producers without directly influencing the price of the parts to users.

Local production of replacement parts for passenger motor vehicles is also influenced by assistance arrangements applying to vehicles and original equipment parts under the Passenger Motor Vehicle (PMV) plan. Overall, these special assistance arrangements are likely to partially offset the effect of tariff protection on prices, although their net effect on replacement parts is likely to be small. These special arrangements, tariff assistance and the general budgetary measures are discussed in Appendix C.

Until recently, the level of tariff protection provided to parts manufacturers was considerable, substantially increasing the cost of imports and, thus, reducing the scope for import competition. However, over the last decade, tariff protection has been reduced substantially. For example, replacement parts for passenger motor vehicles were generally subject to tariff rates of 25, 35 or 37.5 per cent in 1984. These rates have now been reduced to 15 per cent.

The scope for competition from imported parts will increase in line with the Government's program of tariff reductions (see Table 5.1). Under the general tariff phasing announced in the March 1991 Industry Statement (DPM&C

1991), tariff rates applying to virtually all imports not covered by sectoral plans are to be reduced to a maximum of 5 per cent by 1 July 1996.[5]

One important exception is replacement parts for passenger motor vehicles. Although not covered by the PMV plan, the tariff rate on replacement parts for PMVs is to be maintained at the current rate of 15 per cent through to 2000. Any imported parts of a type (or of a kind) that are capable of being used in passenger motor vehicles are to be subject to the 15 per cent rate, regardless of the actual or intended use of the part. Parts common to PMV and non-PMV vehicles (eg light commercial and off-road vehicles) will attract the higher rate even if they are not intended for use in PMV. Thus, the production of replacement parts for passenger motor vehicles (and some generic components) will continue to be afforded significant tariff protection and will increasingly be advantaged relative to most other manufacturing activities.

Table 5.1: Tariff rates, 1994 – 2000[a] (per cent)

Description	*1994*	*1995*	*1996*	*1997 – 2000[b]*
Passenger motor vehicle replacement parts	15	15	15	15
Agricultural vehicle replacement parts	Free	Free	Free	Free
Marine outboard engines	8	7	5	5
Diesel inboard engines	Free	Free	Free	Free
Other replacement parts[c]	10	8	5	5

a All rates as at 1 July.

b Post 2000 assistance arrangements for passenger motor vehicles are to be reviewed in 1996.

c Includes parts for light commercial and "other vehicles" (eg trucks, buses, tractors, motor cycles and other road and farm equipment), with the exception of certain lamps classified to tariff heading 8539 that enter free of duty or are subject to rates of 8 per cent phasing to 5 per cent on 1 July 1996.

Source: Australian Customs Service, Customs Tariff, Schedule 3

Tooling and supply arrangements

At present, motor vehicle manufacturers sub-contract approximately 70 per cent of their requirements (by value) for the supply of OE in the assembly of new vehicles to specialist component manufacturers. The ability of these OE parts manufacturers to supply the aftermarket depends on the ownership of the

5 At the November 1994 Bogor meeting of APEC (Asia Pacific Economic Cooperation), Australia made a commitment to eliminating barriers to trade (including all tariffs) with APEC and non-APEC economies by 2010. Developing economies in APEC have agreed to open their markets by 2020 (see Keating 1994).

tooling involved and any commercial arrangement entered into with the vehicle manufacturer.

Those parts manufacturers using tooling supplied by vehicle manufacturers are normally restricted to supplying parts for assembly in the vehicle manufacturer's product or to the vehicle manufacturer as genuine replacement parts. Where parts manufacturers use their own tooling, they can sometimes supply the aftermarket with their own branded product. However, in some cases, supply agreements prevent OE component manufacturers from independently supplying the aftermarket, even if they own the tooling.

A number of participants were concerned that these arrangements limit competition in the market for spare parts. The NRMA (sub. 54. p. 37) commented:

> ... some local independent component manufacturers have been offered parts supply contracts by certain local car manufacturers which specifically exclude the right to sell parts through independent sales networks. If this becomes commonplace, a source of competition will disappear.

While ownership of tooling and restrictions on supply arrangements limit competition, second-hand parts and, in most market segments, parts produced by other component manufacturers, remain as potential sources of competition. However, for a limited number of parts the very high cost of tooling has effectively acted as a barrier to entry and reduced competitive pressures. This reflects the fact that the tooling usually has no alternative use and therefore cannot be sold easily without incurring substantial losses. This increases the risk for new entrants. Because the likelihood and threat of competition will be weaker, vehicle manufacturers that own the tooling for these parts, or can restrict its use by their original equipment suppliers, will have significant market power .

The importance of tooling costs varies quite substantially between different types of replacement parts. For instance, because of the heavy investment in dies, tooling costs appear to account for a higher proportion of total fixed costs for panels than for most plastic components.

Technological advances, such as reverse engineering, have reduced tooling costs to some extent and increased the scope for competition. As the ICA (sub. 23, p. 26) commented with respect to smash repair parts:

> In recent years technology has enabled independent manufacturers to produce smash repair parts. The range and number of parts in the market have progressively grown.

However, participants generally agreed that, at least to date, the inconsistent quality of alternative body panels generally made them a poor substitute for genuine panels. It is likely that the standard of these panels could be improved

with the use of better quality dies, but this would erode much of the cost advantage of aftermarket producers. Moreover, even though tooling costs may have declined, these and other fixed costs for vehicles unique to Australia (eg the Falcon and Commodore) have to be recouped over relatively small production runs. This makes the investment in high quality tooling by potential competitors in the aftermarket less attractive (see Box 5.1).

Box 5.1: Fixed costs and natural protection for genuine smash parts

The Commission collected a range of data — mainly supplied on a confidential basis — on the cost of producing smash repair parts by both vehicle manufacturers and by aftermarket suppliers.

The data show that genuine manufacturers' total tooling and design costs are typically far higher — sometimes 400 to 500 per cent higher — then those of alternative manufacturers. However, these costs are offset by considerably higher sales volumes achieved by genuine manufacturers in supplying parts used for both vehicle assembly and replacement parts. The information collected by the Commission suggests that the sales volumes of genuine parts suppliers can be often five to ten times higher than that of aftermarket suppliers. In these circumstances, the total fixed costs per unit of a genuine manufacturer can be as low as 50 per cent of the total fixed costs per unit of alternative manufacturers.

The marginal cost of panels manufactured by vehicle manufacturers is generally higher (sometimes double) the marginal cost of panels produced by aftermarket suppliers. In part, this reflects the use of lower quality materials which, in turn, generally implies a lower quality panel.

In terms of total costs per unit, the alternative manufacturer has an advantage only when production volumes are at the higher end of the range, in which case lower marginal costs can outweigh the higher unit fixed costs. However, even in this situation, lower product quality will generally place the aftermarket supplier at a comparative disadvantage.

In summary, unless the alternative manufacturer is supplying a vehicle manufacturer and enjoys a relatively high volume of sales, vehicle manufacturers have a substantial level of natural protection because of their access to a larger market.

The threat of competition from alternative component manufacturers and competition in the new car market provides a cap on the extent to which any market power can be exploited. Nonetheless, vehicle manufacturers have a degree of discretion in setting prices for parts in those market segments

characterised by relatively high tooling costs and relatively low production volumes.

Information shortcomings

Consumers often lack the technical knowledge to determine the quality, performance and safety of parts. In the eyes of most consumers, genuine parts are perceived as being of equal quality to the parts used in the vehicle's manufacture. Consumer's perception of the quality of parts from other sources varies. In the face of mixed information about the quality of non-genuine parts, it is possible that many consumers purchase genuine parts, even though some non-genuine parts may be cheaper and of comparable quality. In practice, this reduces competition in the spare parts market.

Motor vehicle manufacturers have taken advantage of this information gap. They heavily promote the term "genuine" in relation to their replacement parts, and market their parts as maintaining the vehicle to its original standards.

Product differentiation through promotion, packaging etc are features of the way competitive markets operate. However, markets can and do provide other information which assists consumers in their purchasing decisions. For instance, as most parts are purchased during the servicing or repair of the vehicle, consumers are able to call on the expertise and experience of repairers. Independent parts outlets also provide advice to the consumer.

In the case of newer vehicles, less information about alternative parts which may be used with confidence is available. However, a large number of the new vehicles sold on the Australian market are purchased by fleet operators. For example, 70 per cent of new Ford Falcons are sold to fleet buyers. Large fleet operators have strong incentives to explore least cost parts sourcing options for servicing and repairing their vehicles. The information obtained by fleet operators can be quickly disseminated. By the time these fleet vehicles enter the household market, repairers could be expected to have a reasonable knowledge of the availability and quality of different parts and could advise consumers accordingly.

However, participants suggested that often repairers do not inform consumers about the source of parts used in the repair. Some called for mandatory disclosure of the type of parts used (for instance information on non-genuine or second-hand parts used). Some insurers currently have a policy of automatically disclosing the type of parts used in repairs. AAMI (sub. 95, p. 9), for example, said that it informs consumers of the use of "... second-hand or reconditioned parts prior to the commencement of repair work."

The integrity of the industry would be enhanced if repairers and/or insurers were to provide to consumers as a matter of course details of all parts used. Insurers and repairers should consider incorporating disclosure requirements into codes of practice.

Some manufacturers and retailers of alternative fast moving parts have been able to gain acceptance of their product through advertising, independent certification (eg through testing undertaken by National Association of Testing Authorities Australia approved laboratories), the provision of guarantees and the reputational effects that come with reliable products. As FAPM (sub. 43, p. 7) commented:

> These companies have developed high levels of consumer awareness and confidence in their parts. As such they offer them in direct competition to original equipment and against other suppliers. In many cases the level of buyer awareness and confidence in these parts can exceed that of the genuine part.
>
> Equally some retailers have also developed a high degree of consumer confidence in their provision of parts which may include house brands as well as manufacturers' labels.

Consumers also receive information through motoring organisations, motoring journals and consumer publications. Trade journals provide the repair trade with technical information and details about product performance.

Commercial pressures can provide the incentive for manufacturers to inform the market of the quality and performance of their product. For example, in the United States, some manufacturers concerned about the stigma attached to non-genuine parts established the Certified Automotive Parts Association (CAPA). CAPA certifies parts which have satisfied certain specifications. Manufacturers wishing to obtain CAPA certification must demonstrate a designated level of quality control procedures in their factory before their parts can be submitted for testing against the CAPA specifications. After the part is certified, the onus is on the manufacturer to ensure that the part continues to comply. Once the part complies to the CAPA specifications, a distinctive CAPA label is attached to each part. A directory of parts certified by CAPA is published and distributed regularly. Under this arrangement, the competitive position of alternative parts manufacturers and suppliers can be improved by providing consumers with a recognisable and reliable quality standard. This helps to remove the perception that alternative parts are of a lower quality/performance than genuine parts.

There are a number of reasons why an industry based certification and labelling scheme, such as CAPA, has not evolved in Australia. Many of the alternative parts manufacturers and importers of parts have already established quality brand names and are able to supply the original equipment market and/or the replacement parts market without the quality of their product being questioned.

For these producers, the introduction of a certification and labelling scheme would be of limited benefit. The relatively small size of the Australian market in comparison to markets such as the United States is also a deterrent.

The insurance industry, being a large user of genuine parts, has an incentive to consider options for overcoming information gaps and increasing competition in the spare parts market. It recently explored the scope for establishing a CAPA style system. From the insurer's perspective, such a system is attractive. It would help to overcome the stigma attached to non-genuine parts and the desires of policyholders to have only new genuine parts used in smash repairs.[6] It would also help to overcome the unacceptable variability in the quality of some non-genuine parts. The acceptance of non-genuine parts by policyholders would place greater pressure on genuine part prices.

A number of insurers suggested that a major factor inhibiting the development of a CAPA style scheme in Australia is the prospect of widespread design registration of parts. As discussed in the following section, this could constrain the manufacture and use of many alternative parts. The NRMA (sub. 54, p.40), for instance, suggested a certification system such as CAPA "... will not happen until Australian Design Law is amended to enable open competition in the aftermarket."

Design protection

Designers of most products — including motor vehicles and parts — can receive design protection under the *Australian Designs Act 1906*. As stated by the Australian Industrial Property Organisation (sub. 49, p. 3):

> The purpose of the designs system is to encourage good product design through the grant of exclusive rights which, in the public interest, are limited in time and effect.

In practice, the Act provides designers with a monopoly over their design like the patent protection provided to inventors. In relation to automotive parts, Holden and Ford are the major users of design protection. Both manufacturers register exterior panels and bumpers, whilst Holden also registers some other parts such as wheel trims.

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[6] It is not surprising that, having paid their insurance premium, policyholders demand the use of genuine replacement parts. However, many vehicle owners, if given a choice, may prefer to pay a lower premium and accept the use of non-genuine or second-hand parts. Some insurers in the United States offer this type of "budget" insurance cover. The fact that insurers in Australia have not offered two streams of cover could reflect concerns about negative effects on reputation and the potential for legal claims relating to "unsafe" parts.

Compromises of intellectual property law

All intellectual property regimes make inevitable compromises between the objectives of rewarding the production of new ideas and ensuring that competition keeps the selling price of products embodying those ideas in check. Trade-offs made involve the period and the scope of monopoly protection provided and the height of the "innovation hurdle" — the degree of "inventiveness" required to qualify for protection.

Although it confers monopoly rights, intellectual property law should ideally have a pro-competitive effect by providing innovators with greater incentives to produce new and more competitive products. However, intellectual property protection can have an anti-competitive effect if the protection it provides is too great, too easy to get and/or if the protected activity would have taken place without protection. Here the original innovator can "rest on its laurels" and use intellectual property protection to protect it against firms seeking to "catch up".

In Australia, both patent and design laws provide monopoly rights for 16 years from the time of registration, but patent protection is usually more extensive than design protection. This is because a patent protects prior inventiveness and gives rise to a property right in the registered *invention*. To receive patent protection, new inventions must demonstrate a significant degree of "inventiveness" or "non-obviousness". On the other hand, to receive design protection, designs must be new, but need not show any inventiveness. No matter how inventive a new design is, only its *appearance* is protected from unlicensed imitation by design registration.

As Australian design law currently stands, relatively minor design changes are sufficient to release an imitator from the constraints of design registration. Partly because of dissatisfaction with this situation, and perhaps also because the original legislation dates back to 1906, design law has been subject to several reviews since the 1970s. The Australian Law Reform Commission (ALRC) is currently conducting an extensive review of the area.

As currently understood by most legal practitioners, Australian design law offers virtually complete protection for many motor vehicle (and other) spare parts. This is because, very often, those competing with original equipment manufacturers' spare parts cannot alter the design of a product without impairing its ability to repair the vehicle for which it was intended. The design of a Falcon front fender for instance, cannot be materially varied if it is to restore a damaged Falcon to its previous condition, appearance and value.

Costs and benefits of design protection for spare parts

Because competition with aftermarket suppliers helps contain the price of "genuine" replacement parts (see above), design protection is likely to involve substantial costs. Each of the vehicle manufacturers participating in the inquiry commented on the importance they attach to meeting market competition in their pricing of spare parts. For example Toyota (sub. 31, p. 4) stated:

> Toyota engages in an active programme of market price review and adjustment, to ensure that competitiveness is maintained.

The NRMA indicated that some spare parts prices had fallen by 40 per cent following the introduction of competition. Studies in the United States (cited in ICA, 1993, p. 6) also suggest that the effect of competition on the price of spare parts is considerable.

The costs of design protection in terms of reduced competition must be weighed against its potential benefits. Intellectual property is often easily copied and it can be difficult for its creators to prevent unlicensed competition.[7] This can lead to underinvestment in innovation as firms free ride on the innovations of others. Intellectual property rights address this problem by providing incentives for greater innovative activity. For instance, research and development will often be motivated by a desire to reap the profits available from having exclusive (patent protected) access to new technology.

However, it is hard to see how design protection for spare parts would encourage greater design activity. The commercial motive behind virtually all automotive design activity (and so the "value added" in automotive design) relates virtually exclusively to the commercial attractiveness of *new* vehicles. Accordingly it seems likely that the extent of design activity will depend upon the rewards to it in new car sales, irrespective of the price of, and returns to, spare parts.

Manufacturers of complete vehicles enjoy virtually complete *natural* protection from imitation of the designs, obviating the need for them to apply for protection under the Designs Act. This is because the fixed costs of tooling for

[7] Unlike many goods, to a significant extent intellectual property is both non-rival and non-excludable. Non-rivalry exists where the enjoyment of a product by one person does not diminish the capacity of another person to enjoy it. Once produced, intellectual property can generally be replicated at much lower cost than its original cost of production. For instance, software is easier to copy than to write. Partly by the ease with which it can be copied, it also exhibits non-excludability. In the absence of enforceable property rights, once intellectual property is created and conveyed to others, it becomes difficult for its creator to prevent those who have had the intellectual property passed to them from competing in the market place, even though these competitors have not invested in the production of the original intellectual property.

a complete vehicle are so immense that any firm capable of undertaking such a venture would choose to differentiate their product rather than market it as a "non-genuine" copy of another brand.

Moreover, there are reasons to believe that the extent of free riding on the design activity of manufacturers is minimal.

- Confidential information provided to the Commission suggests that design work represents less than 1 per cent of vehicle manufacturers' total costs.[8] Frequently firms imitate others and are able to free ride on innovations to a much greater extent than this without infringing intellectual property law. Providing this is not choking off innovative activity — which does not appear to be occurring here — the Commission would regard this as economically healthy.
- Original manufacturers enjoy a range of advantages over their rivals which restrict 'free riding', even without intellectual property protection. Generally original producers have a 'captive' market for original equipment parts. In the case of most crash parts (and particularly panels), this provides them with substantially greater volumes over which to amortise tooling than those alternative parts manufacturers that are restricted to competing in the aftermarket. They also enjoy strong reputational advantages in the aftermarket associated with their manufacture of the original product. This is particularly the case with insurance repairs where vehicle owners are generally indifferent about any price premium which is charged on "genuine" aftermarket parts. For these reasons, non-maintenance "genuine parts" typically enjoy very high market shares, for instance, of the order of 80 per cent for replacement crash parts.

Although design protection can improve returns to firms designing locally, the actual location of the design activity is incidental to the receipt of design protection. Australian design law conforms with international norms in offering the same protection for imported design as for design undertaken in Australia. In fact many more imported designs are eligible for Australian design protection than local designs.

At present, Ford and Holden, which both engage in substantial Australian design activity, are the major users of design protection for automotive spare parts. However, the Commission doubts whether this design activity is dependent on the availability of design protection for spare parts. It more likely to be a function of the need these firms have to market attractive and

[8] This needs to be distinguished from tooling costs for new models which is more substantial, but which does not, and according to the principles discussed here, should not, attract any intellectual property protection.

differentiated vehicles and the relative competitiveness of Australian design for Australian manufactured products. To the extent that other manufacturers or importers (who market entirely or predominantly foreign designs) also find advantages in undertaking design work close to the primary location of manufacture (ie overseas), design protection for spare parts is likely to have a negative net impact on the level of Australian design. This is because the protection afforded these foreign designed parts in Australia prevents firms (including those in Australia) from performing the design work necessary to produce tooling which will manufacture the parts for "non-genuine" aftermarket supply.

Appropriate economic principles for design protection

Some countries' design law seeks to minimise the extent to which design protection can act anti-competitively to prevent firms competing against design protected products with products of their own design. Thus, in English law, design rights do not accrue to features of a product that are "dictated solely by the function that the article has to perform" or to those aspects of spare parts that either "must fit" or which "must match" original products in order to repair or restore them. The draft design protection regime for the European Community is similar in this regard. As it currently stands, design protection will not be provided "to the extent that the realisation of a technical function [by the design] leaves no freedom as regards arbitrary features of appearance". The draft regime exempts from protection designs of parts which must fit other parts and limits design protection for must match parts to just three years from the date of registration.

This is consistent with the fundamental principle that design protection protects appearance rather than function. And to do otherwise would allow design protection to be used in an anti-competitive rather than a pro-competitive way. The ease with which designs can be registered (ie the lack of an "innovation hurdle" for them to clear) suggests that the extent of protection which design protection provides should be relatively circumscribed. Where a particular function can only be achieved with one design, its design registration would effectively provide patent protection over a particular function without the

innovation having met the "innovation hurdle" necessary to justify patent protection.[9]

As noted above, in a range of circumstances the provider of spare parts has "no freedom as regards arbitrary features of appearance" if that provider is to supply a product which will satisfactorily repair and restore a specific damaged vehicle to its previous condition, appearance and value. That is, the design of many spare parts is "dictated solely by the function which [they have] to perform". The "function" of spare parts is not simply performing some technical function, but also repairing and restoring the value of a specific, otherwise complete product. In Australian jurisprudence, "function" in this context is currently interpreted to mean "technical function". Thus, the technical function of a Falcon front fender would be to protect certain interior components of the car, but not to restore the Falcon to its previous condition, appearance and value.

The concept of function is useful in considering how the law might be crafted in the future. If it is to be used as a criterion for demarcation between what can or cannot be design protected, the word should be applied in a manner consistent with the policy rationale of its use in the first place. Provided the "function" of a product can be defined to include the "commercial" function — that is restoring a complete assembled product to its previous condition, appearance and value — it seems to offer a criterion which is legally and administratively workable and, at the same time, economically defensible.

Economic efficiency would be promoted if design protection were not provided in those instances where design is dictated solely by the function which products are sold to perform. In this regard, "function" should be interpreted to include commercial as well as technical function. The function of a spare part for a motor vehicle is typically to restore the vehicle to its previous condition, appearance and value. Accordingly, where spare parts either "must fit" or "must match" the vehicle which they are intended to repair, their design is, to that extent, dictated by their function. Such parts should not qualify for design protection.

Some participants suggested that the "must fit" and "must match" definitions currently used in British and draft European Union legislation may lead to an undue degree of litigation over their precise meaning in individual cases. The

[9] The ALRC (1994) has suggested that to qualify for protection, designs should pass a test which requires them to be "distinctive". This will raise the "innovation hurdle" for design protection to some small extent although, in the Commission's view, it would still be insufficient to justify the very strong protection which design protection provides "must fit" and "must match" parts. For these to be protected, it is appropriate that an altogether higher level of innovation be required — as for instance is provided for in the test of "non-obviousness" in the case of patents.

intent of these expressions seems clear and even if there were some litigation at the outset, it could be expected that judicial interpretation would produce a workable and relatively certain definition. Some degree of litigation is probably inevitable following the introduction of any new legislative distinction between what can and cannot be design protected.

Notwithstanding this, if it was considered that the "must fit" and "must match" distinctions would lead to unacceptable uncertainty, the Industry Commission considers that the preferable course of action would be to remove design protection from all spare parts. Vehicle manufacturers would continue to enjoy the very substantial "natural protection" from the volumes of production available to them for new car production and "genuine" aftermarket parts supply and they would remain free to register entire vehicles for design protection and any particularly innovative spare parts for patent protection.

At the draft report hearings, a number of participants argued that existing mechanisms for addressing anti-competitive behaviour would adequately address the scope which design protection allows for the misuse of market power. For example, Ford (sub. 94, p. 24) stated:

> ... whilst the holding of an intellectual property right does not constitute anti-competitive conduct, its exercise may do so in some circumstances. Part IV of the Trade Practices Act is geared to address those circumstances.

Similarly, General Motors Holden's (sub. 87, p. 5) commented:

> ... statutory and regulatory mechanisms are already in place to control the exercise of monopoly power where there is evidence in particular cases of its abuse. For example, it is expected that the Prices Surveillance Authority would take far more interest in components for which design registration had been granted than it would in other parts.

While the TPC and the PSA do have some powers to counter anti-competitive behaviour, the Commission does not consider their existence weakens the case for denying design protection for "must fit" and "must match" parts. The nature of spare parts production whereby manufacturers typically produce a range of parts using common facilities makes it difficult to prove that pricing practices are anti-competitive. More importantly, it is more efficient to eliminate the cause of the problem rather than to rely on mechanisms to treat the symptoms of the problem at a later date when some of the costs have inevitably been incurred. Adopting the approach advocated by Ford and General Motors would be analogous to allowing all merger proposals to proceed, and subsequently taking action if it could be demonstrated that a particular merger was contrary to the public interest. Clearly, this would be neither sensible nor practical.

A further question arises concerning the extent to which the principles discussed here can usefully be generalised to other areas. Although the Commission has not examined other markets, the reasoning set out here would appear to apply to most circumstances in which spare parts are sold for the repair of larger assemblies. Accordingly it seems likely that the rule proposed here should apply to spare parts for other consumer products such as whitegoods. Other considerations might apply where products were sold in modular form — such as "lego" blocks or dinner sets sold by the piece or setting.

The Commission's view

There is some concern that key features of the replacement parts market such as distribution arrangements, dealer practices, tooling costs and related proprietorship arrangements, provide vehicle manufacturers with considerable scope to overprice parts. Observed price movements and price differences have been advanced as evidence of overpricing. These issues were considered by the PSA in 1988 in its inquiry into replacement part prices. The PSA (1988, p. 49) considered the desirability of price monitoring and concluded:

> ... participation by the Authority in this kind of activity would not be likely to produce substantial additional benefits, and will not be pursued.

There are also likely to be considerable practical difficulties in sensibly monitoring prices, given the very large number of parts involved.

In the market for maintenance parts, potential and actual competition generally provides an effective constraint on vehicle manufacturers' pricing behaviour. In relation to some other parts (eg certain body panels), vehicle manufacturers have a considerable degree of discretion in setting prices. However, even for these parts, the threat of competition from alternative component manufacturers provides a cap on the extent to which vehicle manufacturers can exploit their market power.

Indeed, with the exception of recent moves to register parts designs, the scope for competition has increased since the PSA's review. There have been large reductions in tariff protection (providing increased potential for competition from imports) and advances in reverse engineering (reducing costs associated with tooling). Consequently, the Commission has not found any compelling need for government intervention, such as price monitoring.

However, vehicle manufacturers are now making greater use of design protection for motor vehicle parts. This has the *potential* to substantially reduce the competition that presently moderates the pricing behaviour of vehicle manufacturers and their dealers.

The stigma attached to non-genuine parts has not been sufficient to encourage non-genuine parts suppliers and manufacturers to establish a CAPA style testing and certification system. The uncertainty regarding design protection laws appears to have mitigated against the establishment of such a system. Clarification of the design protection laws — by not allowing protection in those instances where design is dictated solely by the function for which products are sold to perform — would remove one obstacle to the establishment of such a facility.

While competition has an important role to play in ensuring parts are priced "fairly", informed consumers can also exert pressure on parts suppliers and on prices. They can, for instance, take account of spare part prices when buying their vehicle. Vehicle owners can do this either directly, or indirectly by reference to the vehicle's insurance rating and/or information on vehicle operating costs (which detail the costs of commonly replaced parts) gathered by motoring organisations and fleet operators.

5.3 Safety Issues

One dimension of quality is safety. However, safety is different from the other attributes of a product. If safety is compromised, lives can be at risk. In the case of motor vehicle components, unsafe parts threaten the lives not only of the occupants of vehicles in which they are incorporated, but also occupants of other vehicles and pedestrians. Furthermore, unlike some aspects of quality (eg fit and finish), consumers are usually not in a position to assess the safety of many products. Consequently, governments have legislated to protect users and others in the community.

Many parts used in the assembly of new motor vehicles are required to comply with the Australian Design Rules (ADRs) (see Box 5.2).

Box 5.2: Australian Design Rules

The Australian Design Rules set minimum standards for the safety of motor vehicles and trailers. They are established as standards under the provisions of the *Motor Vehicle Standards Act 1989*. All vehicle manufacturers and importers must meet relevant ADRs in order for their vehicles to qualify for registration in any Australian state or territory.

The ADR system has been in place since 1970. New or amended rules are introduced as issues arise and technology develops. The general principle is that a vehicle (or component) is expected to comply with those requirements that were in place when the vehicle was originally supplied to the market.

Standards and tests set out in the ADRs provide the basis for establishing whether a vehicle part is unsafe. Some components require comparatively simple and low cost testing (eg lamps, hydraulic hoses and mirrors). However, the performance of certain other parts can only be determined by testing the complete vehicle. For instance, assessments of occupant protection levels require crash testing. Such performance orientated tests assess safety features of the vehicle by testing the synergistic arrangement of parts (eg parts are designed and integrated so that on impact there will be a certain level of protection provided to occupants). Because of the performance orientation of many ADRs, not all safety related components used in vehicles have explicit/specific standards.

Source: FORS (sub. 40)

There is no corresponding requirement for replacement parts to meet ADRs. However, the likelihood of unsafe replacement parts being available in the Australian market is reduced in other ways:

- there is a legal requirement under state and territory legislation that owners ensure that their vehicles continue to comply with ADRs;
- provisions of the Trade Practices Act allow for the recall of parts with safety defects and/or the banning of parts from sale. These provisions are administered by the Federal Office of Road Safety (FORS) (see Box 5.3); and
- product liability laws and consumer protection legislation provide legal redress where defective products cause injuries or other losses.

Box 5.3: Safety role of FORS in the parts market

FORS has had the responsibility for the investigation and recall of unsafe automotive parts since 1986 when the mandatory product recall provisions of the Trade Practices Act were introduced. Tests are normally conducted by FORS in cooperation with the manufacturer, including overseas manufacturers, or the supplier in Australia. In some cases, insurers and others not involved in the production of parts have supplied FORS with parts believed to be unsafe.

FORS tests parts to see if they comply with the relevant standards (where they exist) or whether, in the terms of the Trade Practices Act, failure "will or may cause injury to persons". Where safety concerns are identified, manufacturers or suppliers are required to institute a recall of the parts. While mandatory recalls can be initiated under the Trade Practices Act, all recalls since the introduction of the mandatory recall provision — including those initiated by FORS — have been undertaken voluntarily by manufacturers or suppliers. Some 370 recalls of vehicles and parts have been conducted under these arrangements. Most of these recalls involved parts that were manufactured for both OE and the aftermarket (as genuine and/or manufacturers' own brand). Where parts are found to be unsafe, FORS can also take action under the banning provisions of the Trade Practices Act.

To assist in its investigations into unsafe parts, FORS refers matters to an advisory committee consisting of Federal, state and territory transport officials, and representatives of consumer protection agencies, vehicle manufacturers, local component suppliers, importers and consumer groups.

Source: FORS (sub. 40)

Some participants consider that these mechanisms provide sufficient incentives to ensure that the sale of unsafe parts is not a significant problem. The AAAA (sub. 64, p. 8), for instance, argued that:

> Australia has extremely severe liability provisions under the Trade Practices Act and other laws which act as an alternative deterrent to inferior products or commercial practices.

This view was contested by other participants (eg FAPM, FCAI and individual vehicle manufacturers) who consider that the safeguards are not particularly effective and, as a result, non-genuine parts — many of which are imported —

jeopardise vehicle safety.[10] For example, Ford (sub. 20, p. 3) expressed the following concern:

> The use of suspect replacement parts allows the ADR compliance or original design intent of the vehicle to be compromised. The result may increase the risk of injury to the occupants in the event of an accident.

Similarly, Nissan (sub. 35, p. 3) commented that it:

> ... had no doubt that its customers who have either intentionally or unintentionally utilised non-genuine parts risk significant deterioration in the vehicle's safety ... Whether the risk be caused by rust in non-genuine panels, inferior braking, reduced suspension performance, reduced body rigidity or mechanical failure, the result is a higher risk level for the consumer.

These participants contend that the safeguards outlined above are ineffective for several reasons:

- other than in New South Wales and the ACT, there is no systematic and regular inspection of motor vehicles to ensure that vehicles continue to comply with ADR requirements; and
- low levels of awareness of consumer rights, the complexity associated with assigning fault and the cost of legal action impair the effectiveness of consumer protection legislation.

The threat of legal action or the recall/banning of parts is likely to impose a more important discipline on large well established suppliers (including suppliers of genuine parts) than many smaller firms supplying unbranded or generic parts in relatively low volumes. This is because of their greater incentive to protect reputations and brand names.

Some argue that FORS is unable or unwilling to take action against substandard parts. In relation to this point, FAPM (sub. 56, p. 4) stated that a FORS investigation into imported fuel filler caps was:

> ... yet another example of FORS inactivity that only further fuels a lack of confidence in the organisation. The industry is becoming increasingly reluctant to expend considerable time and money to prove a part is unsafe and then get little or no support from FORS.

FAPM claimed that testing by a "respected independent engineer" had shown that the imported filler caps "would negate a vehicle's ability to meet the emissions ADR". According to FAPM, FORS rejected the case on "doubtful technical grounds".

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[10] A number of specific examples of imported replacement parts that were considered to be unsafe were raised by participants. The most commonly cited were doors without side intrusion bars and substandard headlights.

FORS believes these claims to be inaccurate, arguing that testing had only demonstrated non-compliance with vehicle manufacturers' specifications and had therefore not provided a case for action against the imported fuel caps. FORS (sub. 75, p. 2), stated that, whilst deciding not to take action in this case, in other cases it has "... used persuasion very successfully to limit or stop the sale of undesirable parts. ... [and has] invoked the powers in the Trade Practices Act to prohibit the sale of unsafe parts". FORS (sub. 75, p. 2) added:

> There is no question that FORS is willing and able to take action against unsafe parts, but we should not and will not take action merely because parts fail to meet a manufacturer's specification/expectation.

Most concerns regarding the safety of parts are raised by vehicle manufacturers and their parts suppliers. These parties have a commercial interest in casting doubt over the safety of parts produced or supplied by some competitors.

From the insurer's perspective, the introduction of safety standards for relevant parts would help overcome the stigma attached to non-genuine parts. Insurers would then have greater opportunities to use non-genuine parts without fear of commercial repercussions.

Impact of replacement parts on vehicle safety

There is little doubt that the malfunction of a part, such as a brake calliper, could compromise vehicle safety and cause, or contribute to, personal injury or property loss. However, as discussed in Chapter 4, Australian studies suggest that only a small proportion of accidents — perhaps between 1 and 6 per cent — may be attributable to vehicle defects. Furthermore, most defects arise because of factors other than substandard parts, such as poor maintenance, vehicle modification and pre-existing damage. Of these, poor maintenance appears to be the most significant factor. Consequently, the number of accidents caused or contributed to by the malfunction of a part is likely to be substantially less than 6 per cent. Furthermore, the parts that may have malfunctioned are likely to include genuine as well as non-genuine parts.

Parts could lead to personal injury in ways other than a malfunction causing or contributing to an accident. For instance, a poorly designed or constructed part may not "crumple" appropriately, adding to personal injury. However, the Commission is not aware of any studies which have attempted to establish the extent to which substandard parts have contributed to personal injury in this way.

A number of participants, while accepting that substandard parts can have safety implications, considered that many of the concerns raised relate to quality issues

(eg fit, finish and durability) rather than safety. For instance, FORS (sub. 40, p. 2) stated:

> ... many of the complaints are found, after intensive investigation and analyses, to be more related to consumer issues such as fit, and finish or durability rather than safety.

The AAAA (sub. 64, p. 6) noted that the incidence of safety related problems with aftermarket replacement components is very low. It also commented (sub. 64, p. 8):

> The volume of aftermarket parts sold within Australia which could be fairly categorised as being of inferior quality is very low and often relates to appearance rather than function.

There is little evidence linking substandard non-genuine parts to motor vehicle accidents. However, the available information suggests that defective parts (genuine as well as non-genuine) are a very minor contributing factor.

Measures to overcome safety concerns

Participants expressing concerns about the safety of replacement parts suggested a range of measures to address the problem including: the application of ADRs to replacement parts; replacement parts certification; and improved enforcement of ADR compliance. These are discussed below.

Extending ADR compliance

A number of participants argued that all safety related replacement parts should be required to meet the ADR standards to which vehicle manufacturers and importers must comply in supplying new vehicles. For instance, Toyota (sub. 31, p. 10) recommended that:

> ... replacement parts be made subject to the same ADR requirements as the base [original] vehicle equipment.

This approach has a number of practical difficulties. As ADRs are largely performance related, it is difficult to determine which parts are safety related and which are not. For instance, some crash parts such as guards, bootlids and bonnets are considered by some industry participants to be "cosmetic" and serve no safety function. However, as AAMI (sub. 30, p. 33) commented:

> ... it appears that a real question does arise whether these "cosmetic" parts form part of a vehicle's effective crumple zone and are therefore caught by a general rather than a specific ADR.

Similarly, FORS (sub. 40, p. 4) noted the difficulties in establishing whether parts are safety related or not:

> On occasions it is difficult to establish whether a part falls into the "cosmetic" or non-safety related category and subjective judgements have to be made. An example of the conflicting advice provided to FORS was where a vehicle manufacturer claimed that exterior or "skin" panels do not affect crash worthiness and a barrier crash test was unnecessary to demonstrate compliance with safety requirements following a face-lift for an existing model involving changes to the "skin" panel shape. On the other hand, the vehicle industry has suggested that the safety of repaired vehicles is compromised by using non-genuine panels.

Where ADRs are specified in terms of performance requirements, testing for compliance can be difficult and expensive. For instance, if panels were nominated as safety related parts, crash testing (as part of the vehicle) would be required to assess whether they provide the appropriate level of occupant protection. There are also other parts which have safety implications, but are not explicitly covered under specific or performance based standards. Examples include ball joints, steering arms and road wheels. Appropriate ADR standards and testing procedures for these parts would have to be established.

The need for performance testing could be reduced by establishing ADR standards for safety related replacement parts based on OE specifications (eg metal type and thickness and subframe structures). However, experience with prescriptive standards in other industries suggests that there is a danger that manufacturers may limit product innovation and development in order to minimise risks and avoid administrative problems associated with departures from the standards (eg additional testing). Also, OE specifications may not be appropriate as minimum safety standards since in many cases they exceed (in some cases quite substantially) existing ADRs.

Irrespective of the basis for assessing "safety", all safety related parts — including genuine parts — would need to be tested. Ideally tests would be undertaken prior to the release of new parts and also periodically to ensure ongoing compliance.

The costs associated with determining which parts are safety related, the determination of relevant standards and testing procedures, undertaking tests and assessing ongoing compliance would add to production costs. These costs would, in turn, be passed on to consumers in the form of higher parts prices. FORS considered that such costs would be significant. It claimed that many of the complaints about safety are motivated by commercial pressures and that the existing measures are sufficient to address safety concerns about replacement parts. FORS (sub. 40, p. 6) commented that:

> ... the introduction of a component approval scheme would not in itself resolve the issue. As has been already noted the issues are not generally safety related and there would also be enforcement difficulties. Any proposals that the Motor Vehicles Standards Act be extended to certify replacement parts would require a large increase

> in resources to deal with approvals, monitoring and enforcement. It has been estimated that as much as a quadrupling of resources would be required. Further, considerable resources would be required to establish the scheme and write the necessary standards.

Parts certification

A variant on the proposal to extend the ADR compliance to safety related parts is to require all suppliers to certify that safety standards have been met. Ford (sub. 20, p. 3) suggested that replacement parts:

> ... should be required to meet the same performance standards as the original parts supplied by the vehicle manufacturer. It is contended that suppliers should be responsible for certifying that the parts they supply do meet such standards and appropriate penalties should be imposed for breaching such requirements.

FAPM suggested the introduction of a parts labelling and certification system similar to the "E-Mark" system that operates in the European Community (EC). The E-Mark system consists of both input and output monitoring to ensure a prescribed standard of manufacture from a specific location. The Commission understands this process consists of:

- an inspection by the governing body of the parts producer's facilities to assess quality control procedures;
- the parts producer submitting the drawings and samples of the parts to a registered test laboratory;
- a certificate being issued indicating compliance to the E-Mark standard following the successful completion of tests;
- a certificate being passed on to the governing body, which subsequently issues a unique number to be marked on the part clearly identifying the manufacturer of the part; and
- regular auditing of both the part and the production facility's compliance to the prescribed standard.

All EC manufacturers and foreign suppliers of replacement parts are subject to this process prior to the part or component being placed on the EC market.

Irrespective of whether parts certification is required of suppliers through a coordinated approach such as E-Mark or through an alternative independent scheme, it would involve many of the same costs as a system which extended ADR compliance to replacement parts. O'Brien Glass advised the Commission that the initial cost of E-Mark certification for its glass products would be about $150 000, and the maintenance of certification approximately $50 000 per annum. It is not clear whether this is representative of the costs of certification for other components.

Vehicle inspection procedures

Vehicle owners are responsible for ensuring that their vehicles meet roadworthiness standards. This includes maintaining the vehicle so that it continues to comply with the ADRs applying at the time of the vehicle's manufacture. In this respect, the ICA (sub. 23, p. 30), while supporting the general principle of ADR compliance, commented:

> The notion of compliance with ADRs for the life of the vehicle is an unrealistic ideal, not a practical reality.
>
> Obviously, with use and the passage of time, vehicles are exposed to wear and tear, deterioration and accidents, so vehicles require maintenance, service and repair. Not all vehicles are serviced at regular intervals, particularly in tough economic times and often the cheapest option is used when breakdown occurs. Furthermore, some vehicles are modified, for example, suspensions lowered, wide wheels, bull bars and the like. All these factors may effect ADR compliance to some extent during the life of the vehicle.

A number of participants considered that regular annual inspections are required to enforce compliance. For instance, Toyota (sub. 31, p. 10) commented:

> ... there is a very strong case for regular inspection of vehicles to ensure that environmental and safety standards in the national fleet are maintained as originally intended.

Monitoring compliance is fairly straight forward for some components or systems, for example, brake systems, tyres, headlights and seatbelts . However, the ability of vehicle inspection procedures to identify non-compliance with ADRs of many other unsafe parts is extremely limited. In the case of some parts, compliance can only be determined by crash testing the whole vehicle. Even where a specific ADR exists (eg the requirement that all doors be fitted with side intrusion bars), inspection procedures may not easily identify breaches. The role of inspection procedures in ensuring vehicle safety is considered in Chapter 4.

The Commission's view

The introduction of a system to assess, monitor and enforce ADR compliance (or equivalent standards) for all safety related replacement parts can only be justified if the benefits are assessed to exceed the costs. The small number of vehicle accidents attributable to defective parts suggests that the potential benefits from reducing personal injury and property loss resulting from minimising the use of "unsafe" parts would be small. On the other hand, the costs associated with a comprehensive safety testing regime (eg extending ADR compliance to replacement parts or introducing a mandatory certification system akin to E-mark) appear to be considerable.

The evidence available suggests that there are unlikely to be significant net benefits from the mandated testing and/or certification of all safety related replacement parts.

While an all encompassing parts safety compliance system is not warranted, vehicle inspection procedures can help to identify some unsafe parts (eg headlights). Where unsafe parts are detected, vehicle owners should be required to have them removed from the vehicle (ultimately at the expense of the supplier of the part). Governments could enhance detection by ensuring more systematic reporting to FORS by vehicle inspection agencies. FORS receives some feedback from inspection agencies on unsafe parts, but the information appears to be provided in a rather *ad hoc* fashion. The scope for establishing/refining systems that facilitate reporting of unsafe parts directly by vehicle owners should also be examined.

Under existing consumer legislation, vehicle owners are entitled to return unsafe components to the supplier for a refund (ie goods not of merchantable quality or fit for the purpose for which they were sold). However, consumer protection legislation (including the recall and banning provisions of the Trade Practices Act) and product liability laws (where personal injury or property loss have resulted) may not provide sufficient incentive for some replacement parts suppliers to ensure their parts are safe. Increasing the penalties associated with supplying these parts would create a stronger incentive for suppliers to ensure the safety of their products.

Manufacturers/importers and suppliers that knowingly supply parts that pose a significant safety risk (eg headlights that cannot be aligned) should be subject to substantial financial penalties.

One option would be for the Trade Practices Commission to be given the authority to prosecute when advised by FORS of parts that are likely to cause injury.

6 TOW TRUCK SECTOR

Tow trucks play a pivotal role in the repair industry — providing breakdown, accident and trade towing services. Although all of these functions are important, most attention by governments, and also by participants in this inquiry, has focused on accident towing of passenger motor vehicles. Accordingly, this chapter focuses primarily on smash towing.

The concerns raised by participants generally related to:

- the payment of drop-fees and spotters' fees, and the "loading" of these fees into repair costs;
- the potential for property damage and personal injury as tow truck operators "race" to an accident scene to secure a tow;
- the harassment of vehicle drivers by tow truck operators trying to obtain an authority to tow;
- intimidation of some tow truck operators by other operators with a view to securing a tow; and
- overinvestment in tow trucks.

The concerns were raised primarily in relation to tow truck operations in major urban centres where the number of accidents is greater and accidents are more frequent.

6.1 The economics of smash towing

In the accident towing market, consumers are usually in a poor position to negotiate. They are frequently in trauma, often under pressure to have their vehicle removed from the accident scene and/or inexperienced about the towing market. Few consumers have a "preferred" tower and, even if they did, that tower might not be available in the area where the accident has occurred. Moreover, with insurance covering towing fees, insured drivers have little or no incentive to negotiate at the scene of the accident.

In these circumstances, the speed with which towers can arrive at the scene of an accident will very often be crucial to their ability to secure a tow. This incentive provides some important benefits. In particular, prompt service is important, especially as traffic delays associated with accidents can impose high costs on other motorists.

Major repair jobs can cost in excess of $10 000. Where tow truck operators have secured a valuable repair job, they can frequently negotiate a "drop-fee" with a repairer.[1] Many repairers are willing to pay drop-fees, and they can sometimes amount to many times the towing fee. The rewards associated with arriving at an accident site first — be it in the form of a drop-fee or lucrative repair work — have also led towers to offer "spotters' fees" or cash rewards to those who advise them of accidents.

Where drop-fees are large, there is strong competition for towers to beat others to the scene of an accident. This provides an incentive for both unsafe driving — "smash chasing" — and harassment of motorists and other tow truck drivers at accident sites. It also creates the possibility that the level of investment in the industry is not appropriate from a community perspective (ie large surplus capacity).

The following sections consider these issues. Section 6.2 outlines the regulatory strategies which different governments have adopted to deal with the perceived problems. Section 6.3 deals with the related issues of drop-fees, spotters' fees, smash chasing and harassment at accident scenes and Section 6.4 examines the role tow truck allocation systems can play in addressing the perceived problems. The subsequent section explores whether the level of investment in the towing market is appropriate from a community perspective and the extent to which regulation can improve outcomes. Section 6.6 considers the regulation of towing fees. Other regulatory matters are examined in Section 6.7.

6.2 How governments are dealing with the problems

The problems raised by participants are not new and have been the subject of a range of recent reviews and inquiries (eg Queensland Criminal Justice Commission 1994, Queensland Transport 1993a, Vicroads 1993 and New South Wales Government 1993). Indeed, many governments were reviewing, or had recently completed reviews, on the operations of their tow truck sector during the course of this inquiry. Generally, the reviews have focused on regulatory and other options for addressing the problems.

State and territory governments have responded in different ways to the perceived problems of the towing market, although there are some similarities. For instance, drop-fees are illegal in all jurisdictions except Western Australia. This may reflect an aversion to what are frequently perceived to be "secret commissions" and a belief that preventing their payment will remove

[1] Drop-fees are also known as "drop-off fees", "off-the-hook fees", "kick-a-brick fees", a "brick", "slings" and "secret commissions".

costs which, though "hidden", are passed on to consumers and insurers in the form of higher prices for smash repairs. It may also reflect concern about the scope for the corruption of public officials, particularly police, if drop-fees were legal.

In a number of jurisdictions, namely Victoria (Melbourne), South Australia (Adelaide), Tasmania, the ACT and the Northern Territory (Darwin), allocation systems are used. Under these arrangements, towing jobs are allocated on a roster basis by a central agency. Some authorities also check that tow truck owners and/or operators are "fit and proper" persons before they are allowed to perform towing services.

The key elements of the current regulatory environment in each jurisdiction are summarised in Table 6.1. Further details are provided in Appendix D.

The extent of the behavioural problems in the accident towing sector is not well documented and there is little consensus about the severity of the problems. Furthermore, the varying perspectives of the problems do not correspond closely with differences in the regulatory regimes which exist between jurisdictions. For example, there is some evidence to suggest that there are relatively few problems with accident towing in Sydney which, by Australian standards, is not extensively regulated. A recent survey commissioned by the New South Wales Department of Transport found that over 90 per cent of respondents rated the tow truck services they had received as "quite good" or better (Ernst and Young 1993). Based on its own research, the NRMA (sub. 54, p. 42) commented that:

> Most people spoke well of the tow truck drivers, despite the drivers often "rough" exterior and appearance.

Substantially different views were expressed by some participants about accident towing in Victoria — where there is extensive regulation. For example, AAMI (sub. 30, p. 45) stated that, in Victoria:

> ... the public are exposed to the dangers of tow trucks racing to the scene of a collision in order to secure a job and the accident victims are then harassed or cajoled into proceeding with a certain towing operator ...

On the other hand, some participants consider that the Victorian system is working effectively. Indeed, concerns were expressed about moves to relax the regulations. For example, the Victoria Police (sub. 68, p. 7) stated that:

> Over recent years the Victorian Tow Truck industry has been well regulated and the 'cowboy' element all but removed. Recently there has been significant relaxation of the controls on the industry and it is believed that this has the potential to both harm the industry and allow the 'cowboy' element to return.

Given these disparate views on the operations of accident towing, it is difficult to assess whether the problems are sufficient to warrant government

intervention, and the costs that are generally attached to intervention. This is a judgment for individual governments to make having regard to the circumstances in particular regions within their jurisdiction. Because it has not been possible to examine each market in detail, a number of the Commission's suggestions are in a "conditional" form. That is, they suggest that it may be possible to meet current regulatory objectives more directly and at lower cost than is currently the case, but they do not necessarily endorse the decision to regulate.

Table 6.1: Key features of accident towing regulation, by jurisdiction, 1994

Feature	*NSW*	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*[a]	*NT*
Licensing:								
- Owners	yes	no	yes	no	no	yes	no	no
- Operators	yes	no	yes	no	yes	no	no	no
- Assistants	no	no	yes	no	no	no	no	no
Fit and proper person tests (or equivalent) for:								
- Owners	yes	no	yes	no	yes	yes	no	no
- Operators	yes	no	yes	no	yes	no	no	no
- Assistants	no	no	yes	no	no	no	no	no
Drop-fees permitted	no	no	no	yes	no	no	no	no
Spotters' fees permitted	yes	no	no	yes	no	no	no	no
System for allocating trucks to accidents	no	yes	no	no	yes	yes	yes	yes
Fee regulation:								
- Accident towing	yes	yes	no	no	yes	no	yes	no

a No specific regulation applies, but activity is subject to an agreement between the Australian Federal Police, the Motor Trades Association and the ACT Towing Association that covers the operation of a roster system, fee determination and certain other matters.

Source: Based on information provided by state and territory authorities.

6.3 Smash chasing, harassment, "spotters' fees" and "drop-fees"

This section explores the incentives underlying smash chasing, harassment, drop-fees and spotters' fees. It also assesses the effectiveness of existing regulatory responses.

Smash chasing and harassment

As most vehicles are repaired in the smash repair shop to which they are first towed, the accident scene represents the principal avenue for smash repair shops to secure non-driveable repair work. AAMI (sub. 30, p. 52) argued that:

> In the accident/repair cycle the towing industry is the [only] point at which there is any level of competition.

Arriving at the accident scene before other tow truck operators increases the prospects of securing a tow. This can give rise to "smash chasing" by some tow truck operators which can result in accidents, leading to personal injury and property damage.

Competition at the accident scene was described as "fierce" and "overvigorous" in some jurisdictions. On occasions this was said to give rise to the harassment of victims to sign a towing authority, and also intimidation and violence as tow truck operators "compete" over a tow. This competitive environment was also said to attract an "undesirable element". As Stone and Stone (1993, p. 4) describe it:

> The nature of tow truck driving as an occupation does not always attract the most upstanding and community conscious people. Since well prior to the present regulations the job has been seen as requiring a fairly rough and tough character. It is a job requiring long and inconvenient hours and it is not well paid unless you are a "good driver". That is, a driver who can get good repair jobs into the workshop.

Existing means of addressing smash chasing and harassment

In addition to general traffic laws and criminal laws, most governments have introduced towing regulations which generally prohibit certain types of behaviour by operators, namely:

- trying to obtain an authority to tow by coercive means or actions;
- treating other tow truck drivers with disrespect or in an intimidating fashion;
- misrepresenting themselves or their firm; and
- trying to obtain an authority to repair a damaged vehicle.

In New South Wales, Queensland, South Australia and Tasmania there are provisions that seek to ensure that owners and/or operators are "fit and proper persons".[2] This normally involves relevant authorities checking criminal records as well as character references and other forms of evidence regarding the character of prospective owners/drivers. The checks are intended to ensure that owners and operators do not have a history which suggests they are likely to take unfair advantage of accident victims or act violently towards other tow truck drivers. However, in the view of the Queensland Department of Transport (1993a, p. 27):

> The involvement of Government in the assessment of industry personnel and in attempting to control ... behaviour has generally not been successful.

Another measure which has been used by Victorian and South Australian governments to address smash chasing and harassment problems is to restrict the number of trucks allowed to perform accident towing services (see Section 6.5).

The Commission's view

Tow truck drivers are subject to general laws which are intended to prevent dangerous driving and violent or intimidating behaviour.

There are already relatively strong general incentives for operators to drive safely. In all states and territories, tow truck drivers detected committing offences when travelling to accident scenes are subject to the same provisions and penalties as other motorists. Throughout Australia, a demerit point system now applies. This provides for the suspension of driving licences if drivers exceed a designated number of demerit points within a given period. In addition to the financial penalties which apply, the prospect that tow truck operators could lose their driver's licence — and thus their livelihood — should provide a significant disincentive to smash chasing.

Nevertheless, the probability and costs of being caught and fined for unsafe driving relative to the benefits of securing a tow could be too low to have the desired effect on driving behaviour. If this is the case, there may be grounds for reviewing policing resources and the level of fines. However, if the level of fines were judged to be not commercially significant, it would be difficult to justify singling out tow truck operators for larger fines than drivers of other types of vehicles.

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[2] Fit and proper person requirements were repealed in Victoria in 1993, but are to be reintroduced in 1995. Authorities are also negotiating with the tow truck sector to establish a code of practice which will include competency training for operators.

There is no demerit system applying to harassment and intimidating behaviour and it may be appropriate to introduce one to prevent repeated and sustained misconduct. However, should a driver lose his licence, the owner of the tow truck can employ another driver. In these circumstances, the most effective means of reducing the problems could be to make tow truck owners accountable for the behaviour of their drivers. This could involve penalising owners for irresponsible action by the drivers they employ.

In those jurisdictions where smash chasing, harassment and intimidation are regarded as serious problems, it may be appropriate to make tow truck *owners* accountable for *driver* behaviour under a demerit point system. Owners would lose demerit points and/or be fined if their drivers are convicted of driving or towing related offences while in charge of a tow truck. Penalties should be commercially significant and, under the demerit point system, owners should lose their right to operate where unacceptable behaviour is frequently repeated and/or serious. Tow truck drivers (including owners) would continue to be subject to any sanctions that apply to motorists generally, including the demerit point system.

The demerit point system should encompass an appeals mechanism and appropriate administrative procedures to address those situations where a driver has "deliberately" or "vindictively" acted against the owner. If the fine/demerit point approach proves to be successful, "fit and proper" person tests for industry personnel could be abolished.

Spotters' fees and drop-fees

The Commission was told that it is common for tow truck operators to use "spotters" to inform them about accidents. As Car Craft (sub. 5, p. 24) said:

> Tow truck drivers operate a network of spotters. Almost anyone can qualify as a spotter, taxi drivers, couriers, service stations, even police. It is the spotters' responsibility to alert the driver of an accident before it is announced over the various police, ambulance and fire brigade radio frequencies.

Spotters' fees are paid in most cities and major urban centres, even though they are illegal in most states. AAMI (sub. 30, p. 57) stated that:

> Spotters fees are endemic, even in allocation states. They are paid to all manner of people, including bureaucrats and police. The amount of spotters fees varies from around $20 to around $60. Large tow operators pay full time canvassers to employ spotters who are paid their fees in cash.

Drop-fees are paid by repair shops to tow truck operators in return for the delivery of a vehicle. These payments are over and above the authorised or regulated towing fee. Generally they take the form of a cash payment at a flat

rate or a percentage of the estimated value of the repairs, whichever is the greater. Their payment is related to truck ownership arrangements (see Box 6.1).

It is generally accepted that drop-fees are paid in all jurisdictions, even though their payment and receipt is illegal except in Western Australia. The NRMA (sub. 54, p. 42) said it had "... little doubt that drop-fees are paid by smash repairers ..." in New South Wales. In a review of the regulation of the tow truck sector in Queensland, the Department of Transport (1993a, p. 24) stated that it is "... widely acknowledged in the industry that drop-fees ... are common practice".

Box 6.1: Truck ownership and drop fees

The payment of drop-fees is directly related to the ownership and operation of tow trucks. Three forms of ownership are common:

- *owner-operators* — owned and operated by a smash repair shop;
- *quasi-independent operators* — smash repair shop owned, financed or leased, but operated by "independent" drivers; and
- *independent operators* — trucks that are owned and operated independently of any repair shop.

Drop-fees are not usually associated with owner-operators. As the truck is an integral part of the business, drop-fees that may otherwise be paid to an operator are "internalised" in the overall returns of the repair business. In this respect, Queensland Transport (1993a, p. 18) stated:

> In South Australia more than 90 per cent of tow truck operators are also vehicle repairers. This reduces the incidence of tow truck drivers 'selling' damaged vehicles off the back of the truck with the repair often going to the repair business owned by the tow truck owner or operator.

Drop-fees are commonly associated with independent and quasi-independent operators who will often sell a damaged vehicle "off the hook" to the highest bidder. Typically, they have arrangements with one or more repair shops with whom they negotiate drop-fees. In the case of quasi-independent operators, vehicles requiring major repair work are likely to be directed to the repair shop owning or providing the financial backing for the tow truck.

In Queensland, drop-fees are said to range from $100 per $5000 to 10 per cent of the value of repair work. AAMI (sub. 30, p. 57) stated that, while drop-fees vary, "... the norm seems to be about 10 per cent of the value of the repair of the vehicle." The Professional Towers' Club of Western Australia Inc.

(sub. 19, p. 3) commented that drop-fees typically range from $50 to $500 and are "regularly paid".

The preparedness to "buy-in" work is not unique to the repair sector. Parallels can be drawn with other activities. For instance, restaurant owners pay fees to tour operators who bring tourists to their shop. Just as the restaurant owner makes a commercial decision not to operate a tour business, some smash repairers find it commercially sensible not to invest directly in a truck.

From this perspective, drop-fees can be viewed as a marketing expense or strategy that is an alternative and/or supplement to truck ownership. Thus, the NRMA (sub. 54, p. 42) commented that drop-fees:

> ... are a means of attracting business which may substitute for other expenditures, for example some repairers may choose to operate a fleet of tow trucks with all the associated overheads, while others may choose to locate their business in a prominent, high rent location, while others may choose to spend more on advertising.

On the other hand, there is some evidence to suggest that drop-fees are also a reflection of the potential to "overprice" some vehicle repairs (see Chapter 4). Several participants considered that there is excess smash repair capacity, both because of the potential to overprice and because of recent reductions in the number of accidents. Where excess capacity exists, there would be a greater incentive for smash repairers to pay drop-fees to buy-in business. As capacity in the repair sector becomes tighter, drop-fees would be expected to fall. This appears to occur in the market place. As Car Craft and Panel commented (sub. 5, p. 24):

> The "brick" is supply and demand in its purest form. As crash work becomes scarce, the tow truck driver clearly has the initiative and the "brick" tends to increase.

The Commission's view

Experience has shown that, despite being illegal, preventing the payment of both spotters' and drop-fees is extremely difficult because these transactions are mutually beneficial to both payer and recipient. Thus, neither party has an interest in providing information which would facilitate detection and/or prosecution. Indeed, the Commission is aware of only one case in the last five years where prosecution was successful.[3] Moreover, a recent review by the New South Wales Government (1993, p. 15) identified a range of commercial arrangements which can be legally used to circumvent provisions aimed at making the payment and receipt of drop-fees illegal.

[3] This case was heard in New South Wales in 1993. An operator was fined $1000 for demanding a drop-fee.

Even if it were possible to cost-effectively eliminate these payments, it is doubtful whether there would be a significant reduction in smash chasing and harassment. As long as securing a tow remains the main avenue for obtaining non-driveable smash repair work, the incentives to smash chase and harass will persist.

Drop-fees appear to perform an important economic role in directing investment and smash repair work in the repair sector. The Commission agrees with the NRMA (sub. 54, p. 42) that:

> Viewing these fees as illegal may not be appropriate. ... They ... could be considered part of normal business overheads in operating a body repair business. Possibly a cost-effective, competitive way of attracting business.

Concerns that drop-fees are passed on in repair costs can be addressed by insurers. For instance, all insurance companies employ assessors who aim to ensure that repair quotations are not inflated. Moreover, AAMI claims that its two-quote system for non-driveable vehicles removes the ability of repairers to pass on drop-fees and other costs (eg spotters' fees and inducements offered by repairers, such as loan cars and payment of excesses). The incentive to pay drop-fees is removed because repair work is allocated on a competitive basis rather than to the shop to which a vehicle is first towed.

The New South Wales Government review (1993) recommended that consideration be given to the decriminalisation of drop-fees paid to authorised operators. If the payment and receipt of drop-fees were decriminalised, smash repair shops would be more likely to keep formal records of their payment in order to claim them as a taxation deduction. Taxation authorities would then be better placed to correctly assess the income of tow truck operators.

There are substantial difficulties associated with enforcing the existing criminal sanctions concerning the payment and receipt of spotters' fees and drop-fees. Even if enforcement were cost-effective, it is unlikely to have a marked impact on smash chasing and harassment problems.

6.4 Allocation systems

Several jurisdictions engage in more extensive regulation of the towing market in the form of allocation schemes. Legislatively based allocation systems operate in Melbourne, Adelaide, Tasmania and Darwin, and an informal allocation system, overseen by the police, operates in the ACT.[4] In Melbourne

[4] Provision for the introduction of allocation systems exists under the New South Wales legislation, but an allocation system has not been introduced in any area.

and Adelaide, there are separate rosters for geographic zones within the respective metropolitan areas. In Tasmania, four zones are used. In Darwin and the ACT only one zone is used. In three jurisdictions — Melbourne, Adelaide and Tasmania — entry to the allocation roster is restricted. In practice, this has the effect of limiting the number of trucks that can provide accident towing services.

A number of participants were supportive of the existing allocation systems, and some called for their introduction in other capital cities and major centres. The main benefit is seen to be a reduction in the incentives to smash chase and to harass or intimidate vehicle owners and other tow truck drivers. Allocation schemes are also said to reduce operating costs by reducing the time spent "looking" for accidents or attending accidents without securing a tow.

Contrary views are held by some participants who question the effectiveness of allocation schemes in reducing smash chasing and harassment, and their implications for competition. The New South Wales Government (1993, p. 10) stated that allocation schemes:

> ... will be ineffective in eliminating drop-fees, will not necessarily ensure orderly arrangements for towing, will remove incentives to provide high levels of assistance at accidents, and will result in reduced consumer choice both in relation to towing and repairs. It can however be expected to reduce costs of towing operations ...

The central allocation of towing jobs and regulations which have the effect of limiting the number of trucks permitted to operate, perform quite separate functions. This section considers the merits of allocation schemes, whilst the next section considers the restriction of entry into the towing market.

Issues which need to be considered when evaluating allocation schemes include: administration costs; enforcement; effectiveness; freedom of choice; and price and service competition. Each of these matters is examined below.

Administration costs

In Melbourne, tows are allocated to licensed trucks using a computer based allocation scheme. Although Vicroads is responsible for the allocation system, the rights to operate the system are determined by tender. Currently, the RACV has the tender. It costs about $340 000 annually to operate the system.

In Adelaide, the allocation scheme is operated by the Police Department. It costs between $150 000 and $200 000 annually to operate. In both Melbourne and Adelaide, the operating expenses are partly funded through industry charges and fees. However, in both jurisdictions, there is a shortfall which is funded from consolidated revenue — approximately $130 000 in Melbourne and

$75 000 to $100 000 in Adelaide. The South Australian Government is presently reviewing the roster system with a view to removing the call on community funds.

The potential costs associated with smash chasing (eg property damage and personal injury) are created by the behaviour of operators and should be considered as part of the costs of towing. Accordingly, all costs of administering allocation systems aimed at overcoming these problems should be borne, in the first instance, by tow truck owners and operators.

The operation of tow truck allocation schemes should not be funded by government.

Enforcement

Tow "pirating" — towing vehicles allocated to other trucks — has been a problem encountered under allocation systems, particularly in Melbourne. Pirating is said to be possible because the allocation system is not policed effectively and because the penalties for pirating are not commercially significant. AAMI (sub. 30, p. 45) stated:

> Accident towing allocation systems in those states employing them are simply not working at present due to the lack of interest/enforcement by the responsible authorities. Thus, "pirating" is rife ...

Pirating also occurs if allocation centres are not informed about accidents. In this case, the operator at the head of the roster has to wait for the next accident reported to the centre.

The legislation underpinning the allocation systems in both Melbourne and Adelaide makes it an offence to tow a damaged vehicle from an accident scene without being given a job number from the allocation centre. The ICA suggested that tow truck operators be required to use uniform towing dockets which identify the operator and contain the job allocation number. This information would provide the basis for an audit trail which could be used to identify "pirated" tows. The ICA and AAMI also suggested that insurance companies should have the right to demand a copy of the towing authority and to have access to the allocation centre's records to assist in identifying pirated tows. This would reduce the monitoring burden on authorities.

The Commission understands that some insurers intend to withhold payment of towing fees from operators who are unable to provide an allocation number. This practice would reduce the profitability of tow pirating, but may not eliminate it where there is scope to obtain substantial drop-fees or a lucrative repair job.

Another approach may be to make it an offence for smash repair shops to accept a towed vehicle from any accident site without a standard towing authority (including job allocation number). There would need to be random auditing and commercially significant sanctions for operators and repair shops detected committing offences. In these circumstances, tow truck operators would have an incentive to advise the allocation centre of accidents which may not otherwise have been reported to the centre in order to advance their position on the roster.

There is concern that spotters' fees undermine the operation of allocation schemes. However, the payment of spotters' fees is underpinned by the profitability of pirating tows. If the pirating of tows were appropriately sanctioned, there would be limited benefit to operators in paying spotters' fees.

Effectiveness

Allocation schemes are perceived to reduce smash chasing and harassment and intimidation at accident scenes because operators are "allocated" to a tow. Nonetheless, in multiple-vehicle accidents there remains an incentive to be first at the accident. As Queensland Transport (1993a, p. 17) commented with respect to the allocation scheme in Melbourne:

> Tow trucks still race to the scene of multiple vehicle accidents to enhance their chance of securing the 'most valuable' vehicle for either repair or to obtain drop-fees ...

Once at a multiple-vehicle accident scene, operators may harass vehicle owners or other drivers with a view to securing the "best" tow. There also remains an incentive under allocation schemes for tow truck operators to harass vehicle owners in order to obtain a repair authorisation for the vehicle which offers the "best" return for repairers. As Stone and Stone (1993, p. 4) commented:

> There is accordingly a high degree of competition to get the best repair jobs from accidents and there is an urgency in obtaining a repair authorisation. This sometimes results in harassment of drivers at the scene of an accident.

In order to overcome these problems, information regarding the number of vehicles requiring towing and their identification (eg registration numbers) would have to be provided to the allocation centre. The allocation centre could then allocate trucks to specific vehicles requiring towing. However, the information needed to allocate trucks on this basis would make this approach difficult to implement.

Some have justified allocation systems as a means of reducing or eliminating drop-fees. The allocation system in Adelaide is said to have substantially reduced the incidence of drop-fee payments. However, this could reflect the fact that the majority of tow trucks in Adelaide are owned and operated by

smash repair shops. Hence, drop-fees are internalised. Additionally, Queensland Transport (1993a, p. 18) commented:

> Tow truck drivers are further discouraged from 'selling' off the back of the tow truck by peer pressure generated by the size and nature of the industry in Adelaide.

Drop-fees are paid in Melbourne where an allocation system also operates. More fundamentally, it needs to be recognised that allocation schemes do not remove the incentive for drivers to seek, or repair shops to pay, drop-fees.

Freedom of choice, price and service competition

A criticism of allocation schemes is that they remove or reduce freedom of choice and the scope for price and service competition. Where multiple vehicle accidents are involved and a number of trucks are allocated, choice is constrained. But operators still have an incentive to offer inducements in order to secure the most valuable tow.

Given their infrequent involvement in accidents and the "trauma" associated with an accident, it is likely that many motorists would not have a preference for any particular tow truck operator and would not wish to negotiate with operators. However, this may not be true for all motorists.

The extent to which an allocation scheme will reduce the opportunity for a motorist to "choose" a truck at the accident scene is not clear. There is some information to suggest that in New South Wales, where no allocation system applies, there is frequently little choice anyway. A survey conducted for the New South Wales Government (Ernst and Young 1993, p. 8) found that, in around half the number of accidents, the number of tow trucks equalled the number of vehicles requiring towing.

Most vehicles involved in accidents are covered by comprehensive insurance. This covers the payment of accident towing fees. Consequently, the extent of choice available is not particularly relevant because the majority of owners have limited incentive to negotiate a fee. In the case of third party property damage insurance, the fees associated with towing the third party are also normally covered. The major insurers in New South Wales (NRMA and GIO) advised the Trade Practices Commission (TPC 1990, p. 11) that:

> ... the owner rarely discusses the towing and salvage fees prior to the tow truck operator taking the vehicle away.

Allocation schemes could also restrict freedom of choice in other ways. For example, they could prevent operators combining to provide a network service for a particular region (as occurs with taxis). Insurers are also unable to pursue/support the development of such networks for their clients.

The Commission's view

If properly enforced, allocation systems could reduce the number of tow trucks arriving at the accident scene and have some favourable impact on speeding and harassment. Notwithstanding this, the experience is that smash chasing and harassment of drivers and operators are still problems under allocation systems. Whilst this may, in part, reflect inadequate enforcement, it also reflects the fact that operators continue to have an incentive to get to the accident scene quickly to secure the most valuable tow. Drop-fees are still likely to be paid under allocation systems.

Account also needs to be taken of drawbacks associated with allocation schemes. First, they can result in slower response times as the criterion for job allocation is typically the rostered position rather than the speed with which a tow truck operator can get to an accident site. Second, they reduce competition. Where there is one vehicle involved in an accident, there will be no choice of operator as an allocation will in effect carry an "entitlement" to tow a specific vehicle. Where there are two vehicles, some choice may be available, albeit severely restricted. Third, allocation systems may also constrain other forms of competition (eg tow truck operators cannot band together to offer their own towing service network for particular regions).

In those areas where no allocation system applies, behavioural problems should be addressed by introducing the demerit point system discussed above. Where an allocation system already applies, the demerit system could also be introduced. If it is successful in reducing speeding and harassment, consideration could then be given to abolishing the allocation system.

Allocation schemes offer a means of monitoring response times and auditing the quality of service provided. Although the Commission has not conducted a detailed examination of the allocation system in each jurisdiction, allocation schemes do not appear to have been run with these objectives in mind. Indeed, the interests of towing operators appear to have dominated system design. For instance, the Victorian allocation system has operated for many years but has only recently introduced standards for ensuring that response times do not rise above a set maximum. An apparently generous maximum response time of 30 minutes has recently been stipulated. Under the Victorian arrangements, jobs are sometimes swapped between zones — with trucks travelling some distance to jobs — in order to more "fairly" distribute towing work. This can involve increases in response times. In this context, "fairness" to individual towers is likely to involve "unfairness" to consumers and to other motorists impeded by damaged vehicles at an accident site.

Where allocation systems are used, they should be run with a view to advancing the public's interest in receiving cost-effective towing services. To this end, performance — in terms of response times to accidents and quality of service provided — should be monitored and performance indicators published.

6.5 Overinvestment in tow trucks

Some participants considered that there is overinvestment in tow trucks. For instance, with respect to the situation in Western Australia,[5] Car Craft (sub. 5, p. 23) commented:

> There is no doubt that there is serious oversupply of trucks servicing an accident market that has shown marginal growth over the past 3 years ...

Reviews by Queensland Transport (1993a) and the Trade Practices Commission (1990) noted an apparent oversupply of trucks in Queensland and Sydney respectively. A more recent review of the New South Wales tow truck sector (New South Wales Government, 1993, p. 8) found that concerns about the oversupply of trucks were misplaced and "... reflect what occurs at a relatively small number of well known accident hot spots". This may help to explain concerns about overinvestment in tow trucks in other jurisdictions.

The Commission understands that in some areas the average number of tows per truck per month is around four. However, this may understate the utilisation of trucks for a number of reasons. First, not all accident tows are reported. Second, authorities in all jurisdictions advised that accident towing operators also perform other towing services (ie trade, breakdown and/or clearway). In New South Wales, around a third of operators provide smash and breakdown towing services. In some other jurisdictions, authorities suggested that the proportion of accident towing operators also providing other services is higher (50 per cent or more).

Reducing investment in tow trucks

If an appropriate level of service could be provided by fewer trucks, regulation that reduced investment levels could, from the community's perspective, lead to an improvement in the efficiency of resource allocation (ie resources would be freed up for use elsewhere in the economy).

[5] Between 1987 and 1994, the number of tow trucks in Western Australia increased by over 300 per cent, from 100 to more than 400. The number of registered passenger motor vehicles increased by approximately 30 per cent over the same period.

The level of investment in trucks reflects the returns (real and perceived) associated with performing towing services. As towing operators often perform more than one type of towing service, the returns can take numerous forms — trade, accident or breakdown towing fees, drop-fees (if accepted) and charges for smash and breakdown repairs (where the repairer owns the truck).

In principle, if governments consider that there are problems because of overinvestment, a direct solution would be to reduce the income available from performing towing services. One option would be to reduce towing fees. However, reducing towing fees may be insufficient to reduce the number of trucks to the desired level because other payments are likely to represent a far more important source of returns (eg drop fees).[6] In these circumstances, governments could use a number of approaches to offset or extract some of the other benefits that are associated with securing a tow. One straightforward approach would be to charge owners for the right to operate. Other approaches involve auctioning or selling the rights to perform towing services (see Section 6.6, Box 6.2). Under these approaches, operators would compete for the right to provide towing services on the basis of price. To the extent that operators undercut each other, returns would fall, and some owners would leave the sector. For remaining operators, there would be an increase in the work load. Provided response times were appropriately set and monitored, the level of investment would approach that level which was best from the community's perspective.

Another approach is to limit the number of trucks that are allowed to perform accident towing services. Such restrictions already apply under allocation systems operating in Adelaide and Tasmania and throughout Victoria. However, in South Australia, the Government has recently taken steps to ease entry restrictions on roster positions.

Depending upon their stringency, entry restrictions can concentrate the financial returns associated with truck ownership in the hands of relatively few operators and create the potential for operators to earn higher than normal returns. For instance, entry restrictions that apply throughout Victoria have given rise to significant plate values. In 1993, the average value for metropolitan accident towing plates was about $80 000. In the same year, the average value of non-metropolitan accident towing plates was about $30 000.

In jurisdictions where no entry restrictions apply, repairers can choose whether they wish to own a truck or buy-in work. However, where entry restrictions exist, the cost of purchasing a plate increases towing costs and may limit the

[6] Including any implicit drop-fees where tow trucks are owned by repair shops.

number of repair shops competing for non-driveable repair work. In this context, the South Australian Government (sub. 106, p. 10) commented:

> At present in Adelaide, the number of places on the tow truck allocation roster is limited, and companies currently on the roster have a commercial advantage over those that are not.

and that:

> ... entry to an allocation system should not be exclusive to certain participants within the industry.

The Commission's view

If it could be established that an acceptable level of towing services could be delivered to the community with fewer resources (ie the number of tow trucks could be reduced without compromising appropriate response and clearance times), there could be a case for government involvement. However, the majority of governments have chosen not to introduce regulations to restrict entry to the tow truck sector. Only three governments have restrictions on entry and one, South Australia, is moving to relax entry restrictions to the roster in Adelaide. Moreover, there is nothing to suggest that the primary objective has been to address overinvestment concerns in those jurisdictions which have restricted entry to the towing market .

Using entry restrictions to reduce investment levels introduces a number of significant risks. It is extremely difficult to calculate what the "ideal" level of investment in the industry should be. The demand for towing services is highly variable. It is high when driving conditions are hazardous and, as a result, there is a disproportionately high number of accidents. As a consequence, there is a danger that governments will determine levels of investment which may be appropriate for some places at some times, but inappropriate for others. Restricting entry also carries with it the risk of reducing average response times and so jeopardising the interests of both accident victims and the driving public in achieving prompt clearance of accident sites.

By reducing the scope for competition in both the tow truck and repair sectors, entry restrictions also reduce the incentives to innovate and respond to customers' needs. For example, entry restrictions coupled with an allocation system, would limit the incentive to provide higher quality service. Additionally, interventions of this type carry the risk that, over time, they will evolve to serve the interests of the incumbents rather than the community.

A significant advantage of an unregulated tow truck market (ie no entry restrictions) is that operators have the flexibility to meet the varied requirements of the market for different types of towing services (eg accident, breakdown and

trade towing). For instance, during peak hours or bad weather when accident rates are relatively high, operators who normally concentrate on trade towing can focus on accident towing. This service is provided at a low marginal cost (because the capital is already in place to perform trade towing) and the community benefits from quicker response and clearance times. Entry restrictions are likely to stop this type of opportunistic, low marginal cost service.

There is also some prospect that market developments will make restrictions unnecessary. For instance, to the extent that insurers pursue initiatives that successfully reduce repair costs (eg introduce competitive quotation systems and form closer relations with repairers), returns to towing will reduce over time, and the level of investment in the sector will fall.

There are considerable risks associated with entry restrictions in the tow truck sector. The Victorian and Tasmanian Governments should consider following the lead of the South Australian Government by relaxing the restrictions on entry that apply to the rosters in their States.

As existing operators have considerable capital tied-up in plates, relaxation of restrictions should be gradual. One approach would involve the government selling a limited number of new licences by public tender, say, every twelve months. The sale program would need to be announced in advance. The net proceeds of the sale could be distributed to existing licence holders in proportion to their licence holdings. The program would continue for a number of years until no bids were received. At that time, the government would issue any new licences on demand, subject to the payment of prescribed (user pays) fees and the operator meeting any other requirements (eg equipment standards). A variant of this approach would involve selling fewer new licences, with the proceeds of the sale being kept by the government. Although operators who had paid for plates would not receive direct financial compensation, the reduction in plate values would be slower as less licences would be released.

6.6 Fee regulation

In a number of jurisdictions, accident towing fees are regulated (see Appendix D). The fees typically include a flat rate for a specified number of kilometres and additional loadings for factors such as extra distance travelled or tows outside normal work hours. The regulation of fees appears to be based on a concern that operators may exploit the situation at the accident scene (eg the emotional state of drivers, pressure to clear the accident scene quickly and limited choice of operators at the site of the accident).

Accident towing fees are not regulated in Queensland. They are determined by negotiation between the tow truck sector and the insurance industry. The fees in Queensland are significantly higher than those in jurisdictions where fee regulation exists (eg $160 compared to $95 in New South Wales). In practice, some insurance companies in Queensland have negotiated a lower fee (eg RACQ has negotiated a fee of $140 with some operators) and it is common for operators to offer much lower fees to vehicle owners who are not insured and must pay for the tow themselves.

In New South Wales, fees have been regulated since 1991. Prior to this, where an insurance claim was involved (which is the majority of cases) and the vehicle owner had not paid the towing fee, the insurer would pay what was deemed to be a "reasonable fee". In assessing a reasonable fee, insurers took into account factors such as the time of day when the tow occurred, the distance of the tow, the type of vehicle involved and the nature of the damage to the vehicle. Where the vehicle owner had paid the fees, insurers would reimburse the vehicle owner and seek to recover any excess charge from the operator.

Fees for the storage and release of vehicles and for repair quotes are also regulated in some jurisdictions. This regulation appears to be based on concerns that:

- uninsured consumers may not be aware that they may be liable for these charges; and
- repairers/operators may charge unreasonable fees to dissuade owners/insurers from removing their vehicles.

The Commission's view

Accident towing services, and to a lesser extent associated services, are provided under circumstances which are not conducive to competitive or efficient fee outcomes. However, a high proportion (about 80 per cent) of towing and related fees are paid by insurers as part of insurance claims. This suggests that the case for regulating fees on the grounds that accident victims will be exploited and have to pay "unfair" fees is weak.

There may be other grounds for regulating towing fees. Where insurers collectively negotiate a uniform fee with the towing industry, the fee for towing may not be as low as they could be (ie they are overpriced). When insurers negotiate as a group, they face no competitive pressure *between* themselves because any advantage or disadvantage obtained in negotiation is an advantage or disadvantage for them all. While the Commission does not suggest that this

has been the case in Queensland, it is notable that the collectively negotiated fee in that state is nearly double the amount in other states.

On the other hand, it is doubtful whether collectively negotiated fees which are "too high" would be sustainable because individual insurers would have an incentive to minimise all components of insurance payouts (including towing fees) in order to maintain or enhance their competitive position in the market. Indeed, there is some evidence that insurers do seek to reduce the cost of towing services. For example, as noted above, some insurers in Queensland have negotiated fees lower then the fees determined on a collective basis. Additionally, prior to the regulation of accident towing fees in New South Wales, the Auto Recovery Association (ARA) requested that the TPC grant it permission to negotiate fees on behalf of towers, in part because of claims that insurers were forcing tow truck operators to accept uneconomical towing fees (TPC 1990).

Where fee regulation is used, it will be difficult for governments to assess the appropriate level of fees because a range of factors need to be taken into account (eg cost structures, capacity utilisation and warranted levels of return). Ideally, fees would be set to achieve that level of investment which was optimal from the community's perspective. However, as the fee that would achieve this level, and the level itself, would be extremely difficult to determine, there is a danger that fee regulation could lead to inappropriate levels of investment.

Underinvestment does not appear to be a problem currently in those jurisdictions which regulate fees. This possibly reflects the fact that there are other sources of income for tow truck owners (eg fees from breakdown and trade towing, drop-fees and/or from repairs). However, if the nexus between trucks and repair shops were severed — say because most or all insurers moved to a two-quote system — towing fees would represent a much higher proportion of total income for operators. In these circumstances, problems arising from underinvestment (eg slow response times giving rise to congestion) could arise if regulated fees were set too low.

In theory, there are a number of approaches that could be used to establish competitive fees for towing services that remove the need for governments to be directly involved in fee setting (see Box 6.2). However, these approaches are untested and there may be substantial obstacles to their implementation.

Box 6.2: Options for competitively pricing towing services

A number of approaches could be used to obtain competitively priced accident towing services.

The government could establish towing zones and specify performance standards (eg response times, service quality) for operators to meet in servicing a zone. Tenders would be invited for the right to be the sole provider of accident towing services in a zone. Selection of an operator would be based on proposed accident towing fees. The successful tenderer's proposed fees would be mandated as the maximum towing fees for the zone. The successful tenderer might choose to sub-contract to some (or all) existing towers. Alternatively, unaffiliated tow truck operators may form operating groups that would bid for accident towing rights for a zone(s).

Allocation systems provide another means for establishing "competitive prices" for accident tows. Allocations could be awarded to the operator with the lowest bid in an "auction" which would be limited in time to (say) one or two minutes and subject to performance (particularly response time) criteria. Care would have to be taken to ensure that operators did not collaborate on fee bids. Allowing free entry to the scheme would help ensure that operators did not collaborate. A maximum fee might be needed in situations where "unreasonable" bids may otherwise surface (eg where there was a very small number of bidders). Insurance companies and vehicle owners (in the case of non-insurance claims) would need to be informed of the winning bid to know what fee to pay.

Under both these approaches, the government would have to monitor performance (eg response times), and ensure that tow pirating did not undermine the system.

Another approach would involve the establishment of regional network services for particular regions by groups of operators (as occurs with taxis). These operator groups could compete for the rights to perform accident towing services on behalf of customers such as insurers and fleet operators (private and public). Some heavy vehicle operators already enter into such arrangements to cover situations where their vehicles require towing. As the client would be expected to establish and monitor performance (eg response times), the need for government involvement in the system is eliminated.

As currently structured, the towing market is not conducive to competitive fee outcomes. Governments, in consultation with industry, should examine the scope for re-structuring the arrangements for the supply of towing services with a view to obtaining competitively priced outcomes. Where governments consider fee regulation is necessary, they should regularly review settings to ensure they are not giving rise to significant market distortions (eg under or oversupply of trucks) and periodically assess the merits of approaches used in other jurisdictions.

6.7 Other issues

Independent holding yards

An option raised by a review of the tow truck sector in Queensland was the establishment of independently operated holding yards. Queensland Transport (1993a) considered that, in addition to breaking the nexus between repair shops and tow trucks in the repair cycle, independent holding yards would:

- remove the incentive for vehicle repairers to operate or own tow trucks;
- eliminate drop-fees;
- reduce, over a period of time, the number of trucks to a level consistent with a reasonable return on the capital invested in the industry; and
- assist owners and insurers in obtaining a number of quotes on repair work.

The Department noted that the success of such an approach would depend upon:

- the independence of the holding yard operator;
- the costs involved in operating the holding yard(s); and
- the costs involved in second tows (to move the vehicles from the yard to the repairer).

Following a recent investigation into the tow truck and smash repair industries, the Queensland Criminal Justice Commission (QCJC 1994) recommended that a system of holding yards (independent of repairers and towing operators) be established, subject to trialing in the Brisbane area. The QCJC (1994, p. 239) considered that holding yards were:

> ... the most efficient way of substantially eradicating the payment of drop-fees and attaining fairer towing and smash repair industries.

The holding yard approach is also a means of overcoming problems that insurers have in removing vehicles from smash repair shops. Examples were cited to the Commission of repair shops using delaying tactics, such as not accepting cheques, demanding written confirmation from a vehicle owner before a vehicle is released, placing the vehicle behind other vehicles awaiting repair and even dismantling the vehicle to avoid, or defer, its movement. The problem is exacerbated if the repairer has paid a drop-fee or offered inducements to acquire the vehicle.

While some participants saw merit in establishing independent holding yards, some concerns were expressed. For example, after setting out some of the perceived advantages of the proposal, GIO (sub. 36, p. 4) observed:

> On the other hand, the costs to the insurer of operating a holding yard, especially in metropolitan areas are substantial, as is the cost of double towing vehicles. There are some 300 crashes in metropolitan Sydney each day which gives an indication of the number and size of holding yards which would be needed were this system to be widely adopted.

AAMI (sub. 30, pp. 56–7) saw:

> ... considerable practical difficulties ... outweighing the benefits. First, it would be a major logistical effort to ensure that all smashed cars are towed to holding yards .... It would need to be closely policed ... Secondly, as a new bureaucracy would be necessary and ongoing consumer education required, costs would be high. Third, it is a prescriptive method of dealing with a problem arising from the capture of a vehicle. Fourth, it would shift the focus for illicit practices to a centralised spot ... Fifth, benefits of the scheme would only flow for insurers committed to obtaining competitive quotes. That would seem unlikely as some insurers market themselves as requiring one quote.

The Commission's view

The cost of establishing and operating holding yards could be considerable, especially in major centres where land is expensive. As government subsidisation would be inappropriate, costs would need to be recouped from users. Imposition of these charges on insurers, who are the largest users of accident towing services, would place upward pressure on premiums.

Holding yards would probably reduce returns to towers by reducing or eliminating drop-fees. This would reduce, but not eliminate, the incentives to smash chase and harass. Operators would still need to be first at the accident scene in order to earn income from towing fees.

Insurers and vehicle owners already have the capacity to obtain two or more quotes on vehicles. Indeed, some insurers — such as AAMI — remove non-driveable vehicles from repair shops to a holding yard where repairers are called in to give quotations.

Independent holding yards would reduce, but would not eliminate, incentives to smash chase and harass. Insurers are best placed to make an assessment of the commercial benefits and costs of establishing their own independent holding yards. The Commission considers that governments should not mandate independent holding yards.

Equipment standards

In all jurisdictions, generally applicable road safety restrictions impose carrying capacity limits on vehicles used for towing. In a number of jurisdictions (eg Victoria and South Australia), the types of equipment that can be used are also regulated.

These capacity limits and equipment standards appear to be in place to address safety concerns. A number of participants considered that restrictions on the types of towing equipment that can be used are outdated and cause inefficiencies in the way the sector operates.

Governments should periodically review, and remove or modify where necessary, all regulations on towing capacity limits and restrictions on equipment types.

Heavy vehicle accident towing

Some of the problems which occur in passenger motor vehicle accident towing are also said to occur in heavy vehicle accident towing (eg payment of drop-fees, smash chasing, driver and operator harassment). For instance, the RACV (sub. 10, pp. 32–33) commented:

> ... on occasions five or six heavy tow trucks are attending the scenes of heavy vehicle accidents... this is not in the public interest.

A number of participants considered that, like passenger motor vehicle accident towing, heavy vehicle accident towing should be regulated to address the perceived problems (eg through the introduction of an allocation system). An allocation system for heavy vehicle accident towing currently operates in Melbourne and Adelaide.

The discussion and principles enunciated with respect to passenger motor vehicle towing apply equally to heavy vehicle accident towing. However, two factors suggest that the severity of the problem — and the need for government involvement — may be less. First, the absolute level of any problems would be relatively small as it accounts for a very small proportion — about 5 per cent — of all accident tows. Second, it is not uncommon for firms operating heavy vehicles to have arrangements with particular tow truck operators in the event of an accident.

Non-accident towing

There is considerable variation in the regulation of non-accident towing across jurisdictions. In Victoria and South Australia, for instance, there is extensive regulation of trade towing (eg restrictions on plate numbers in Victoria and fit and proper person tests in South Australia). In other jurisdictions, specific regulation of non-accident towing is not considered necessary. As Queensland Transport (1993a, pp. 13–14) commented:

> ... at an accident scene a vehicle owner is not likely to be in a position to make an informed choice about towing services, and may well be traumatised as a result of the

accident, whereas in most other towing situations a vehicle owner has the opportunity to "shop-around" and to make a decision at their leisure about suppliers of towing services.

A number of participants considered that there is no public benefit from the regulation of non-accident towing and that it should be deregulated. No concerns were raised by participants regarding non-accident towing. Moreover, no participants called for its regulation (in jurisdictions where it is not regulated) or continued regulation (in jurisdictions where it is regulated).

The Commission has not identified any reason for the regulation of non-accident towing. Governments should review the existing regulation of non-accident towing and remove regulations that do not confer net benefits on the community.

6.8 Summary

There is insufficient information to establish the severity of perceived problems in the tow truck sector, such as smash chasing, harassment of drivers and intimidation of operators. The views of participants with respect to these matters were disparate. In these circumstances, there is a need to tailor any regulatory responses which may be contemplated to particular circumstances. In some instances, say in the case of small towns, there is unlikely to be a need for any specific regulation. This may not be the case in cities. However, before regulatory imposts can be justified, it must be established that serious problems exist and that the benefits of the proposed (or existing) regulatory responses exceed the associated costs.

Some of the mechanisms currently employed by governments are unlikely to be effective in achieving their goals. These include the criminalisation of drop-fees and spotters' fees, "suitability" tests for industry personnel and, to a lesser extent, allocation systems. Additionally, the Commission considers that holding yards should not be mandated by governments.

The Commission's preferred approach is to establish a demerit point system. Under this system, owners of tow trucks would be registered and would face significant financial penalties and/or demerit points for inappropriate behaviour by themselves or the drivers they employ. Owners who do not take responsibility for their own actions, or the actions of their drivers, could lose their right to operate a tow truck.

The demerit point system should also be applied in areas in which allocation systems presently exist. If successful in reducing the perceived behavioural problems, consideration could be given to phasing out the allocation system. If

allocation systems are to be maintained, they need to be appropriately policed and incorporate commercially significant sanctions that can apply when breaches occur. The performance of operators (eg response times and service quality) should be monitored.

The Victorian and Tasmanian Governments should consider removing the restrictions on entry to the tow truck market that exist in their states. As some operators have significant capital tied-up in the plates, consideration should be given to phasing the restrictions out over a period of time.

7 MOTOR VEHICLE THEFT

The theft of motor vehicles, their parts and accessories is a major problem in Australia. Around 125 000 vehicles were stolen in Australia in 1992–93. The direct cost is approximately $400 million, but substantial additional costs and inconvenience are incurred by vehicle owners. In addition, the community at large expends resources policing vehicle theft and enforcing criminal law against vehicle thieves. A variety of measures are in place which seek to reduce theft by increasing both the difficulty of theft and the likelihood of thieves being detected and successfully prosecuted. However, the efficiency and effectiveness of current antitheft efforts can be improved by all stakeholders — vehicle owners, manufacturers, motor dealers, insurers and governments.

The following section outlines the extent of vehicle theft in Australia. The logistics of vehicle theft and current antitheft measures are described in Section 7.2. Section 7.3 discusses additional measures to reduce theft. Section 7.4 argues that progress in improving antitheft strategies should be reviewed in 1999.

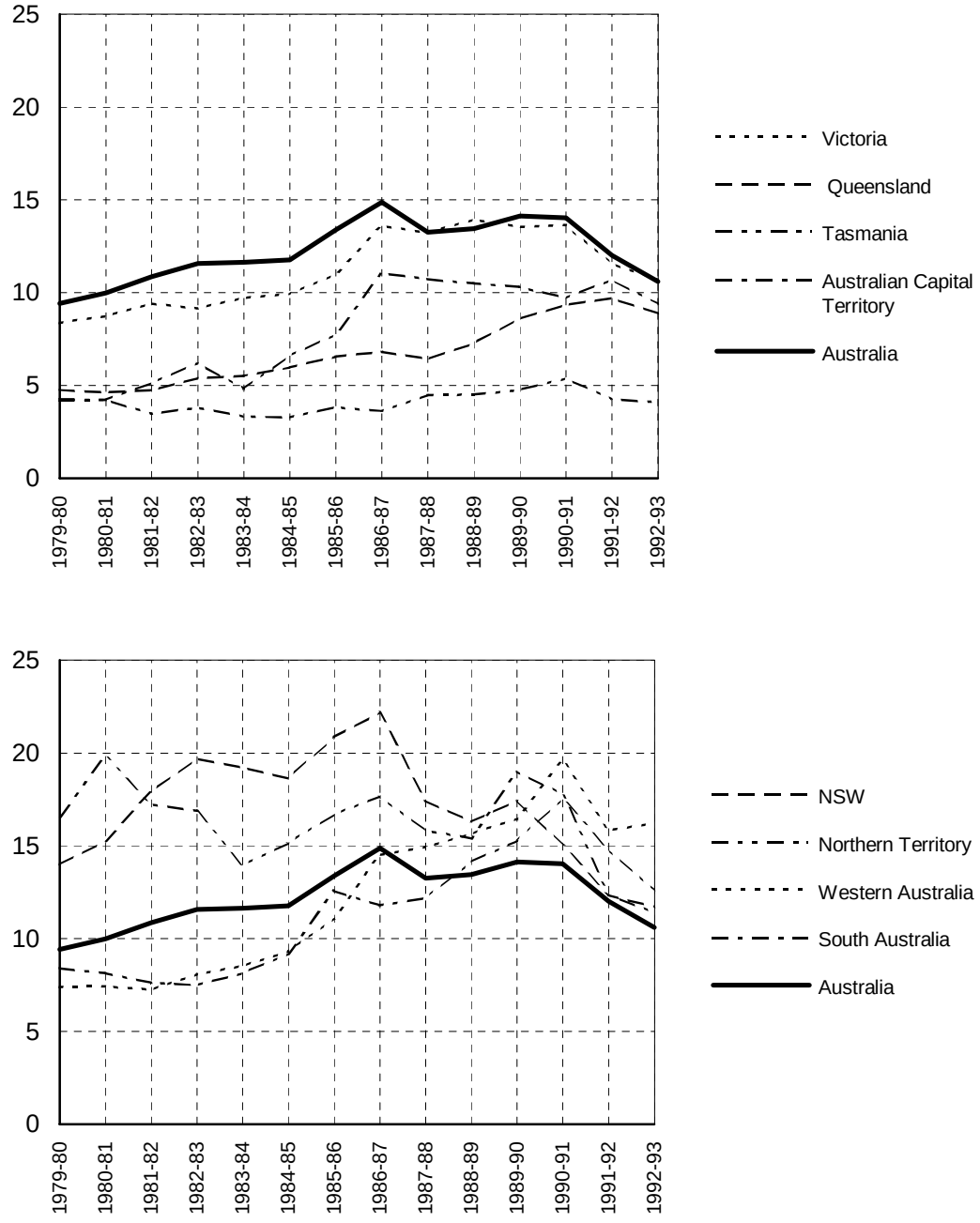
7.1 Theft in Australia

Theft rates

Motor vehicle theft rates in Australia rose steadily throughout the early to mid 1980s, peaking in 1986–87 at approximately 15 thefts per 1000 vehicles registered (see Figure 7.1). At that time, theft rates were highest in New South Wales (about 22 thefts per 1000 vehicles).

Since 1986–87, theft rates have fallen in most states and territories. At the national level, the theft rate declined to around 11 per 1000 vehicles in 1992–93. The largest fall was in New South Wales where the rate declined by over 40 per cent to 12 thefts per 1000 vehicles. The most significant departure from this trend was in Western Australia where, over the same period, the theft rate increased from about 14 to 16 thefts per 1000 vehicles — the highest in Australia.

Figure 7.1: Theft per 1000 vehicles, by state and territory, 1979–1993



Note: Vehicle registrations are as at December each year, while reported thefts are as at June each year.

Source: Information supplied by the Australian Institute of Criminology and State and Territory Police.

Comparable theft rate statistics for 1993–94 are not yet available. However, according to the NRMA, during 1994 there has been some increase in the theft rate amongst its policyholders. In contrast, AAMI stated that it had not experienced any significant increase.

A number of factors — such as vehicle type, location and age — affect the risk of theft (see Box 7.1). Most insurance companies require potential insureds to disclose information on these factors to enable them to tailor premiums to reflect individual risk.

Box 7.1: Factors affecting the risk of car theft

There are 5 key factors which influence the risk of theft:

- *Where a car is parked/garaged*: Cars parked on the street are the most common targets of car thieves. In 1993, almost 50 per cent of stolen cars were parked on the street at the time of the theft.
- *Vehicle type*: Some types of motor vehicle are more prone to theft than others (eg early model Ford Falcons and Holden Commodores).
- *Vehicle size:* Large vehicles have been most popular with thieves, particularly 1985 to 1987 models.
- *Vehicle age:* According to the NRMA, older vehicles are most vulnerable (eg 1978 models experienced a frequency of 12.8 thefts per 1000 vehicles in 1993). Older cars may be more attractive to thieves because they are easier to steal or because of their value for spare parts. Recent year models have the lowest risk of theft — theft of vehicles purchased in 1993 accounted for 1.4 claims per 1000 vehicles in that year.
- *Geographic area:* Some geographic areas are more prone to car theft than others. The incidence of theft in city areas is substantially higher than in country areas. In 1993, there were 4.5 theft claims per 1000 NRMA policies in country areas compared with 13.9 in metropolitan Sydney. High risk areas in Sydney include Fairfield, Blacktown, Sydney City, Bankstown, Penrith, Parramatta, South Sydney, Canterbury and Marrickville.

Source: NRMA (1994)

According to police statistics, more than 75 per cent of vehicles are recovered within a week of being stolen, and close to 50 per cent are found within 48 hours. New South Wales Bureau of Crime Statistics and Research data show that 17 per cent of all stolen cars are not recovered, and a further 4 per cent are

recovered stripped. The longer it takes for a vehicle to be recovered, the more likely it is that it will be extensively damaged.

Types of theft

It is possible to distinguish three broad classes of motor vehicle theft:

- professional theft by thieves who either change the identity of the stolen vehicle so that it may be reregistered and sold (so-called "rebirthing"), or strip it and resell the parts;
- petty theft where components, accessories and personal belongings are removed for resale or use by thieves; and
- joyriding and/or vandalising vehicles by thieves who steal vehicles to obtain transport or, alternatively, for the thrill of it.

In addition, there is a significant number of claims lodged which allege theft, but which insurers suspect to be fraudulent. The New South Wales Government (sub. 113, p. 4) commented that:

> ... NSW Police have estimated insurance fraud to be in the 10% to 15% range whilst the NRMA prefers the 2% to 5% range.

The difference largely reflects different criteria for classifying fraud. Where as police may count as fraudulent incidents which they assess to be the likely result of fraud, insurers only classify a theft as fraudulent if they consider they have the information required to reject a claim on these grounds.

During the late 1980s, professional theft was the most common form of motor vehicle theft. However, in recent years, petty theft and joyriding/vandalism have accounted for the largest number of insurance theft claims. As shown in Figure 7.2, petty theft accounted for the largest proportion of NRMA's theft claims in 1993 (40 per cent). The second largest number of theft claims (37 per cent) related to joyriding and vandalism, followed by professional theft (22 per cent) and cases treated by insurers as fraud (1 per cent).

Costs of theft

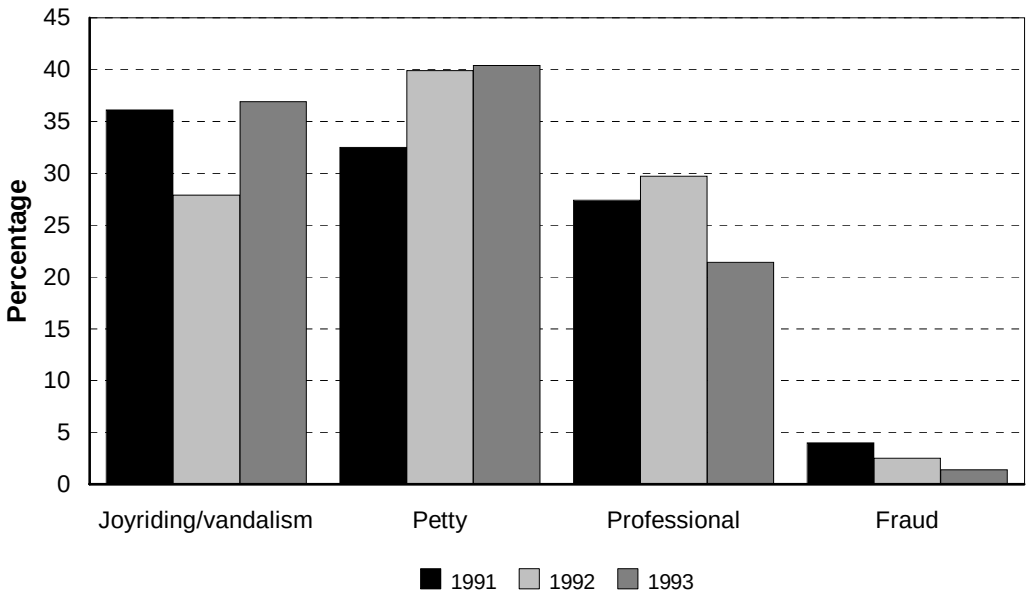
The costs associated with the theft of vehicles are difficult to assess. In 1992–93, theft related insurance claims cost the insurance industry $190 million. This represented 11.2 per cent of total motor vehicle claim costs. Ultimately, this cost is passed on to policyholders in the form of higher insurance premiums:

- according to the ICA, in 1992–93, costs associated with motor vehicle theft added 9.3 per cent to insurance premiums;

- the RACV estimated that theft added about 10–12 per cent to premiums in 1992–93; and
- the NRMA calculated that the average cost of theft per NRMA policyholder was $46 in 1993.

The average claim cost for vehicle theft is higher than the average cost of other vehicle related claims paid by insurance companies. NRMA data for 1992–1993 show that claims for theft represented 7.1 per cent of all vehicle related insurance claims, but 12.5 per cent of total claim costs.

Figure 7.2: NRMA car theft claims, by category, 1991–1993



Source: NRMA (1994)

The cost of theft to insurance companies appears to be declining due to a fall in theft rates, particularly in the area of professional theft. For instance, the cost of stolen vehicles to the NRMA fell by 38 per cent over the three years to 1993. The cost increased in 1994, but this was partly attributable to an increase in the number of policies in force.

The majority of thefts (approximately 62 per cent) do not involve insurance claims. This may be because the stolen vehicle is uninsured or the cost associated with making an insurance claim — including payment of an excess

and loss of no claim bonus — makes it uneconomic to claim (eg the vehicle is recovered with minimal damage). Hence, when non-insurance thefts are taken into account, the cost of theft is considerably greater than the payouts made by insurance companies.

The NRMA estimates that, Australia-wide, vehicle theft cost about $388 million in 1993. According to the New South Wales Bureau of Crime Statistics and Research and the NRMA, the total cost of theft in New South Wales in 1993 was $148 million — 36 per cent less than the cost in 1991.

These estimates exclude costs which are borne by vehicle owners directly, rather than their insurers, such as loss of no claim bonuses and excesses. They also exclude indirect costs incurred by the policyholder, insurer, and/or the wider community — such as: the inconvenience associated with making a claim; damage to private and public property caused by car thieves; the additional costs associated with owners finding alternative transport; police costs; and court costs associated with the prosecution of thieves.

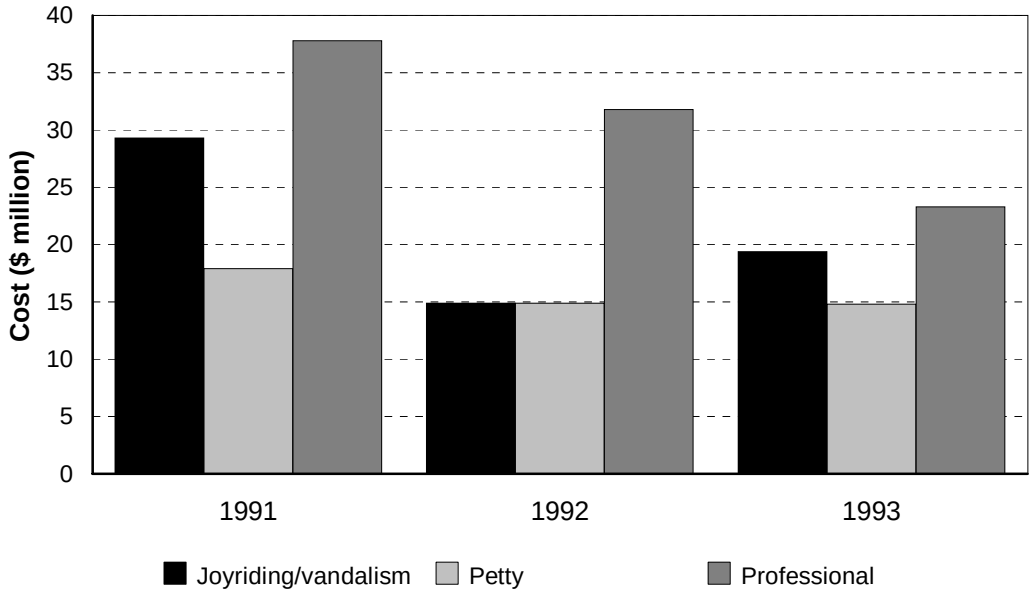
Some types of theft impose greater costs on insurers (or self-insurers) than others (see Figure 7.3). For example, while petty theft accounted for the largest number of the NRMA's theft claims in 1993 (40 per cent), the average cost per vehicle was less than other types of theft (ie 26 per cent of total theft costs). Professional theft is the most costly form of theft. In 1993, it accounted for only 22 per cent of the NRMA's stolen vehicle claims, but represented around 40 per cent of its total motor vehicle theft costs. The high cost associated with professional theft reflects the failure to recover most vehicles, or their recovery with extensive damage, and the subsequent payment of most or all of the sum insured.

7.2 Existing antitheft measures

The extent of the motor vehicle theft problem is directly related to the ease with which thieves can break into and/or steal a car. In the case of professional theft, it is also related to the ease with which thieves can dispose of the stolen vehicle, or its components, for profit.

A range of antitheft actions by the major stakeholders — consumers, vehicle manufacturers, insurers and governments — has contributed to the reduction in vehicle theft rates since the mid to late 1980s. These actions can be broadly categorised as primary antitheft measures or secondary antitheft measures.

Figure 7.3: NRMA car theft costs, by category, 1991–1993



Source: NRMA (1994)

Primary antitheft measures

Active or "primary" antitheft measures seek to reduce the likelihood of thieves being able to gain access to a vehicle and/or drive it away. They can, depending on their level of sophistication, assist in the reduction of all forms of motor vehicle theft — joyriding, petty theft and professional theft.

Current measures

Current primary antitheft measures include those taken by consumers to secure their vehicles against theft, such as:

- locking vehicles;
- installing devices which protect the ignition switch (eg full metal jacket and ignition lock shields);
- avoiding on-street parking, where possible;
- removing valuables from the vehicle or placing them out of sight;
- fitting and using car alarms. (According to the NRMA, in 83 per cent of cases where a car fitted with an alarm was stolen in 1992, the alarm had not been activated);
- using detachable steering locks; and

- using fuel shut-off switches or fitting engine immobilisers.

Consumer pressures for more secure vehicles lie behind many recent primary antitheft initiatives by vehicle manufacturers. In the mid 1980s, the Australian insurance industry was alarmed at the cost of theft and some insurers began to provide information to consumers on theft rates for different makes and models. This placed pressure on motor vehicle manufacturers to ensure that their vehicles became more "competitive" in terms of antitheft devices. The MTAA (sub. 93, p. 3) noted that:

> ... the market has given strong signals to the industry that vehicle security is a desirable characteristic ...

The NRMA initiated a campaign to make manufacturers and consumers more aware of the nature and extent of the theft problem. The NRMA (sub. 83, p. 1) submitted:

> We ...decided that the perceived lack of interest on the part of car buyers was more a factor of not being able to define the differences between good and bad security design, rather than not valuing the "Theftability" of their cars.

In 1988, the NRMA developed a security rating standard, in consultation with local car manufacturers and major importers, to encourage vehicle manufacturers to become more security conscious. The standard rates vehicles out of a possible 100 points for the level of protection on doors, ignition and other relevant areas (eg engine immobilisers, alarm systems and protection of sound systems). This standard has since been adapted internationally under the aegis of the Research Committee for Automobile Repairs and introduced in Britain, Europe, Canada and parts of the United States.

The standard shows that the security of Australian manufactured vehicles has improved dramatically. Vehicles which were disproportionately targeted for theft in the 1980s — the Ford Falcon and Holden Commodore — have improved their security rating considerably.[1] The ranking for these vehicles is now significantly higher than other standard vehicles, including high priced imports. In addition to enhanced door and ignition lock security, some vehicles incorporate digitally coded engine immobilisation systems. According to the NRMA, these initiatives have resulted in an exceedingly low number of thefts of Holden Commodores. Other participants commented that it is virtually impossible to steal recent model Falcons other than by towing the car away.

[1] In 1988, the NRMA security rating for the Ford Laser and Ford Falcon (adjusted to compensate for subsequent changes in the index) was 3 and 12 respectively. In 1995, the ratings were 33 and 81.

Secondary antitheft action

While primary antitheft measures are ideal to target petty theft and joyriding, they may not be as effective in reducing professional theft. Professional thieves can be expected to go to greater lengths to get around antitheft technology — including towing vehicles away — since the potential rewards are high (relative to other forms of theft). Several participants stated that they expect "tow away" theft to increase as vehicles are fitted with more sophisticated immobilisation systems.

Secondary antitheft measures — which include parts labelling and reregistration checks — seek to build on primary measures by reducing the value of stolen vehicles and their parts and increasing the difficulty with which they can be disposed of without detection.[2] Consequently, they tend to target the professional theft problem specifically.

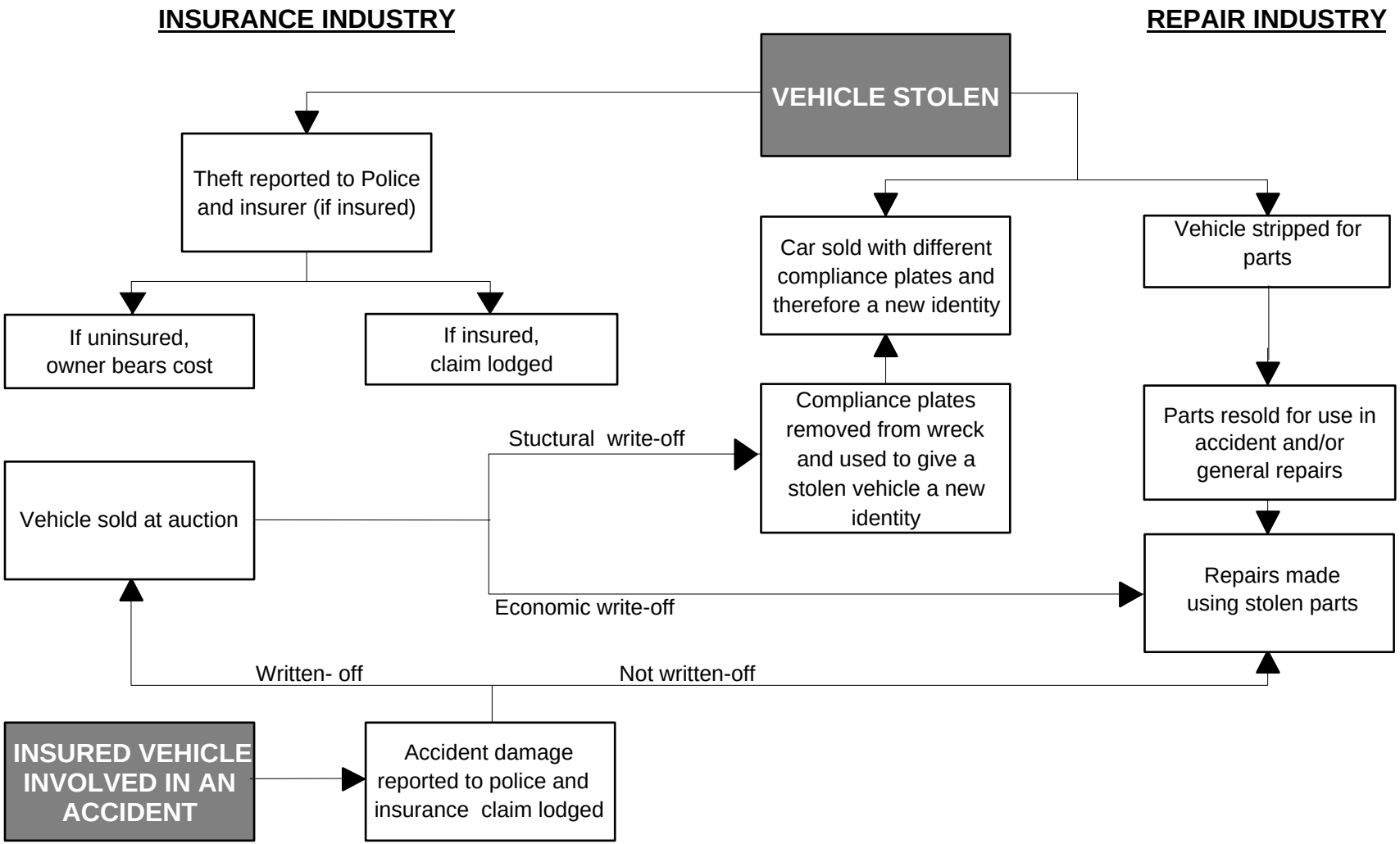
Professionally stolen vehicles are generally "rebirthed" or dismantled and sold as replacement parts. These processes are illustrated in Figure 7.4 and described below.

Vehicle rebirthing

"Rebirthing" involves giving a stolen vehicle a new identity, reregistering it under its new guise and then selling it — usually to an unsuspecting buyer. To be successfully rebirthed, a stolen car must be given an identity which corresponds with the identity of an actual vehicle imported or manufactured in Australia. The identity cannot correspond with the identity of a car which has been reported as stolen or is in use by its legitimate owner for, in each case, the true identity of the stolen car could be detected during vehicle inspections by registration authorities. Accordingly, thieves generally rebirth stolen vehicles by attaching to them the identity of a wrecked vehicle of similar specifications. This is done by stripping the stolen vehicle of items which would confirm its true identity — particularly the compliance plate and/or any identifying numbers marked on its engine and chassis — and attaching to it the corresponding identifiers of a wreck which has (usually) been bought at auction specifically for that purpose.

[2] The distinction between primary and secondary antitheft measures may not always be obvious. If secondary actions are widely adopted they may so alter the return to risk ratio that they deter thieves from stealing in the first place, just as primary initiatives do.

Figure 7.4: Flow chart illustrating the professional motor vehicle theft problem



Parts stripping

Vehicles are also stolen by professional thieves for the purpose of dismantling and selling or otherwise using the parts (eg to restore a damaged vehicle). According to the NRMA, each year more than 6000 vehicles are stolen in New South Wales to be stripped for parts. It is believed that the majority of parts stripped from stolen cars are sold to wreckers or to repairers. The Victoria Police (sub. 68, p. 4) estimates that as much as 20 per cent of market supplies of second-hand parts are "the proceeds of theft". In some instances, thieves target a specific make and model of vehicle in order to fill a replacement parts "order" for a vehicle under repair.

Existing secondary antitheft measures

Secondary antitheft measures target either rebirthing, parts stripping or both of these elements of professional theft. The measures involve police action and the use of databases by registration authorities to provide information which can be used to help verify the identification of vehicles and parts.

Policing and prosecution through the courts

Governments play a central role in secondary antitheft activity by providing policing and administrative services which increase the chances of detection of theft and by conducting prosecutions through the courts.

Little comment was received on the level of policing. However, a number of participants contend that existing penalties provide an insufficient deterrent against vehicle theft. A study by the New South Wales Bureau of Crime Statistics and Research (1992) found the age of persons guilty of motor vehicle theft as a primary offence was mostly between 14 and 19 (usually 16) years of age. According to some participants, young offenders are frequently subjected to a reprimand or a very modest bond or financial penalty.

VIN register

At the heart of most recent secondary antitheft activity has been the attempt to raise the costs of professional theft by improving the integrity of vehicle identification systems. An initiative supported by all states and territories has been the establishment of the vehicle identification numbering (VIN) system for vehicles sold in Australia since 1989 and, more recently, the national register of VINs (see Box 7.2). This register, which is administered by the New South Wales Roads and Traffic Authority, records the identification number and ownership details of all new vehicles and imported second-hand vehicles sold in Australia. In its present form, it targets vehicle rebirthing by providing registration authorities with a means of checking that the VIN of a vehicle

presented for reregistration is a legitimate VIN — that is, one which corresponds with a domestically registered vehicle.

Box 7.2: Vehicle identification systems in Australia

Since 1971, new and imported motor vehicles sold in Australia have been required to carry a compliance plate.

Compliance plates provide information such as: vehicle classification (eg passenger vehicle or commercial vehicle); manufacturer; make and model; engine number; chassis number; date the vehicle complied with the relevant ADRs; the seating capacity for passenger vehicles; and the gross vehicle mass for goods vehicles. Since January 1989, compliance plates have also had a vehicle identification number (VIN) and an approval number (which certifies that the vehicle satisfies the ADRs). Prior to 1989, chassis and engine numbers were used to identify a vehicle and the specific ADRs which the vehicle complied with were listed on the compliance plate.

The VIN contains a range of information about the vehicle. It is a 17 character alpha/numeric identification code. The first three characters of the code identify the manufacturer and country of manufacture. Characters four to nine describe the vehicle's general attributes such as model, engine, transmission etc. The last eight characters distinguish individual vehicles by indicating (*inter alia*) the model or compliance year and the assembly plant.

Vehicle identification plates are another form of identification. Heavy vehicles are required under legislation to carry a vehicle identification plate, while passenger motor vehicle manufacturers voluntarily place these plates on their vehicles. They display some of the information contained on compliance plates, but also include details about: the date of manufacture; paint type and colour; trim colour; and, in the case of heavy vehicles, specific information such as load limits and towing capacity.

The New South Wales Roads and Traffic Authority administers the national register of VINs in Australia. It maintains a central computer system to which all state and territory road traffic authorities have access.

Each road traffic authority also stores many of the details contained on compliance and vehicle identification plates for vehicles registered in its jurisdiction.

In the longer term, the VIN register is intended to be part of a more comprehensive information system to which all states and territories will be linked. However, at present, it is of limited use for dealing with professional theft because it does not include details of vehicles registered prior to its inception in 1989 or details of ownership changes.[3] There are also some doubts about the integrity of the data held on the VIN register. For example, at the draft report hearings, Polk and Co. stated that there are some 800 000 to 900 000 VINs on the VIN database which are not allocated to any registered vehicle. This has arisen because low and high volume suppliers are allocated a block of VINs each year. Low volume vehicle suppliers — mainly importers or people making special vehicles — often do not use their entire allocation before the next year's block of VINs is distributed. Consequently, the pool of unallocated VINs becomes larger every year. This creates a problem because some registration authorities only check to see if vehicles presented for reregistration have a legitimate VIN number, and do not check to see whether the characteristics of the vehicle match those encoded in the VIN. In this situation, if a rebirthed vehicle with forged identification plates corresponding to an unallocated VIN were checked against the VIN register, it would be found to have a "legal" VIN and would be eligible for registration. Secondly, unlike its overseas counterparts, the Australian VIN does not have a check digit to help verify the integrity of the information encoded in the VIN. According to Polk and Co., this factor has contributed to undetected data entry errors which considerably undermine the value of the VIN data base.

Limited access to the VIN register also reduces its usefulness. The Commission understands that some registries (ie in some country areas) do not have facilities to quickly access the information held on the register. Moreover, even where facilities do exist, not all administering authorities consult registers as a matter of course during vehicle reregistration.

Wrecks registers

Some road traffic authorities have moved to frustrate rebirthing by maintaining wrecks registers. These provide registration authorities with information regarding the identity of vehicles which have been classified by insurers as economic or structural write-offs. If there is a match between the identification numbers on a vehicle being reregistered and a wreck listed on the register, inspectors can place the vehicle under special scrutiny.

A Written-off Vehicles Register introduced in New South Wales is based on information supplied by insurers to the Roads and Traffic Authority. The

[3] This latter feature also reduces its value to manufacturers as a means of facilitating vehicle recalls.

register identifies vehicles written-off by insurers (eg VINs for post 1989 vehicles and engine and chassis numbers for pre 1989 vehicles) and the extent of damage to each vehicle. A wrecks notification system, which operates along similar lines to the New South Wales register, is in use in Victoria. In South Australia, wreckers and insurance companies are required to notify the motor registry within 7 days of acquiring or disposing of written-off vehicles.

Inspection processes are made more effective if the register includes information about the damage (eg whether front end or rear end collision damage) and the feasibility of repairing the vehicle. By identifying the nature and extent of damage, a wrecks register can also assist authorities to focus on certain safety aspects of repair during reregistration inspections.

While wrecks registers offer promising rewards in the fight against professional theft, their effectiveness has been frustrated by a lack of consistency in their use. Procedures applying to vehicles presented for reregistration vary both between and within jurisdictions. They range from rigorous inspections by qualified tradespeople which are, in part, designed to identify whether the vehicle has been stolen or is carrying false identification (eg in New South Wales) to cursory procedures which do not involve a thorough inspection of the vehicle.

Another problem relates to coverage. While it is possible to cover most wrecks sold at auction by insurance companies, it is difficult to include wrecks from other sources (eg fleet vehicles written-off by government agencies and large companies that self-insure, including vehicle rental companies, wrecks sold privately and abandoned vehicles). To the extent that these vehicles are not included, there remains a source of "clean" identification plates.

The Commission was also informed that there are considerable difficulties in accessing information about wrecks held by other jurisdictions. However, the problem is not confined to information about wrecks. The Commission understands that police seeking to trace stolen vehicles are usually involved in "ringing around" the various states to check listings of stolen vehicles.

7.3 Additional measures to reduce theft

Most participants felt that more could be done to reduce vehicle theft. For example, the NRMA (1994, p. 54) commented:

> While it is encouraging to see the NSW Government and the Federal Government taking steps to prevent car theft, more can be done. Other States and Territories need to get serious about car theft. ... Co-operation between States and Territories, supported by the Federal Government, can only assist in the fight against car theft ...

Similarly, the MTAA sub. 27, p.45) submitted:

> ... vehicle theft is a significant and pervasive social and economic problem. A concerted national effort is needed by governments at the state and federal level to solve it.

It is difficult to assess the costs and benefits of alternative proposals advanced by participants. Issues of particular importance include the targeting, quality and coordination of antitheft effort. Should antitheft efforts be targeted towards new vehicles — where the costs of introducing antitheft initiatives are lowest? Or should it target older vehicles — where the costs of antitheft effort may be higher, but so, in all probability, will be the benefits? In each case, should all vehicles be targeted, or just "high risk" vehicles? Also, what measures are most effective, and do some measures obviate the need for others?

These are difficult questions to answer. Governments will often be poorly placed to answer them and, providing it does not interfere with the coordination of antitheft initiatives, it will be advantageous to permit experimentation and competition between different antitheft initiatives and strategies to allow the most cost-effective solutions to emerge.

Some antitheft activity — for instance general policing — improves security for all motor vehicles. However, much antitheft activity protects particular vehicles. This is the case with the use of security measures such as parts etching and labelling, high security ignitions and alarms. Most of the benefits accrue to the owner of the vehicle in question, who will enjoy a reduced likelihood of theft and potentially lower insurance premiums. Thus, consumers have an incentive to purchase vehicles with effective security technology, or pay to have it fitted. Manufacturers likewise have an incentive to satisfy their consumers' needs, providing they can do so at a cost which is acceptable to consumers. Insurers also face lower costs if they succeed in encouraging their policyholders to purchase secure vehicles or to fit effective security technology.

However, the likelihood of consumers, vehicle manufacturers and insurers reacting in this manner depends crucially on the availability of appropriate information, in particular, information about the "theftability" of the various vehicles sold in Australia. Consequently, the availability of an industry-wide security rating system — along the lines of that presently compiled by the NRMA — is a central plank of the proposals developed by the Commission to encourage individuals and organisations affected by theft to *voluntarily* take actions to discourage theft. Where such developments occur without compulsion, there can be some confidence that their benefits outweigh the costs. A regulated approach does not have these safeguards.

On the other hand, market signals in this area are far from perfect. In particular, while the installation of security technology during original manufacture will usually be relatively less costly than fitting it to used vehicles, there is likely to

be considerable delay between the time security technology is fitted to vehicles and the time at which it will be of most use — when the vehicles reach about ten to fifteen years old and are most prone to theft. The security of vehicles will have some bearing on their re-sale values, which manufacturers are generally keen to maximise. However, it would be surprising if market signals at the time of manufacturing a new vehicle were ideal from the point of view of the vehicle park over a decade later.

For this reason, the antitheft measures recommended by the Commission might broadly be understood as "no regrets" measures (ie even if they are not effective, the costs associated with their introduction would be relatively low). They seek to improve:

- the integrity of vehicle identification systems;
- the information available to consumers on the security of vehicles; and
- the incentives upon consumers and manufacturers to engage in antitheft initiatives themselves.

Additional primary antitheft action

As noted above, Australia has led the way in the development of some of the more sophisticated primary antitheft devices. Other countries have followed Australia's lead and more advanced antitheft devices, such as engine immobilisers and tracking systems, are being developed. In Germany, this initiative is being led by insurers who are insisting that highly sophisticated engine immobilising devices be fitted to the vehicles they insure. Where a vehicle does not comply with this minimum standard of security, vehicle owners risk refusal of insurance. These developments suggest that the outlook for market driven primary antitheft initiatives is promising.

It is possible that government regulation mandating minimum vehicle security standards in Australia may add to the cost of motor vehicles, yet have few offsetting benefits. Currently, one Australian Design Rule (ADR 25/02) requires manufacturers and importers to install steering locks of particular specifications in new vehicles. The original rule (ADR 25) was introduced in the early 1970s at a time when mechanical locks were the dominant security technology. There was little competition between manufacturers with regard to vehicle security, and the design rule is likely to have improved vehicle security. Today, however, ADR 25/02 approved steering locks can be circumvented by thieves in a matter of seconds. Indeed, competition to improve vehicle security is sufficiently intense between manufacturers that ADR 25/02 may be redundant — at least for vehicles with digitally coded engine immobilisation systems. In

this situation, ADR 25/02 is likely to add costs without yielding any improvement in vehicle security.

Market pressures have already resulted in substantial improvements to the security of most vehicles sold in Australia. These pressures would increase if, as proposed by the Commission, steps are taken to increase consumer awareness of the security rating of vehicles. However, ADR 25/02 could impair vehicle manufacturers' capacity to respond to these pressures. In particular, it prevents them being the first to develop a vehicle security system without mechanical locks and keys because it mandates their use in steering locks.

The current vehicle security regulation — ADR 25/02 — has become redundant and should be abolished.

If ADR 25/02 were to remain in operation, it should become performance based — that is, it should require a specified minimum standard of vehicle security, but should not specify the technical means for achieving this standard. Minimum standards of vehicle security could be expressed in terms of an independent vehicle security index (see later discussion). As vehicle manufacturer performance improves, consideration could be given to replacing minimum security requirements with a standard which manufacturers would be free to fall below, providing they inform their customers of this fact, and of its likely consequences in terms of the increased likelihood of theft and higher insurance premiums.

Additional secondary antitheft action

While there is potential for improvement on the part of insurers, vehicle manufacturers and motor dealers, most secondary antitheft measures require government to shoulder some responsibility. Participants identified a number of additional secondary antitheft measures which could be used to reduce professional theft. They include: improving the integrity of vehicle identification (through improved registration procedures; refusing to reregister written-off vehicles; and/or destroying, marking or changing vehicle identifiers) and parts labelling (compulsory and voluntary). This section reviews these suggestions and proposes a suite of secondary antitheft initiatives to combat the professional theft problem.

Improving the integrity of vehicle identification

Reregistration procedures

As noted earlier, inadequacies in registration procedures used in some states and territories contribute to the incidence of rebirthing. There appear to be two main

shortcomings under the current system. First, there are only limited checks carried out on interstate vehicles presented for reregistration to ascertain whether they have been reported as stolen or listed on a wrecks register in the state/territory where they were previously registered. Second, inspections in some areas are only cursory.

The limited checks on interstate vehicles are partly attributable to inadequate databases maintained by some jurisdictions and poor communications between the states and territories. Operating the VIN system on a national basis overcomes some of the shortcomings of the data bases maintained by individual states/territories. Nonetheless, as outlined in Section 7.2, there are several weaknesses in the present VIN register which limit its effectiveness. If the VIN register is to help reduce professional theft, it is essential that it be accurate and regularly updated. If state, territory and Commonwealth Governments cannot work together to solve these problems, one option would be to contract out the updating and maintenance of the VIN database, as is done in the United States.

While most jurisdictions have established registers of wrecks and stolen vehicles, the effectiveness of these registers is limited unless they are comprehensive and can be accessed by authorities in all states and territories, and at all registration agencies within each jurisdiction. If any one state or territory has an inadequate wrecks register, or if access to the register is limited, this substantially lowers the value of all such registers as antitheft devices. This is because wrecks from that jurisdiction would remain readily available to those seeking to rebirth a stolen vehicle. For example, if information held on the wrecks register of one jurisdiction cannot be accessed by other states/territories, "border-hopping" will occur (ie thieves will exploit the weaknesses by using wrecks acquired in that jurisdiction to rebirth vehicles in another state/territory).

With computer technology, it should be a relatively straightforward task to ensure that the information collected by each state and territory — including information on the identity of stolen and written-off vehicles — is accessible to all relevant authorities across Australia quickly and relatively cheaply.

For some time, the National Road Transport Commission (NRTC) has been working with registration and licensing authorities in all states and territories to develop a system to facilitate the exchange of information (ie the National Exchange of Vehicle Driver Information System (NEVDIS)). The New South Wales Government (sub. 113, p. 6) indicated that the "first phase of stage one ... will begin in the near future".

At a meeting of Premiers and Chief Ministers in November 1994, state and territory governments agreed to establish a National Motor Vehicle Theft Taskforce to develop a comprehensive motor vehicle theft prevention plan. The Taskforce is to report back to Premiers and Chief Ministers by the end of 1995.

The Commission supports this initiative, although given the role played by Commonwealth agencies such as the NRTC and FORS, some of the responsibility for improving antitheft strategies must also lie with the Commonwealth Government.

Commonwealth, state and territory governments should recognise that vehicle theft is a major microeconomic reform issue and take steps to accelerate the development and implementation of systems to integrate existing state and territory databases so that they are accessible to registration authorities in all jurisdictions. Responsibilities for progressing this issue should ultimately rest with the Council of Australian Governments. Each jurisdiction should maintain comprehensive and up to date registers of wrecks and stolen vehicles.

If it is considered likely that there would be difficulties in obtaining the agreement of all jurisdictions to collect data on a consistent basis and to cooperate to permit on-line access by other jurisdictions, an alternative would be to establish a central register. This could be an adjunct to the current VIN register.

The other major problem with registration procedures relates to the rigour of vehicle inspections. In some areas — particularly some non-metropolitan centres — inspections are superficial and not undertaken by staff with suitable mechanical experience or training.

Reregistration inspections are an important mechanism for identifying stolen vehicles and reducing the incidence of professional theft. However, the present procedures are not working as effectively as they should. Governments should act immediately to rectify the existing shortcomings.

State and territory governments should ensure that, before reregistration, vehicles are thoroughly inspected by personnel with appropriate training and/or experience. This should include checking listings of wrecks and stolen vehicles held by authorities in the state/territory in which the vehicle was previously registered.

Refusal to reregister total losses

The Motor Trades Association of New South Wales (MTA) suggested that rebirthing could be significantly reduced if wrecks were removed entirely from the system. Under this proposal, vehicles deemed by insurers to be a total loss could not be reregistered. Instead, wrecks could only be purchased for dismantling.

While this approach would make it more difficult for thieves to acquire a wreck, let alone use its identity to rebirth a stolen vehicle without detection, it is a relatively high cost proposal.

Not all vehicles written-off by insurance companies are beyond repair. Insurance companies write-off vehicles for two reasons — they cannot viably be repaired for structural reasons or they cannot be repaired for economic reasons (eg the cost of parts and labour would be too high). However, some vehicles falling into the latter category can be restored by repairers that have lower cost structures. Thus, under the MTA proposal, there would be a loss incurred by those who legitimately want to buy a wreck because they believe they can economically repair it, but who would no longer be allowed to do so.

The MTA pointed to a need for one category of exemptions — "classic" cars. It recognised that, from an insurer's perspective, the difficulties in sourcing parts and/or their price could mean that (say) a 30 year old E-type Jaguar with one damaged panel could be rendered a write-off. However, if this exception is permitted, it is difficult to see why the same logic would not apply to other vehicles which are written off by insurers, but can be economically repaired by others.

The MTA suggested that the scheme should extend to all wrecks, including those owned by individuals and fleets. However, it would be difficult to define a write-off outside the insurance industry and virtually impossible to monitor compliance.

A requirement that vehicles classed as wrecks not be reregistered would reduce rebirthing but is not the most cost-effective means of doing so.

Destroying or marking wrecked vehicle identifiers

The scope for stealing vehicles is enhanced by the sale of wrecked vehicles with their identifiers intact. The high price paid for some wrecks is believed to reflect the value of identification plates to thieves. The Victoria Police (sub. 68, p. 5) stated that:

> ... checks were made of the prices obtained for wrecks with their identification intact. When this was compared with the prices obtained for the same wreck with the identification endorsed identifying the vehicle as being 'written off', a difference of between $1 500 and $2 000 was detected. When previously stolen vehicles with altered identity are returned to the market with the altered identity removed it is an accepted fact that the vehicle will fetch a price considerably lower than if all original identification is intact.

Most wrecked vehicles are sold at auction by insurers who have an incentive to maximise the value of wrecks. As noted by AAMI (sub. 30, p. 50), the removal of compliance plates would reduce the value of wrecks:

> Insurers attempt to maximise their recovery on claims. One way is to obtain the best salvage value on "write offs". Normally they are sold at auction. However, the price paid for a wreck at auction often far exceeds its value to a "genuine" purchaser, with the result that insurers receive inflated prices for their wrecks.
>
> On the one hand, this is an appealing option for insurers ... however, ... whilst they may receive $5 000 for a wreck worth $2 000 ... the very next day they could face a theft claim for a stolen car worth $25 000. The stolen car is, of course, the same make and model as the car sold at auction, and was purpose stolen to match the compliance plates on the wreck.

The value of a wreck sold without compliance plates would fall because the vehicle would be less attractive to those engaged in illegal activities, and also to legitimate repairers who would face additional costs in registering the vehicle. A second factor which may explain why insurers continue to sell wrecks with their identity intact is the relatively low probability (in some markets) of any given insurer having to meet a theft claim on a stolen vehicle to which the identifiers from a wreck it sold are attached.

Several participants, including one insurer, proposed that insurance companies be required to remove and destroy identification plates before a wrecked vehicle is auctioned. FCAI (sub. 13, p. 6), which saw this as an adjunct to a national wrecks register, argued that:

> ... when a vehicle is "written off" the compliance plate should be destroyed by the insurance company authorising "write off" ... This would prevent compliance plates from wrecked vehicles being attached to stolen vehicles.

While destroying identification plates would limit the scope for vehicles to be rebirthed, it would also penalise those seeking to legitimately repair economic write-offs. They would have to obtain new vehicle identification before selling the vehicle (or accept a lower price). On the other hand, they would gain to the extent that the absence of vehicle identification is reflected in lower auction prices of wrecked vehicles.

If this is viewed as a problem, one option would be to destroy the identification plates of only those vehicles regarded as structural write-offs, and not those of vehicles classed as economic write-offs. This approach, which has recently been adopted in the United Kingdom, involves a degree of subjectivity. Insurers, in a bid to maximise their claims recovery, have an incentive to be liberal when determining whether a vehicle is an economic write-off. Government oversight (eg random auditing) may help, but the subjectivity of determinations about whether a vehicle was a structural or economic write-off would remain a source of disputation.

The Victoria Police (sub. 68, p. 5) are not in favour of compliance plate destruction:

> ... it results in vehicles returning to the system with no identification and makes tracing of a vehicle's history extremely difficult if not impossible.

The destruction of identifiers would also hamper vehicle manufacturers' recalls (ie owners of vehicles that had once been wrecked, but subsequently repaired and reregistered, would not receive recall notifications).

An alternative to destroying vehicle identifiers involves permanently marking identifiers on wrecked vehicles. The stolen car squad in Queensland suggested that this be done by stamping compliance plates with the letter "W" to indicate that the car is, or was, a wreck. A variant to this approach suggested by the Victoria Police is to cut compliance plates in half.

Where they were not subverted, these approaches would allow authorities to identify vehicles which were once wrecks and — since the identity of most rebirthed vehicles initially comes from a wreck — place these vehicles under greater scrutiny. Destroying or marking identifiers would be administratively easier than an approach which involves distinguishing between structural and economic write-offs. Because all of the relevant identification would still be attached to the vehicle, legitimate reregistration of a marked vehicle would also be easier. Also, potential second-hand car buyers would benefit from knowing that certain vehicles had once been wrecks.

There would, however, be some disadvantages. For instance, since all of the relevant vehicle identification would remain on the vehicle, it may be (relatively) easily replicated on forged identification plates. (Some participants contend that it is relatively easy to copy the current aluminium plates). This cannot be done where plates are removed from the vehicle and destroyed. On its own, this approach would not provide registration authorities with the detailed information which can be provided from a wrecks register (ie the nature and extent of the damage).

Changing the form of vehicle identifiers

Rebirthing is made possible by the ability to remove and refit vehicle identifiers with relative ease. To overcome the portability problem associated with the aluminium plates currently used, the Victoria Police (sub. 68, p. 6) suggested the use of self-voiding stickers, similar in type to those used for many years in the United States:

> In order to transfer these identifiers to another vehicle the criminal will need to remove a large section of the "clean vehicle", and refit that section to the stolen vehicle. Although it is still possible to carry out such an operation it becomes considerably more difficult and will deter the majority of criminals currently involved in this practice. This system has been well proven. With recent advances in label technology this

> system is a relatively simple and extremely cost effective method of significantly reducing the trade in compliance plates.

Information relating to the vehicle compliance status (ie the compliance approval number), vehicle identification number and build date details could be included on such labels.

To be fully effective, any labelling system should resist counterfeiting, alteration or relocation. Labels should be easily fitted, authenticated and integrated into the manufacturing process. And there should be reliability and security in the supply of labels. One participant — 3M— currently manufactures labels which it claims meet all these criteria. The company is a supplier to the United States market where labelling of certain vehicle parts is mandatory (see later discussion).

The Federal Office of Road Safety (FORS) raised concerns about the durability of self-voiding adhesive labels, in particular whether they would retain their integrity over the life of a vehicle. It submitted (sub. 84, p. 3):

> The use of self-voiding stickers as compliance plates has been previously considered but on information available at that time their use was not recommended. The main concern put forward by State and Territory registering authorities is that the material has not been proven to be sufficiently durable to withstand physical conditions encountered over the life of the vehicle such as heat, dirt, grease and solvents. FORS would have no objection to the use of self-voiding stickers provided that the physical properties and durability of metal plates were maintained. Accordingly it would be necessary for proponents of self-voiding stickers to demonstrate the performance of the plates before there would be general support for their use. In the event there was general support, FORS would put in place the necessary changes ...

FORS indicated that it has not undertaken, or commissioned on its behalf, any testing of the durability of self-voiding adhesive labels. It argued that the onus is on the supplier to provide the "persuasive evidence" to demonstrate that adhesive labels would be superior to aluminium plates.

In response to the FORS's claims, 3M stated that its labels have been proven durable over a fifteen year period. The company has produced and sold automotive security labels to the automotive industry since 1979.

> ... These labels meet the performance requirements of the major automotive manufacturers, including G.M's specification 6244M, which includes exposure to moisture, heat, cold, and common automotive chemicals.
>
> ... 3M labels have been used on high theft production vehicles since 1979 with no reports of illegible or missing labels.
>
> ... dealings with Ford and G.M. engineers who conduct annual label audits of used cars have never reported any missing or difficult-to-read labels.

Self-voiding plastic labels may be cheaper to manufacture and fit than aluminium compliance plates. However, retrospective fitting would be significantly more costly than targeting new vehicles.

Additional security would be provided if labels were attached to more than one place on the vehicle. Some participants suggested attaching compliance identifiers to the front and back of vehicles. A variant of this approach would involve an additional, concealed label — that is, a small label bearing the VIN placed (during assembly) in one of a range of positions in which it cannot be easily discovered. The location of the label would be known only to the manufacturer and registration authorities. When vehicles were inspected for reregistration, authorities would consult their records to find where the concealed label should be positioned. By this means they would verify the identity of the vehicle. A concealed label would be useful in securing prosecutions because, even though a removed label would raise suspicion, it may not be adequate to establish a case against a suspected thief. Police confirmed that the parts labelling used by Ford had assisted them in securing convictions in instances where defendants had removed the parts labels of which they were aware, but had left others of which they had been unaware.

A recent development involves the use of a concealed microchip. The chip, which emits a coded signal, can be concealed in soft fittings, seats, carpets, the roof or the side panels. A database records the unique chip code against the vehicle's VIN or chassis number. During reregistration or random inspections, special scanners emit signals which induce the chip to emit a coded signal.[4] If the coded signal does not match up with the VIN or chassis number recorded on the database, authorities would be alerted. However, in order for microchips to become an effective antitheft device, inspection authorities would need to have access to the central database. Also, scanners would need to be provided to all reregistration authorities in Australia, otherwise thieves would avoid registering rebirthed vehicles in jurisdictions known to have scanners and turn instead to those that do not (most likely non-metropolitan registration centres). The necessity for scanners to be provided to all vehicle registries would increase the chances of them falling into the hands of thieves. As technology develops, it may be possible to match the chip code directly with the vehicle VIN. This would eliminate the need to consult a separate register to match the VIN and significantly boost the attraction of this option.

[4] In South Africa and the Netherlands where this technology has been adopted as an antitheft device, scanners are subject to high security. Each one is registered and provided only to police forces.

The replacement of the current aluminium plate identifiers with self-voiding stickers is likely to be an effective, low cost deterrent to rebirthing. Design rules should be altered to permit the use of such stickers.

The use of self-voiding adhesive labels would not obviate the need for a wrecks register that is accessible to all registration agencies. Indeed, unless all existing vehicles were retrospectively fitted with the new labels, a wrecks register would be essential as long as the vehicle fleet comprised a significant proportion of vehicles with aluminium identification plates. Even if adhesive labels were retrospectively fitted, it would still be appropriate to maintain a wrecks register as a backup measure in the fight against theft and to allow reregistration authorities to ensure that wrecks are repaired satisfactorily from the perspective of road safety.

Compulsory parts labelling

Several participants suggested that a system of compulsory parts labelling should be introduced in Australia to help reduce the incidence of professional theft. There are a number of ways in which a parts labelling system could be designed. The system incorporated in a draft ADR and advocated by some participants to this inquiry is based on VINs. It involves attaching labels with a vehicle's VIN on nominated key components.

Parts labelling can reduce the incidence of parts stripping by professional thieves by allowing authorities to check whether the VIN on a particular part corresponds with the VIN on a vehicle listed as stolen. It also allows authorities to check spare part inventories held by wreckers and repairers. If there were a requirement for these businesses to maintain a record of their parts purchases, it would be possible to identify the source of stolen parts.

It is not clear whether or not a requirement to record sources of supply under a parts labelling scheme would impose a significant cost on repairers, wreckers and the like. Some participants contend that the necessary record keeping processes are already in place and that the cost is modest, while others view it as a logistic nightmare.[5] If costs could be contained, it is likely that checking stocks held by wreckers would be more cost-effective and successful in tracing sellers of stolen parts than a system based on inspections of individual vehicles.[6]

Parts labelling also increases the cost of rebirthing a stolen vehicle. Upon presentation for reregistration inspection, authorities would discover a

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[5] Confidential information provided to the Commission suggests that the cost of maintaining records of parts sourcing in 1993–94 could amount to around 1.5 per cent of wage costs.

[6] In New South Wales, the Motor Dealers Act has, since 1989, required dismantlers to be able to show with a simple numbering system where any prescribed part was sourced.

discrepancy between the VIN on the (switched) identification plates and the VIN on key components if the vehicle has been illegally rebirthed. To reduce the risk of detection, thieves would need to replace all numbered parts. Depending on the number and type of parts labelled, this could provide a strong deterrent to rebirthing activity.

The concept of a compulsory parts labelling scheme is not new. In Australia in 1991, parts labelling requirements for new vehicles were incorporated in a draft Australian Design Rule — ADR 61 — and were subsequently the subject of intergovernmental discussions.[7] In the United States, legislation mandating parts labelling has applied since the mid 1980s (see Box 7.3). A necessary accompaniment to such legislation is legislation making it an offence to remove or deface labels.

The MTAA, AAA, ICA and RACV strongly support compulsory parts labelling. The ICA (sub. 23, p. 30) claimed that:

> The marking of parts with a unique number (VIN) provides an audit trail for the tracing of stolen items. Thieves are more likely to be convicted when caught in possession of labelled items that have been reported stolen because the labels provide hard evidence.

In contrast, most local motor vehicle manufacturers oppose the idea of parts labelling. For example, General Motors Holden's (sub. 51, p. 3) stated that:

> ... parts marking is an inferior concept to the application of theft prevention technology. Given the significant incidence of joy-riding in unprotected cars, and the resulting personal injuries and property damage, a solution which addresses only professional thefts is not attractive.

The Federal Office of Road Safety (sub. 84, p.4) commented that:

> ... the costs of introducing parts labelling would most likely outweigh the benefits.

The benefits (and costs) of a compulsory parts labelling scheme are influenced greatly by the scheme's design. In particular, it will depend upon: the number of key parts which must be labelled on each vehicle; vehicle coverage; the number of suppliers to which the requirements apply; and the form of labelling used. Each of these factors is considered below.

Number of parts labelled

As there are many thousands of individual parts that make up a motor vehicle, it is clearly not cost-effective or practical to label all components. Consequently, while the benefits (in terms of maximising the likelihood of detecting stolen

[7] The draft rule was considered by the Australian Transport Advisory Council. Although the Council had some reservations (eg the proposal did not involve the labelling of replacement parts), it requested that the Prime Minister raise the matter with the Premiers and Chief Ministers. No agreement was reached to progress the matter.

parts) may be greater if most parts were labelled, the scheme would need to be confined to a relatively small number of key components — those which are most attractive to thieves.

Participants in favour of a compulsory parts labelling scheme argued that labelling should be applied only to major body parts. The MTAA (and the draft ADR) propose labelling should be confined to: the chassis or major body section; all doors; front and rear bumper bars; both front guards; front apron; bonnet; boot; and both rear quarter panels. The US system involves the labelling of the engine and transmission as well as key body parts.

Box 7.3: Parts labelling in the United States

In October 1984, the United States introduced a compulsory vehicle component marking system for manufacturers of high risk vehicles. It was thought that this would have much the same effect in reducing theft as the marking of property in one's home. It was also intended to improve the "clear up" rate of vehicle theft cases by providing an effective basis for convicting car thieves.

In 1992, the scheme was modified when legislation was passed to extend parts labelling to all new vehicles. Under the system, several major parts are required to be marked with the vehicle's identifying number: the engine; the transmission; each door; bonnet; grille; each bumper; each front guard; boot lid, tail gate or hatch back; rear quarter panels; boot floor plan; and body frames. In addition, replacement parts for high risk vehicles must also be labelled.

Vehicle coverage

Parts labelling could be made compulsory for all vehicles, new vehicles only or selected high risk vehicles.

Including all vehicles would maximise the effectiveness of the scheme in detecting stolen parts or illegally rebirthed vehicles. However, it would involve the retrospective labelling of all vehicles currently on the road. The costs would be substantial. The cost of labelling fully assembled vehicles, many of which would be covered in accumulated grime, would be considerably higher than labelling new (unassembled) components. Considerable costs would also be imposed on consumers in terms of the inconvenience of having to arrange for their vehicles to be labelled.

Confining parts labelling to new vehicles would reduce costs. Current practice generally involves the manufacture of parts before the identity of the vehicle

into which they are to be fitted is known. For this reason, in the United States, labels are attached to the vehicle during assembly. Participants indicated that labels can be attached at this stage of the manufacturing process for a low per unit cost — as little as $5 per vehicle.

If a compulsory scheme were confined to new vehicles (including imported vehicles), it could apply to all new vehicles or just to those makes and models assessed as being most likely to be stolen by professional thieves.

In the United States, parts labelling initially applied to high risk vehicles only. The major attraction of this approach is that it contains costs and makes the scheme better targeted. However, it relies on the capacity of administrators to accurately assess which vehicles are "high risk". It is a judgment which must be made in relation to the entire life of the vehicle (ie it needs to take account of the likely theft rate of a vehicle when it is 10 – 15 years old). Furthermore, this judgment must be made before the model goes into production. The US scheme was broadened to include all new vehicles in 1992.

It is difficult to assess the likely costs and benefits of each of these options. While labelling all vehicles would make the greatest contribution to reducing vehicle theft, it would also involve the greatest costs. These costs, combined with the inconvenience involved for vehicle owners, may be resented in the community. While the costs of introducing compulsory parts labelling for new vehicles only (whether all new vehicles or only those deemed as high risk) are likely to be substantially less than a comprehensive scheme, so too are the benefits. Indeed, it is likely that a scheme which targeted only new vehicles would not significantly influence the incidence of professional motor vehicle theft until some 10–15 years after its introduction (ie the average age of stolen vehicles in Australia).

Number of parts suppliers

Some participants argued that compulsory parts labelling would need to apply to all sources of components to be labelled, irrespective of whether they were manufactured as original equipment (OE) or for the aftermarket, or made by the vehicle manufacturer, their OE supplier or by a supplier of non-genuine parts. They argued that, if this were not the case, thieves would simply remove labels and claim that the unlabelled parts are replacements parts. While this might still cast doubts about the source of the parts (ie it is difficult to remove labels without leaving some trace), it would make it difficult for police to obtain a conviction, mainly because they would not be able to identify the owner from whom the vehicle had been stolen. In this context, General Motors Holden's (sub. 51, p.3) stated that:

> Not only "genuine" parts, but all forms of non-genuine, second-hand, and bootleg parts would have to be marked (including imported second-hand and bootleg parts). If any of these types of part were not marked, any person in possession of unmarked parts could presumably claim that they came from one of these alternative sources.

Extending the scheme to all aftermarket suppliers would obviously increase labelling costs and make it far more difficult (and costly) to administer. In particular, the security of the system would be more difficult to preserve because there would be hundreds of parts suppliers involved rather than the twenty or so involved if the scheme were restricted to suppliers of OE. Each supplier required to attach security labelling would gain access to the labelling system and so be in a position to subvert it.

For labelling of replacement parts to be useful in identifying stolen replacement parts, it would be necessary to (directly or indirectly) link replacement parts with the vehicle to which they are fitted or to the supplier. Given the large number of suppliers (and fitters) of replacement parts and the large number of repairs performed, the most workable solution may be for suppliers to label replacement parts and for repairers to then provide vehicle owners with a record of the replacement part numbers used in repairs. The system would rely on owners keeping this information and supplying it to police if their vehicle were stolen. In turn, authorities would have to establish and maintain a register of stolen parts (based on the information supplied by owners) to permit the checking of replacement parts by inspectors.

The form of labelling

In principle, most parts of a vehicle could be uniquely identified in a virtually indestructible way by some form of structural stamping of VINs on parts. Even if stamped numbers were buffed off by thieves, there would be a prospect of police recovering them using forensic techniques.

At present, imposing such a requirement on vehicle manufacturers would involve them in substantial costs as their current practice generally involves the manufacture of parts before the identity of the vehicle to which they will be fitted is known. Indeed, many parts are currently manufactured before the decision is made as to whether they will become OE or spare parts. As the Victoria Police (sub. 68, p. 5) put it:

> Stamping the VIN into metal and plastic components is the only positive way of ensuring adequate identification of vehicle components, however, the practical problems and costs associated with this procedure are prohibitive.

Accordingly, existing labelling schemes for new car parts such as those mandated by United States regulation rely on small plastic labels which are attached to the vehicle during assembly. The labels used in the United States

are self-voiding: it is easy to detect if they are removed from one part and replaced on another part. They also leave a "footprint" on parts from which they have been removed which can be detected by ultra-violet light. While the footprint can be ground off, this is a time consuming exercise. Moreover, forensic techniques can frequently reveal that this has occurred.

Voluntary parts labelling

A comprehensive parts labelling system seeks to create an audit trail which will either exonerate or incriminate those suspected of using stolen parts. This may be an over ambitious goal, and one which actually interferes with the primary objective of parts labelling schemes — which is not to ensure that all parts can be definitively identified but, rather, to place obstacles and threats in the way of trade in stolen parts.

If properly designed, voluntary parts labelling schemes may be capable of meeting this objective at lower cost than compulsory schemes. And because firms are free to compete with different systems, this may lead to the development of more effective systems than if labelling were mandated by regulation. Firms competing to improve the security of their vehicles would be able to innovate in search of better parts labelling systems. A voluntary scheme is also capable of substantially raising costs for professional thieves without producing large cost increases for others in manufacturing and repair industries.

At present, Ford labels certain parts of the Falcon. However, it does not label the same parts when it sells them as spare parts. Thus, thieves can remove labels from parts, disguise their removal, and explain the absence of a label on the part by claiming that the part was originally sold as a Ford spare part. Labelling all genuine parts — including replacement parts — would help overcome this problem. However, it would still be possible for labels to be ground off and claims made that the parts are "non-genuine" replacement parts.

One way in which Ford — or any other manufacturers that decided to initiate a parts labelling program — could overcome this latter problem would be to use a dual marking system. This would involve not only labelling all OE and aftermarket parts, but also stamping parts with some form of manufacturer's identification. Under this arrangement, if a label was removed, the part would continue to bear the manufacturer's stamp, demonstrating clearly that the part was not a "non-genuine" part, but a genuine part minus its identification label. While the manufacturer's stamp could also be removed, and the removal disguised, this would consume the time and resources of thieves. Also, if tampering is suspected, it is likely that forensic techniques could prove that it had taken place. It would also be possible to build more information into parts stamping at relatively low cost. For instance, in addition to the manufacturer's

identity, parts could be stamped with their date of manufacture. Given that parts are almost always manufactured within a few days of vehicle assembly, this information could be sufficient to confirm or refute a claim made by a suspected thief as to the identity of the part.

At the draft report hearings, some participants suggested that a dual marking system would not be appropriate where parts are sourced on a global basis (as overseas manufacturers would be unwilling to stamp parts bound for a small market such as Australia) or where essentially the same vehicle is sold under different company names (eg the Holden Commodore is also marketed as a Toyota Lexcen). It is understandable that Toyota would not wish to have a GMH insignia stamped on Lexcen parts. However, the stamp itself would not have to incorporate the company name or emblem. It could comprise any insignia which, although meaningless to consumers, would identify the manufacturer to the trade and registration officials.

There is also scope for parts marking of used cars. In this regard, the Commission is aware of one insurer — RAASA — which actively encourages its clients — and indeed the community generally — to participate in an acid glass etching program. While window etching is unlikely to deter joyriders, petty thieves and professional thieves seeking to strip a vehicle for parts, it can frustrate rebirthing. Although thieves can remove and replace the etched glass, the cost of doing so may reduce profitability sufficiently to deter thieves from stealing etched vehicles in the first place (the RAASA estimates that the glass alone would cost an average of $1400 per vehicle).

Acid etching is low cost — the RAASA etches windows (on a break even basis) for $10 per vehicle (see Box 7.4) — and can be targeted effectively at either older vehicles (the most popular theft target) or new ones. In the United States, the Automobile Club of Michigan introduced a vehicle glass etching program to tackle an organised rebirthing racket and reported a 45 per cent reduction in the theft of etched vehicles compared to unetched vehicles. In Australia, the RAASA claims that its etching service has had considerable success, although at this stage its impact cannot be quantified.

The Commission was informed of some privately supplied parts marking services — other than the glass etching service sponsored by RAASA. However, they do not appear to have been very successful to date. Participants commented that some firms offering these services use their own labelling codes which are rendered useless if clients lose them, lose contact with the security firm or if the firm goes out of business.

Box 7.4: Vehicle glass etching in South Australia

The RAASA introduced window etching to combat professional theft in May 1993. Window etching was already available in South Australia, but at a considerable cost — up to $175 to have all windows treated. The motoring club was able to offer an etching service for approximately $10 per vehicle on a break-even basis. Since its introduction, the windows of some 40 000 motor vehicles have been etched with their VIN number. The RAASA has recently developed mail order do-it-yourself kits. A label with the vehicle's VIN inscribed is affixed to each window. An acid sachet is then dipped in water and applied to the label, etching the glass. These kits cost between $14 and $22.

Details of vehicles etched by the RAASA — including ownership, make and model of vehicle, ownership and accessories — are recorded on a database which is compatible with police and registration authority databases. If authorities discover an etched window, they are then able to trace it back to the vehicle owner.

According to the RAASA, other state motoring organisations are now investigating the introduction of window etching.

Source: Information supplied by RAASA

Assessment of parts labelling

The introduction of a compulsory parts labelling scheme would undoubtedly help in the fight against professional theft. However, relative to the benefits, the costs associated with such a scheme could be high, especially if it encompassed replacement parts and requirements for repairers to maintain records detailing the sources of all parts used.

A voluntary system would avoid the costs invariably associated with compulsion and government regulation. Indeed, in the Commission's view, not only would a voluntary system cost less, it could also be more successful at achieving its objectives. Instead of being driven by manufacturers' need to comply with regulation, it would be driven by competition between manufacturers to frustrate vehicle thieves and reduce the theft of their vehicles. Accordingly, it would provide more room for innovation and experimentation with alternative antitheft systems and technologies. The Commission's proposal to promote consumer awareness of the security of different vehicle types would increase the commercial incentives for manufacturers to label the parts of their vehicles if it is, and for so long as it remains, a cost-effective means of combating vehicle theft.

To support voluntary labelling, there would need to be legislation to make it an offence to remove or damage labels. As discussed below, there is also scope for insurers to encourage voluntary labelling by offering premium discounts or by waiving excesses on vehicles stolen which have parts appropriately labelled.

Parts labelling by manufacturers can substantially reduce theft by impeding both rebirthing and trade in stolen parts. However, the costs and benefits of parts labelling schemes are critically influenced by scheme design. In this regard, compulsory and regulated parts labelling schemes may achieve their objectives inefficiently. A voluntary parts labelling scheme would allow scope for innovation and may offer a more cost-effective option. Accordingly, governments should facilitate the development of parts marking on a voluntary and competitive basis with firms and consumers bearing the costs of any initiatives. In addition to mandating greater consumer information about vehicle security (see below), governments should legislate to make it an offence to remove or damage identification labels with a view to concealing the identity of either the part or the vehicle to which the part is attached.

Additional general antitheft action

There are additional antitheft measures — such as improving consumer information as well as the provision of incentives to consumers by insurers — which could also improve the effectiveness of both primary and secondary antitheft actions.

Improving consumer information

As noted earlier, consumer demand has been a critical driver of improved primary antitheft effort by manufacturers in Australia. This process can be strengthened in several ways.

It would be possible to bring the issue of theft and security to the attention of all new car buyers in a way which helps them make a more informed choice about their vehicle purchase. Standardised information systems currently operate in a wide range of consumer products — from food to consumer durables — improving consumer awareness and information. For example, buyers of whitegoods are made aware of the energy rating of competing products according to standardised scales. There would be merit in applying a similar system to vehicle security.

The current vehicle security rating performed by the NRMA is a useful starting point and the recommendation below is written with this in mind. The NRMA submitted (sub. 83, p.1):

> It is NRMA's contention that the industry-wide "Theftability" rating system ....already exists and is widely accepted by the car industry and the community. The current system, although owned by NRMA, is widely publicised ... As the Insurance Industry has already agreed to its use as an industry standard, we suggest that it is unnecessary to develop a further independently run, possibly legislation driven system.

However, at present, the NRMA's rating system applies mainly to primary antitheft measures. Although the security coding of radios is currently taken into account in the index, parts labelling is not. Ideally, all antitheft measures which reduce or are expected to reduce vehicle theft should be taken into account in vehicle security ratings. The system's effectiveness would be further improved if steps were taken to ensure that the purchasers of new vehicles are well informed about the security of vehicles from theft and the costs of low levels of security.

A comprehensive and up-to-date index of vehicle security encompassing both primary and secondary security features is an important component of strategies to reduce vehicle theft. To increase its usefulness, the Commonwealth Government should require new vehicle suppliers to provide information to consumers about the security rating of each model they sell.

Improving incentives to consumers

While information currently published by a number of insurance companies helps to educate drivers about the risk of motor vehicle theft, insurers are also in an excellent position to provide incentives to consumers to minimise the cost and incidence of theft.

Insurers already provide some indirect incentives. Because premiums are sensitive to the incidence of theft for individual makes and models of vehicles, consumers have some incentive to purchase vehicles which are subject to a low incidence of theft. This, in turn, places pressure on motor vehicle manufacturers to ensure that their cars are "competitive" in terms of antitheft devices.

In addition to insurer sponsored glass etching programs, insurers informed the Commission of initiatives they have sponsored to encourage owners to install primary antitheft devices such as full metal ignition jackets and vehicle alarms. Nevertheless, such initiatives are surprisingly rare.

Insurers could, and should, do more to actively encourage their policyholders to improve the security of their vehicles. In a competitive market, insurers can ultimately be expected to pass a large proportion of the savings generated by such initiatives on to consumers. However, it appears that, so far, little has been done to pass such savings on to clients who have invested in additional antitheft initiatives. Discounts for policyholders who engage in antitheft initiatives of

proven effectiveness would be analogous to the discounts currently offered by some insurers if vehicles identified in high risk areas are parked overnight off the street (eg in a garage).

Governments can play a useful leadership role in raising public and industry awareness of the importance of the issue, and in so doing encourage the emergence of more vigorous competition between insurers to improve their antitheft performance. A useful way of doing this would be for the Commonwealth Government to require vehicle insurers over a certain size to inform it annually of the policies they have initiated to improve performance in this area, along with any actions required to be taken by government to support antitheft strategies. There should be no expectation on insurers to act inconsistently with their own commercial interests, and annual reporting should take place for a limited period of time — say four years. Once the issue becomes a focus of competition between insurers, antitheft initiatives by insurers are likely to be sustained and intensified by the competitive process itself.

Insurers should monitor the effectiveness of available primary and secondary antitheft measures and encourage their customers to adopt them or to purchase vehicles which have them installed. They should promote such measures by offering premium discounts and other financial incentives to their customers which pass on some of the gains resulting from lower theft rates. To allow governments to monitor these developments, for a limited period, insurers should report annually to government on the progress they have made in encouraging policy holders to take cost-effective antitheft measures.

7.4 Review of progress

The measures recommended by the Commission to reduce theft are relatively low cost. If implemented, the Commission is confident that they would have a significant effect on the incidence of vehicle theft. However, in the past, progress in addressing the theft problem has been slow. Cooperative endeavours by governments have suffered from a lack of commitment and insurers have not been active in encouraging the adoption of antitheft strategies by consumers or vehicle manufacturers. Consequently, it is important that future progress in addressing theft be closely monitored.

The Commission recommends that motor vehicle theft and means to combat it be reviewed in 1999.

8 COMPULSORY THIRD PARTY PROPERTY DAMAGE INSURANCE

Several participants were concerned that some drivers are financially unaccountable (or suffer great hardship when they are made accountable) for the property damage costs they impose on others in the event of an accident. One option to address these problems is for governments to make third party property damage (TPPD) insurance compulsory.[1] However, the insurance industry strongly opposed compulsory TPPD insurance schemes, claiming that the problems associated with financially unaccountable drivers are only small. They were adamant that any benefits from a scheme would be far outweighed by establishment and running costs, and probable inefficiencies associated with related government regulation. The industry considered that there are more direct and cost-effective methods of addressing the problem.

This chapter examines options for addressing concerns about financially unaccountable drivers. Section 8.1 provides an indication of the nature and extent of the concerns about financially unaccountable drivers. The main options that have been suggested to address these concerns are considered in Section 8.2. The Commission's view is provided in Section 8.3.

8.1 Putting the problems in perspective

Even though there is a risk that a driver may cause an accident and, as a result, be legally liable for damage to other people's property, some Australian motorists do not have TPPD insurance cover.[2] If these motorists cause an accident, and do not have the capacity to pay for the damage they inflict on others, they impose costs on innocent third parties.

The majority of vehicles involved in collisions with at-fault uninsured vehicles have some form of insurance to cover damage to their vehicle (eg

[1] The case for the introduction of a compulsory TPPD insurance scheme has been examined by governments on numerous occasions (eg Australian Transport Advisory Council 1972; South Australian Parliament 1972; Atiyah 1973; Victorian Department of Management and Budget 1987; Tasmanian Legislative Council 1988; New Zealand Parliament 1988; Amery 1992; and Vicroads 1992). The South Australian Government was conducting a review during the course of this inquiry.

[2] TPPD insurance in Australia indemnifies motorists for the damage they cause to other motor vehicles and private property (such as fences) as well as public property (such as light poles, bridges, road signs and traffic lights).

comprehensive insurance or TPPD with uninsured motorists extension (UME)). These motorists are able to call on their insurance policies to pay for some or all of the damage caused by uninsured motorists. However, even for owners of insured vehicles the accident will not usually be costless. For instance, by claiming on their own first party cover, they may be required to pay an excess and they may lose their no claim bonus — although claimants with insurance policies which provide for faultless no claim bonuses and faultless excesses can avoid these costs. AAMI noted (sub. 95, pp. 13–14) that only one insurer with a significant motor vehicle portfolio does not provide these benefits and commented that:

> For those motorists whose insurance company does not provide such cover, it is obviously a simple matter to switch to a company which does provide such protection.

In the case of claims under TPPD with UME, any damage costs in excess of the specified amount — usually about $3000 to $5000 — are the responsibility of the innocent motorist. However, with the average claim payment under UME being $1340, the number of motorists having to shoulder a proportion of the cost themselves would be expected to be very small (ICA, sub. 89, p. 3).

There are also other costs incurred by insured motorists. While insurance companies are able to recover damage costs from some uninsured drivers, they are not able to recover costs from those who are financially unaccountable. This cost, along with legal and other costs associated with pursuing such parties, are borne by the insurer and passed on to all policyholders in the form of higher premiums. The ICA estimated that the impact of financially unaccountable drivers on premiums for TPPD with UME insurance was in the range of $4.52 to $13.38, with a median of $8.35. The cost impost on comprehensive insurance policyholders would be higher as the average value of vehicles and repairs under comprehensive policies is greater than under TPPD with UME insurance.

The situation is somewhat different for vehicle owners who have only TPPD insurance (ie without UME) or no motor vehicle insurance. While only a relatively small proportion of vehicle owners fall into this category — around 10 per cent — they bear the full cost of the damage caused to their vehicle by an at-fault financially unaccountable driver.

In effect, the damage costs caused by financially unaccountable drivers are transferred to other drivers — either directly, where owners have no insurance or only TPPD insurance, or indirectly, via higher insurance premiums. To estimate the size of this transfer, information is required about the number of uninsured vehicles on the road, the accident incidence of at-fault uninsured drivers, average damage costs and the likely recovery of costs from such drivers. Unfortunately, much of the data are not available.

Some "back-of-the-envelope" calculations of the costs imposed on others by financially unaccountable drivers are offered in Box 8.1. The estimates presented in the draft report have been revised in the light of additional and more recent data. They suggest annual costs of the order of $22 million to $65 million. It must be stressed that the estimates are conditional upon several assumptions for which there is no sound empirical basis. Consequently, at best, they can be considered as only broadly indicative of the actual property damage caused by at-fault financially unaccountable drivers.

These estimates relate only to property damage costs which are *transferred* to other drivers. There are also a number of indirect costs that are not taken into account in these estimates. For example, consumer groups highlighted the costs that are borne by the at-fault drivers of uninsured vehicles themselves — such as damage to their own vehicle — and costs associated with the financial hardship in meeting third party claims. They stated that actions to recover property damage costs from at-fault uninsured drivers often leave these individuals and their families financially devastated. Innocent uninsured parties also suffer significant financial hardship when repair costs cannot be recovered from at-fault drivers. Statistics compiled in 1990 by the Insolvency and Trustee Service of Australia (as cited in CAFCA sub. 25, p. 4) show that, in Victoria, 9.3 per cent of bankruptcies in a ten month period were the direct result of a motor vehicle accident debt. Some costs incurred by accident victims, such as having to make alternative transport arrangements, are also not taken into account. To the extent that court action is taken to recover costs and the courts do not operate on a full cost recovery basis, taxpayers also incur a cost.

8.2 Options for addressing problems associated with financially unaccountable drivers

Options that have been suggested for addressing the problems associated with financially unaccountable drivers include: the introduction of compulsory TPPD insurance; education programs; licence revocation; and increased rate flexibility under compulsory third party personal (CTP) schemes. Each of these options are discussed below.

Box 8.1: Costs associated with accidents caused by financially unaccountable drivers

Morgan Consumer Trend estimates that 10–11 per cent of private vehicles are uninsured nationally. CAFCA estimates a slightly lower proportion — about 9 per cent. The NRMA estimates a rate of 8 per cent for New South Wales, while the RACV and FCLC estimate 8–10 per cent and 14 per cent respectively for Victoria. On the basis of this information, it would seem conservative to assume that, throughout Australia, approximately 8–9 per cent of vehicles are uninsured.

The ICA (sub. 89, p. 4) stated that the Australia-wide claim rate for vehicles was 1:14 as at September 1994 (ie one in fourteen insured vehicles was the subject of an insurance claim). This figure includes theft and single vehicle accident claims, but excludes those multiple vehicle accidents where one or all parties are insured but choose not to claim. The net impact of these opposing factors on the claim rate is not known. Therefore, it is assumed that the Australia-wide multiple vehicle accident rate is 1:14. Applying the collision rate of 1:14 to the total number of registered vehicles in Australia (10.5 million), implies that the total number of vehicles involved in accidents is 750 000. Assuming that 8 per cent of vehicles are uninsured, and in 50 per cent of these cases the uninsured driver was at-fault, there would be around 30 000 accidents involving at-fault uninsured drivers per year.

The ICA (sub. 89, p. 5) estimates an average claim cost based on third party property damage claims of $2000. On the other hand, the ARRB estimated average damage repair costs for passenger cars in 1991 (based on insurance claims data) to be around $4300. These figures imply total damage costs caused by uninsured motorists would be in the range of $60 million to about $130 million. Alternatively, calculations can be based on vehicle damage and repair costs estimated by BTCE ($1.86 billion) or Andreassen ($2.66 billion). Assuming around 60 per cent of all reported accidents involve more than one vehicle (see Queensland Transport 1993 and 1994); 8 per cent of vehicles are uninsured; and the driver of the uninsured vehicle is at-fault in 50 per cent of multiple vehicle accidents, the costs imposed on others by uninsured vehicles would be between $44 million and $64 million.

The cost recovery rate from at-fault drivers of uninsured vehicles used by the NRMA is 50 per cent. Assuming this recovery rate, the direct damage costs imposed by financially unaccountable drivers on others would be between $22 million and $65 million.

8.2.1 Compulsory TPPD insurance

In many OECD countries, compulsory TPPD insurance is the principal means of addressing problems caused by financially unaccountable drivers.[3] It is seen as a means of ensuring that all drivers — other than those that break the law by not complying with the requirement — are covered for damage they may inflict on motor vehicles and other property.

While it is widely accepted that the major benefit of compulsory TPPD insurance is in reducing the financial and non-financial costs imposed on innocent third parties by financially unaccountable drivers, it is possible that further benefits arise because of the effects it has on driver behaviour. More specifically, it is possible that the incidence of reckless driving would be reduced because of drivers' concerns about the implications of accidents for the future level of their insurance premiums.

A number of studies (eg Smith and Wright 1992 and McEwin 1981) raise the possibility of drivers taking more care when they are insured. The underlying premise is that, provided premiums are risk-based, drivers will have an incentive to drive responsibly to avoid having to pay higher premiums when the insurance is due for renewal. To the extent that this occurs, other drivers and the community would benefit through a lower accident rate. The benefits could be significant given that a high proportion of accidents are attributed to driver error (see Appendix B, Table B.16).

A counter argument raises the prospect of moral hazard. That is, because insurance will cover the majority of costs associated with an accident, some people may drive *less* carefully. The incentive to drive recklessly would, however, be tempered by the knowledge that compulsory TPPD insurance would not cover damage to the driver's own vehicle, and by the prospects of higher premiums in the future.

At the draft report hearings, insurance company representatives expressed doubts about whether compulsory TPPD insurance would improve driver behaviour. For example, the ICA (sub. 89, p. 7) commented:

> The experience of car insurance is that people generally believe themselves to be good drivers. They do not expect to cause accidents, they expect to be the innocent party.
>
> There is no evidence that people's driving behaviour is influenced by the insurance they have, its class, or the lack of insurance. There is evidence that all drivers improve with age and experience.

[3] Compulsory third party personal (CTP) injury insurance, which applies to all vehicles registered in Australia, provides compensation for personal injury to individuals involved in accidents in which they are not at fault. However, CTP insurance does not cover property damage liability.

Insurers greatest concerns, however, were about the costs of implementing a compulsory TPPD scheme. They contend that, while the benefits would be small, the costs would be substantial. The ICA (sub. 23, p. 19) submitted:

> The issue of a compulsory third party property damage scheme has been raised over a number of years in the various State Parliaments. The promoters of these schemes see this as a simple solution to what is perceived to be a significant problem ... [However], the extent of the problem is nowhere near as great as popular perception of the issue and ... the implementation of a compulsory third party property damage scheme would in fact be a very expensive alternative which could not be cost justified.

The insurance industry considers that it has gone a long way towards reducing the problems with financially unaccountable drivers. AAMI (1994, p. 3) recently submitted to a South Australian inquiry considering compulsory TPPD insurance:

> The present system provides accessible, effective and extremely cheap third party and comprehensive insurance. These policies and added benefits such as the uninsured motorists extension provide motorists with choice and all the protection they need, even if they are involved in an accident caused by an uninsured motorist.

Insurers also argued that TPPD insurance with UME is not expensive when compared to the cost of owning and running a motor vehicle. Information provided by the NRMA indicates that most insurers in New South Wales charge an annual premium in the range of $130 to $180 for this type of cover. SUNCORP advised that basic TPPD insurance could be obtained for $63 per annum in Brisbane and $57 per annum outside the Brisbane area. This expense is relatively small when compared to the annual costs of owning and running a vehicle — see Table 8.1.

Table 8.1: Operating costs for selected vehicles (tenth year only) ($)

Vehicle	*Ford Laser*	*Toyota Camry*	*Mitsubishi Magna*	*Holden Commodore*	*Ford Fairmont*
Depreciation	621	876	838	829	1062
Interest	na	na	na	na	na
Registration	445	463	463	529	529
Membership (motoring body)	36	36	36	36	36
Fuel	1149	1209	1330	1512	1511
Tyres	360	450	400	440	440
Repairs	655	678	902	583	590
Annual cost	**3266**	**3712**	**3969**	**3929**	**4168**

na not available

Source: NRMA

A number of participants opposed insurers' views and supported the introduction of compulsory TPPD insurance. For instance, the Institute of Automotive Mechanical Engineers (sub. 8, p. 1) stated:

> ... insurance for third party property damage should be compulsory. ... Whenever damage to property is caused by a motor vehicle ... there are costs of rectification which must be met. It is inequitable that such costs should be met by any other than the operator of the vehicle at fault. Whilst remedies do exist at law to attach liability to the guilty party these are expensive and often unenforceable due to the lack of financial resource of the defendant.

Consumer groups — for example, the Victorian Federation of Community Legal Centres (FCLC), the Consumer Credit Legal Service (CCLS), the Consumer Advocacy and Financial Counselling Association (CAFCA) of Victoria and the Consumer Law Centre (CLC) of Victoria — also supported the introduction of a scheme to make TPPD insurance compulsory for all vehicles. As noted in Section 8.1, their major concern is the problems faced by drivers who are uninsured and found to be at-fault in an accident.

In response to the concerns of these consumer bodies, insurers commented that there are many events involving loss that could impose financial hardship on individuals or their families. They include death of the principle income earner, damage to a dwelling (eg fire) and theft of personal property. Insurers pointed out that, for many of these events, insurance is available, but it is not compulsory.

Insurers concerns about the costs that could be associated with compulsory TPPD schemes mainly related to: fraud; protection against damage caused by uninsured or unidentified vehicles; adversarial dealings; bad risks leading to higher premiums; reduced demand for comprehensive insurance; equity considerations; and administrative costs and complexities.

Consideration of these issues is complicated by the fact that there are many possible forms that a compulsory TPPD insurance scheme could take, as evidenced by the variety of schemes operating in other countries (see Box 8.2 and Appendix E).

Box 8.2: Key features of compulsory TPPD insurance schemes overseas

In many countries, motorists are required to have TPPD insurance to register a vehicle and/or obtain a driver's licence. These compulsory TPPD insurance schemes are often integrated with third party personal injury schemes.

Under almost all schemes, at-fault drivers (or their insurer) are expected to pay for third party damage costs. Under some schemes the role of fault is modified — fault determines who is responsible for the payment of an excess, but both first and third party property damages are covered by compulsory insurance. Universal no-fault schemes — where all first and third party damages are covered by the insurer, regardless of who caused the accident — are rare.

Most schemes provide compensation for property damage caused by uninsured motorists. Some also provide cover for damage caused by unidentified motorists. Compensation is usually provided in one of two ways: through nominal defendant arrangements (usually funded by the industry and/or a portion of vehicle registration and/or drivers' licence fees); or through legislation mandating that insurance companies cover such damage.

Several schemes make provision for drivers who cannot afford insurance. This is usually done by premium regulation or regulation prohibiting insurance companies from refusing insurance. In some jurisdictions, dedicated insurance pools have been established to insure what might otherwise be classified as "unacceptable" risks. The costs associated with these pools are pro-rated over the industry.

Compliance with compulsory TPPD insurance schemes varies considerably across jurisdictions. In some places (eg New Mexico), the proportion of uninsured drivers (who are also usually unregistered) is said to be as high as 40 per cent. However, in most jurisdictions contacted by the Commission it is believed to be less than 10 per cent.

In the United States, some jurisdictions use alternative arrangements to make drivers financially accountable for their actions. Motorists need only prove that they have a capacity to pay for a minimum amount of third party property damage. Thus, motorists in these jurisdictions have the choice of taking out TPPD insurance coverage or self-insuring.

For its part, the Commission has not attempted to design a compulsory TPPD insurance scheme. However, as a basis for discussing insurers' concerns it has used as a starting point a basic scheme which could be constructed around the following key elements:

- coverage being similar to that of current TPPD policies (ie there would be no statutory requirement to provide extensions to cover claims involving unidentified or uninsured drivers);
- in line with current practice, the insurance being attached to the vehicle, with premiums being set which take into account the driving record(s) of the regular driver(s); and
- insurance being provided under competitive conditions, with no restrictions on entry to the market.

Fraud

Some participants were concerned that the introduction of a compulsory TPPD insurance scheme would lead to a substantial increase in the incidence of fraud. For instance, although it was not clear what type of compulsory scheme they were referring to, the RAASA (1990, p. 6) states:

> Insurance fraud is already a serious problem. We believe that with a compulsory scheme there's every likelihood that many motorists would be tempted to throw the burden of minor damage, not caused by a negligent third party, onto the insurance system.
>
> To the unscrupulous, there would be no "self-responsible" damage. The minor gate post scrape of today might very well become the fraudulent claim of tomorrow.

Since more motorists would be covered by insurance, the absolute level of fraud would be likely to increase under a compulsory TPPD insurance scheme. It may be the case that the people brought into the pool under a compulsory scheme would stand to lose little from lodging fraudulent claims. However, the Commission has no evidence to support such a view. In any event, as 90 per cent of motorists are currently insured, even a disproportionate increase would be modest.

It also needs to be recognised that fraud is already a problem for insurance companies and they have procedures in place to minimise its incidence. For instance, an important role of assessors is to verify that the type of damage being claimed is consistent with the accident description. In addition, insurance company investigators examine claims which are suspicious. Excesses and/or no claim bonuses are also used to dissuade motorists from making frivolous and petty claims. Insurers would be free to use the same mechanisms to reduce the incidence of fraud under a compulsory TPPD insurance scheme, provided this was not precluded by regulation.

The prospect that a compulsory TPPD insurance scheme could lead to an increase in large scale "professional" fraud was identified by participants as a

particular area of concern. It would be expected, however, that most of the individuals who are prepared to behave in this fashion already have the opportunity of doing so (see Box 8.3). In this context, AAMI (1994, p. 5) commented:

> ... it would be a very simple process for unscrupulous parties to "set up" accidents with unidentified vehicles as has been highlighted by experience in the compulsory third party personal injury schemes. These types of organised scams already exist in other areas of third party [property] damage insurance.

Box 8.3: Professional fraud "scams"

The Commission was given examples of the ways in which some individuals defraud insurers.

One example involves repairers, towing operators, a firm of solicitors, and a group of "independent" assessors. After being involved in an accident, a comprehensively insured driver is advised by the repairer, or an associated towing operator, that they are not at-fault and should not claim on their insurance or they will lose their no claim bonus. Instead, the insured is advised by the repairer that the damaged vehicle can be repaired by them and a solicitor can be arranged to take legal action against the at-fault party to recover the cost of the repairs. The repairer then prepares an inflated quote which is approved by the "independent" assessor. If unsuccessful in taking action against the third party, the vehicle owner claims against the insurer after the repair work is completed. The insurer then has to pay for the repair work that was completed at an inflated price.

Another example described to the Commission involves the staging of accidents. In this case, individuals, who are usually associated with the repairer, agree to have their vehicle damaged in some way (eg running the vehicle into a wall). The repairer prepares an inflated quote which is approved by an "independent" assessor and is lodged with the insurer after the vehicle has been repaired. In return, vehicle owners may receive some form of compensation (eg cash or a respray of their vehicle).

Scheme design would also have a bearing on the incidence of fraud. If the scheme was extended from a simple one covering only claims involving at-fault identified drivers to a no-fault or modified no-fault compulsory TPPD scheme, the scope for fraud would increase. This would also be the case under a scheme which covered claims involving unidentified drivers. However, irrespective of scheme coverage, insurers would be expected to take action to minimise the scope for fraudulent claims. The CCLS considered that insurers' concerns

relating to fraud were overstated. It considered that fraud would not be a major issue under a compulsory TPPD scheme that covered unidentified drivers, mainly because insurers have had considerable experience in efficiently dealing with fraud issues.

Nominal defendant arrangements

Some compulsory TPPD insurance schemes provide protective cover (ie compensation) to innocent parties in prescribed circumstances not covered by the standard insurance contract (such as accidents involving uninsured or unidentified drivers and/or cases where an insurance claim has been refused due to breach of contract).

In most overseas jurisdictions, protective cover for specified events not covered by the standard contract is provided through nominal defendant arrangements. These arrangements work in different ways. In some cases, claims are managed by a government authority and funded by vehicle owners through registration and/or driver's licence fees or through insurance companies. In other cases, the nominal defendant arrangements are overseen by a government authority which allocates claims directly to insurers for claims management and payment purposes. Such allocations are usually made in proportion to market share.

There are some alternatives to the nominal defendant type approach. Although not common, some overseas jurisdictions require insurers to cover the property damage costs of their clients in the prescribed circumstances. In essence, this approach changes the nature of the basic scheme in the sense that it goes well beyond the fundamental objective of protecting innocent motorists against the actions of financially unaccountable drivers. Another alternative, which would not require regulation, could involve the government "encouraging" insurers to provide the desired cover as part of the standard insurance policy. For instance, insurers could offer policies covering situations involving at-fault *uninsured* drivers (including cases where insurance liability is denied). This would be similar to the UME option currently available with existing TPPD policies.

Coverage

A number of participants considered that the provision of a nominal defendant arrangement would substantially add to the cost of a compulsory TPPD insurance scheme.

Clearly, the more extensive is the coverage provided by a scheme (eg if protective cover is provided for damage covered by unidentified drivers as well as uninsured drivers), the greater is the call on the nominal defendant arrangements. These costs would be passed on to motorists either through

registration and/or driver's licence fees or through higher insurance premiums (if the insurance industry was required to fund the arrangements).

The information available suggests that providing protective cover for accidents involving uninsured drivers would be modest. Currently, such coverage is provided under TPPD with UME at approximately $8 per policy. As a compulsory scheme would reduce the number of claims associated with uninsured motorists, the additional coverage could be provided for considerably less than $8. By contrast, according to data provided by a small sample of insurers, the cost per policy for claims involving unidentified drivers is around $45. Consequently, the costs of providing protective coverage for this contingency would be significant.

Participants also claimed that, as the degree of protective coverage is extended, the scope for fraud increases. However, as noted in the previous section, insurers would be expected to use excesses (and possibly no claim bonuses) to deter minor and frivolous claims (including petty fraud). Moreover, claims managers would be expected to take action to minimise payouts (eg verify claims are not fraudulent, attempt to identify "unidentified" drivers and, where viable, recover costs). Notwithstanding the avenues that would be available to minimise the incidence of fraud, the ability to take recovery action may be limited if there are provisions which require social considerations to be taken into account. Such provisions exist under nominal defendant arrangements for compulsory third party personal injury (CTP) insurance schemes in some states (eg New South Wales).

Level of compliance

The existence of some unregistered, and therefore uninsured motorists, also has the potential to significantly reduce one of the benefits of a compulsory TPPD insurance scheme (ie reducing the costs imposed on innocent third parties).

In a number of overseas jurisdictions, the level of non-compliance with the compulsory TPPD arrangements is quite high. For instance, in New Mexico it is believed to be as high as 40 per cent. In California, between 20 and 25 per cent of motorists are uninsured. However, these high levels of non-compliance reflect particular circumstances in New Mexico and California and are not necessarily indicative of possible non-compliance levels in Australia. The size of the uninsured pool in most of the overseas jurisdictions contacted by the Commission varied between 4 and 10 per cent (see Appendix E).

Based on advice provided by motoring authorities, the proportion of the vehicle fleet that is currently unregistered in Australia is around 2–3 per cent. This suggests that, under a compulsory TPPD insurance scheme, the number of unregistered vehicles involved in accidents where the driver is financially

unaccountable would be relatively small. However, there is a possibility that the obligation to purchase insurance under a compulsory TPPD insurance scheme may increase the number of uninsured vehicles. Some vehicle owners would find the costs of TPPD insurance prohibitive, especially if the payment coincided with existing vehicle registration costs (including CTP).

The lower the assessed risk and cost of being caught without registration relative to the perceived costs of registration, the higher the number of vehicle owners who would choose not to register (and insure). In this situation, it would be necessary to ensure that enforcement provisions are adequate. In particular, the penalties imposed for driving unlicensed or driving an unregistered (and therefore uninsured) vehicle would need to be examined. The penalties for driving an unregistered vehicle in states and territories vary. In the ACT, the fine for driving an unregistered vehicle is approximately one-quarter of the cost of registration. This was also the case in Victoria prior to April 1994. The penalty has since been increased from $110 to $500. The Commission was told that this has led to a considerable reduction in the number of vehicles detected without registration.

The Commission considers that — subject to grace provisions for accidental non-registration — penalties for driving an unregistered vehicle should be sufficient to deter individuals from driving on public roads unregistered. Penalties should significantly exceed the annual cost of registration.

There appears to be scope to substantially improve the monitoring of registration compliance — which is currently the responsibility of police. In particular, parking inspectors could be used — under the current system and also under a compulsory TPPD insurance scheme — to detect unregistered vehicles and to initiate actions against offenders. Unregistered vehicles could be immobilised (eg by using wheel locks), towed away or the number plates could be marked to alert police (as is currently done in the ACT). The Commission understands that, in some regions, demarcation issues (concerning the respective roles of police and parking inspectors) have precluded this option in the past.

If increased penalties for non-registration, together with better enforcement, resulted in a reduction in the number of unregistered vehicles from 3 per cent to just 1 per cent of motor vehicles, state and territory governments would stand to gain around $36 million in vehicle registration charges and taxes (excluding stamp duty). A decline in the number of unregistered vehicles would also reduce the pressures on CTP schemes' nominal defendant arrangements.

Registration compliance and enforcement procedures should be based primarily on considerations of cost-effectiveness. There appears to be scope for increasing compliance with registration requirements at

relatively low cost by expanding the role of parking inspectors to include registration checks.

Adversarial dealings

Some participants argue that under a compulsory TPPD insurance scheme problems would arise because consumers with only TPPD insurance would deal directly with the company which insured the at-fault party. They would have no contractual rights against that company — only the possibility of a common law claim — and would therefore be placed in an adversarial position.

Insurers argue that this problem would be exacerbated where disputes arise over which party was at-fault. Frequently, fault cannot be resolved easily — there is often disagreement over the facts. For these reasons, it is claimed that insurers would be less service oriented, more adversarial and more litigious with respect to third parties making claims against them in an attempt to settle at the minimum possible payout. The RAASA (1990, p. 5) commented:

> Under a compulsory scheme, the innocent owners of damaged cars could face a legal nightmare. With little expertise and all the accompanying unpleasantness they would be forced to argue over liability with the insurer of the other vehicle. The other driver's insurance company would (quite rightly) have the right to protect its client's interests and must attempt to settle any claim at the best possible figure. This can only result in protracted settlements.
>
> The bureaucracy required to administer a system for determining which driver was at fault — whether in the existing court system or before a separate adjudication body — would be costed against the scheme, increasing the cost of insurance ...

The NRMA (1992, p. 3) considers that, typically, a two vehicle accident would involve drawing up an initial letter of demand, followed by considerable correspondence, even if information provided by the two parties is similar. It considers that litigation would probably occur if the stories conflicted. Increased litigation would result in upward pressure on premiums to cover legal costs.

There was also concern that disputes over compensation levels, such as those which arise under CTP schemes, would give rise to considerable legal costs. However, it is not appropriate to compare the costs associated with resolving personal injury claims with the costs that may arise in resolving property damage claims. Personal injury claims can be highly subjective and open-ended. Furthermore, as many claims for personal injury are for tens of thousands (and sometimes hundreds of thousands) of dollars, the average CTP claim is likely to be well in excess of the average compulsory TPPD insurance claim. Consequently, CTP claimants have strong financial incentives to pursue claims and the insurer has an incentive to defend claims. Hence, much of the

cost insurers may face in resolving CTP claims reflects the lengthy negotiations and litigation involved in determining compensation. In contrast, property damage claims are smaller and more readily quantifiable. Generally, the maximum liability is the replacement cost of the vehicle.

To some degree, the problems alluded to by insurers regarding adversarial dealings already exist under the current insurance arrangements. However, several insurers claim that these problems are largely averted through knock-for-knock agreements which generally apply to accidents where both parties are comprehensively insured.[4] Under the knock-for-knock agreements, each participating company undertakes to pay for the repair of damage to its own policyholder's vehicle, even if the other party is at-fault and technically liable for costs. Several insurers considered that the gains and losses associated with this arrangement balance out. As a result, participating insurers benefit from being able to avoid the costs associated with negotiation and/or litigation which would otherwise be incurred in determining liability. The NRMA (1992, p. 2) stated:

> The knock-for-knock agreement ... dramatically cuts the cost of administering claims. By means of this simple system, the majority of insurance companies eliminated all litigation and negligence considerations between them.

Not all insurers have knock-for-knock agreements with other insurance companies. A small proportion use the fault-sensitive "barometer of responsibility" approach. Under this system, insurers agree upon a schedule for apportioning fault under various accident scenarios. This schedule is then used to determine which participating insurer is liable once a claim has been made. Like knock-for-knock agreements, the barometer of responsibility is primarily a means of reducing litigation costs and generally only applies where both parties are comprehensively insured.

Insurance companies claimed that knock-for-knock and barometer of responsibility arrangements would not work under a compulsory TPPD insurance scheme. However, there would appear to be some scope to use knock-for-knock agreements to reduce the level of adversarial dealings and the costs associated with disputes over fault if the insured parties *only* had TPPD insurance. Each insurance company could pay for the repair of its own client's vehicle (where those clients were fault-free), along similar lines to the current knock-for-knock agreements. The at-fault party would receive no compensation if only TPPD insurance was held.

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[4] With around 80 per cent of vehicles being comprehensively insured, the arrangements apply to a significant proportion of accidents.

A possible difficulty arises where there is dispute over fault, or fault is not attributable entirely to one party. Under comprehensive policies, insurers that are party to knock-for-knock agreements know that they will have to pay for the repair of a vehicle, irrespective of fault. Under TPPD policies, though, an insurance company will not proceed to repair a vehicle if it is uncertain about the extent of its liability. This could give rise to delays. A barometer of responsibility type arrangement may assist in these circumstances. Indeed, the Commission was told that some of the major insurers in the Queensland market currently use the barometer of responsibility to attribute fault and liability in cases involving TPPD insurance claims. Notwithstanding this, where agreement could not be reached on attribution of fault, there could be delays to the repair of the innocent party's vehicle or in the payment of compensation (where each party is considered to have been partly responsible for the accident).

Nevertheless, it needs to be recognised that the potential for delays and adversarial dealings because of uncertainty over fault or the attribution of fault exists currently. It arises if an uninsured driver, or a driver with only TPPD cover, claims against an insurance company whose policyholder was at-fault. The Commission was told that generally insurance companies are able to negotiate fault and payment in these instances in a fair and timely manner. This suggests that the costs of disputation over fault are significant enough for companies to pursue more cost-effective solutions.

It is difficult to understand why the same pressures would not give rise to similar outcomes under a compulsory TPPD insurance scheme, particularly given the commercial consequences of being labelled as "slow" to resolve claims or "uncooperative". CAFCA (sub. 25, p. 6) commented that:

> ... the market will take care of the concerns raised by companies ... [and] ... encourage insurers to provide the product on fair, efficient and competitive terms ...

The advice provided by authorities in overseas jurisdictions regarding their compulsory TPPD insurance schemes suggests that adversarial behaviour is *not* a significant problem. Insurance companies in these jurisdictions use various measures to minimise the costs arising from disputation over fault and liability. For instance, the Department of Housing and Consumer Affairs of Nova Scotia commented:

> ... these issues do not seem to create problems. There are about 150 insurers licensed to conduct auto insurance in Nova Scotia and normal market forces operate to keep things in line.

In a number of jurisdictions, legislation (to ensure that insurers do not behave inappropriately) acts as a backdrop to market pressures. For instance, the Bureau of Insurance in Maine, USA commented:

> We have unfair claim practices laws which provide for penalties against insurers who take excessively adversarial stances in claims. Many insurers have signed the intra-company arbitration agreement which solves many problems.

The majority of the insurance industry, including the ICA, provided no comment on the Commission's assessment of the issue of adversarial dealings in the draft report. AAMI (sub. 95, p. 18), in its submission on the draft report, commented that:

> We do not see that a compulsory scheme would ameliorate or cause any particular deterioration in adversarial issues.

If some insurance companies accept that the current knock-for-knock and barometer of responsibility type agreements are cost-effective and reduce the prospect of adversarial dealings, the Commission can see little reason to expect that those companies would not also utilise similar arrangements under a compulsory TPPD insurance scheme.

Bad risks leading to higher premiums

Some insurance companies claim that the current pool of uninsured drivers carries a higher than average level of risk. As a result, it is argued that a compulsory TPPD insurance scheme which brought these people into the insurance pool would result in higher premiums for existing policyholders. The NRMA (1992, p. 4) stated:

> TPPD now is carefully underwritten and offered only to a select group of risks and the premium levels reflect this fact. A compulsory scheme applying to everyone must apply a higher average level of risk and require a higher average price to cover costs.

There is no available information about the risks associated with uninsured drivers. However, even if it is assumed that drivers currently uninsured are "high risk", existing policyholders would only be disadvantaged if the premium paid by currently uninsured motorists under a compulsory TPPD insurance scheme did not reflect the real risk they imposed on the pool. In a competitive market, insurance companies would continue to have strong commercial incentives to assess all drivers for the risk they represent (ie expected liability) and to set premiums to reflect risks under a compulsory TPPD insurance scheme.[5] By differentiating between risks, insurers are able to offer more

[5] Insurers use numerous techniques to determine the risk associated with insuring a driver. The techniques involve consideration of a range of factors, such as the age and driving record of the driver and the type of motor vehicle. In practice, assessing the expected liability associated with insuring an individual is a complicated and information intensive exercise. Consequently, some trade-offs are involved between the benefits of assessing risk completely and the costs of obtaining the necessary information to do so.

competitive premiums for low risk drivers as premiums do not encompass a subsidy element or a loading to cover the costs associated with high risk drivers. Any insurer who did not accurately set premiums and attempted to charge "average" premiums would lose lower risk business to other insurers who did differentiate between risk classes.

Reduced demand for comprehensive insurance cover

A number of insurance companies were concerned about the future of comprehensive insurance as a product if a compulsory TPPD scheme was introduced.

Even if a compulsory TPPD insurance scheme were to reduce demand for comprehensive insurance, this would not be a strong argument against such a scheme. Rather, it would suggest that, before the scheme was introduced, consumers were, in a sense, "overinsuring" their vehicles by purchasing comprehensive cover when they principally required insurance against at-fault financially unaccountable drivers.

However, the available evidence suggests that introducing compulsory TPPD insurance would not reduce demand for comprehensive insurance. Insurers participating in this inquiry advised that comprehensive insurance is considered by most policyholders to be a necessity. This implies that, for there to be a discernible change in the demand for comprehensive insurance, there would have to be a substantial change in its price.

Moreover, comprehensive insurance is purchased for many reasons in addition to protection against at-fault financially unaccountable motorists. It is purchased: to pay for damages arising from accidents where insureds are at-fault; to achieve prompt claim settlement in the event of an accident; for add-on benefits such as the provision of a replacement vehicle; and protection against theft. If these factors were not significant, and the decision to purchase comprehensive insurance mainly reflected concerns about being involved in an accident with an uninsured driver, there would have been a significant shift by comprehensive policyholders into TPPD insurance with the introduction of the uninsured motorist extension. The Commission was advised by several major insurers that there has been no significant shift.

Reducing one (relatively small) area of risk from comprehensive insurance cover — namely, insurance against at-fault uninsured motorists — is unlikely to substantially reduce demand for comprehensive insurance, even if

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Nevertheless, insurers consider that generally they are able to adequately assess risk to enable them to set appropriate premiums.

comprehensive premiums did not fall to reflect the reduced risks. Indeed, it seems more likely that there would be some (probably small) increase in demand for comprehensive insurance under a compulsory TPPD insurance scheme because of the likelihood of comprehensive premiums falling to reflect the reduced cost of covering accidents with at-fault financially unaccountable drivers.

Equity considerations

Some vehicle owners might not be able to register and legally drive their vehicle because they could not afford compulsory TPPD insurance. The FCLC (transcript, pp. 259–60) considered that this would be a desirable outcome for high risk drivers and commented:

> ... that's their problem and that's a consequence of their bad driving history. .... [It is] better that that person pay ... or sell their car and give up driving ... driving is not a right or owning a vehicle is not a right, it's a privilege.

From the community's perspective, this outcome could be beneficial in terms of a reduced accident rate. However, a number of participants contended that governments would be concerned about, first, the prospects of relatively high insurance premiums resulting in higher numbers of unregistered (and uninsured) vehicles on the roads and, second, the financial hardship which high premiums would impose on some low income vehicle owners. In these circumstances, many insurers consider that governments would introduce measures to make insurance accessible to everyone. Indeed, with respect to CTP insurance the New South Wales government (sub. 113, p. 10), commented that there is:

> ... a need to keep premiums affordable (because the cover is compulsory, and therefore must be reasonably available for all vehicles and all owners, regardless of circumstance).

A range of approaches could be used to make insurance accessible to low income/high risk drivers. They include premium regulation and mandating that insurance companies insure all risks (see Appendix E). Premium regulation applies to compulsory TPPD insurance schemes in some other countries and parallels can be drawn with the various CTP insurance schemes operating in Australia — all of which constrain insurers' ability to vary premiums according to risk. Where the latter approach has been used overseas, insurance companies have established insurance pools to cover persons who would normally be considered unacceptable risks. The costs associated with these pools are usually pro-rated over the industry.

Making insurance accessible to everyone would involve a subsidy to some high risk motorists (ie they would not pay a premium which reflected the expected

liability they imposed on the insurance pool). Any subsidy to high risk motorists would have to be recouped by charging higher premiums to other vehicle owners (ie cross-subsidisation).[6] In these circumstances, previously insured vehicle owners would no longer have to carry the cost of financially unaccountable drivers, but they would incur the cost associated with making insurance accessible to high risk vehicle owners. Moreover, any benefits associated with reducing accident rates by inducing motorists to drive more safely would be muted or eliminated because premiums would no longer be an accurate reflection of risk.

Administrative costs and complexities

A number of participants raised concerns about the administrative costs associated with establishing and running a compulsory TPPD insurance scheme. For instance, AAMI (1994, pp. 4–5) commented:

> ... the administrative cost of running the scheme ... together with set up costs ... will obviously be substantial having regard to the necessary bureaucracy and the development of software, hardware and systems.

In support of their claim, participants highlighted the costs associated with operating CTP schemes. Most jurisdictions have a dedicated statutory authority responsible for administering the relevant CTP legislation. In states where CTP is provided by insurers (ie New South Wales and Queensland), the responsibilities of these authorities include: public education programs; advice to insurers and the public; maintenance of databases; supervision of insurers; and assessment of suitability of new entrants to the insurance market. In New South Wales, administration costs incurred by the Motor Accidents Authority amounted to $3.6 million in 1992–93.[7] There are also additional administration costs borne by insurers in the provision of CTP insurance. In most other jurisdictions, government authorities are involved not only in the administration of CTP schemes, but also in the provision of CTP insurance. In Victoria, the Transport Accident Commission spent $48.4 million on the provision and administration of CTP insurance.[8]

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6 Insurers could limit their exposure to high risk drivers by limiting the types of insurance they offer to products where the premium was not regulated (eg offering comprehensive insurance but not TPPD insurance). This potential problem has been addressed in most overseas jurisdictions by requiring insurers to provide TPPD insurance which meets the requirements set down by government.

7 Excludes $6.5 million spent on awareness programs and rehabilitation grants.

8 Excludes $43.6 million spent on accident prevention programs and contributions to rehabilitation and trauma centres.

Establishing additional statutory authorities to administer compulsory TPPD insurance schemes would clearly involve considerable administrative costs. However, there may be scope for the one authority in each jurisdiction to be responsible for the administration of both CTP and compulsory TPPD insurance. Nevertheless, additional staff, equipment and furniture, building space, and larger travel and legal fee budgets would be needed.

In addition to the costs faced by governments in administering compulsory TPPD insurance, insurers would face costs in complying with the relevant requirements (eg meeting the reporting requirements of the authority and complying with nominal defendant arrangements). However, insurers would benefit from some cost reductions (eg legal costs associated with pursuing financially unaccountable drivers).

Insurers noted that they could face other administration costs if the form of compulsory TPPD insurance scheme differed between states and territories (assuming all states/territories introduced a scheme). For example, a national insurer would probably have to establish different administrative procedures to comply with the requirements of each jurisdiction.

There would also be costs in ensuring compliance. Overseas, compliance with compulsory TPPD insurance is usually assessed when vehicles are registered and/or drivers' licences are obtained or renewed. On the surface, the use of the existing motor vehicle registration infrastructure would appear to avoid the need to establish a new system to track compliance. However, some additional complexities were highlighted by insurers:

Catering for self-insurers. Currently some parties choose to self-insure their vehicles and are financially accountable for damage they cause to third parties (eg government departments and authorities and large companies). If imposing insurance obligations on such parties was deemed undesirable, a cost-effective system would need to be devised to assess and guarantee the "financial accountability" of parties that wish to self-insure.

Changes in vehicle ownership. Currently, when vehicles change ownership there is a grace period (usually 7–14 days) during which time the new owner is obliged to inform the authorities of the ownership change. Under a compulsory scheme, a vehicle may not have TPPD insurance cover during this period. The potential for accidents involving such vehicles is significant given that, in Victoria alone, there were approximately 700,000 vehicle transfers in 1994. If accidents involving these uninsured but registered vehicles were not covered by the nominal defendant arrangements (if any), another safeguard would have to be introduced.

Policy cancellation. If the right of consumers to cancel policies mid-term is to be preserved, a mechanism would be needed to verify that a replacement policy was obtained prior to cancellation. Where vehicle ownership is transferred, it may be necessary to require a Notice of Transfer to be presented to authorities before cancellation of the first policy was allowed.

Registration and insurance coverage relating to different periods. It is not uncommon for registration coverage and property insurance coverage to relate to different periods. This suggests that authorities would either have to police the reinsurance of vehicles where coverage dates differ or attempt to move to a system where coverage dates coincide, irrespective of whether policies attach to vehicles or drivers. Coordinating coverage dates would be further complicated where vehicles change hands and consumers cancel policies.

While solutions to these difficulties would not be expected to entail significant administrative costs over and above the current motor vehicle registration/licensing system, they may impose costs on vehicle owners (eg the time and effort involved in presenting evidence of a current policy after a policy cancellation or a vehicle purchase).

If the costs of using existing registration systems, or slightly modified versions of the present systems, to administer compulsory TPPD insurance schemes were considered to be prohibitive, then it may be possible to utilise other less burdensome or "light-handed" approaches. A "light-handed" compulsory scheme could simply make it a legal requirement that all vehicle owners insure their vehicles. Penalties (eg fines and/or loss of demerit points) would be imposed on owners who were found not to have obtained the minimum insurance cover (as specified in the relevant regulations) for their vehicle. Compliance could be monitored by police in the course of performing road traffic duties. Minimal administrative costs would be associated with establishing and running such a scheme.

Summary

There are many possible forms that a compulsory scheme could take. The preceding discussion has highlighted a range of design factors that would be critical in considering the merits of a compulsory scheme. It also points to the strong likelihood that some of the concerns raised by insurers are overstated. The key points arising from the discussion are:

- While the *scope* for petty fraud and frivolous claims increases as scheme coverage is extended (eg to cover accidents involving unidentified drivers), provided insurers continue to have the flexibility to utilise co-insurance (eg no claim bonuses), deductibles (eg excesses) and

investigative techniques, there is unlikely to be a marked increase in petty fraud or frivolous claims.

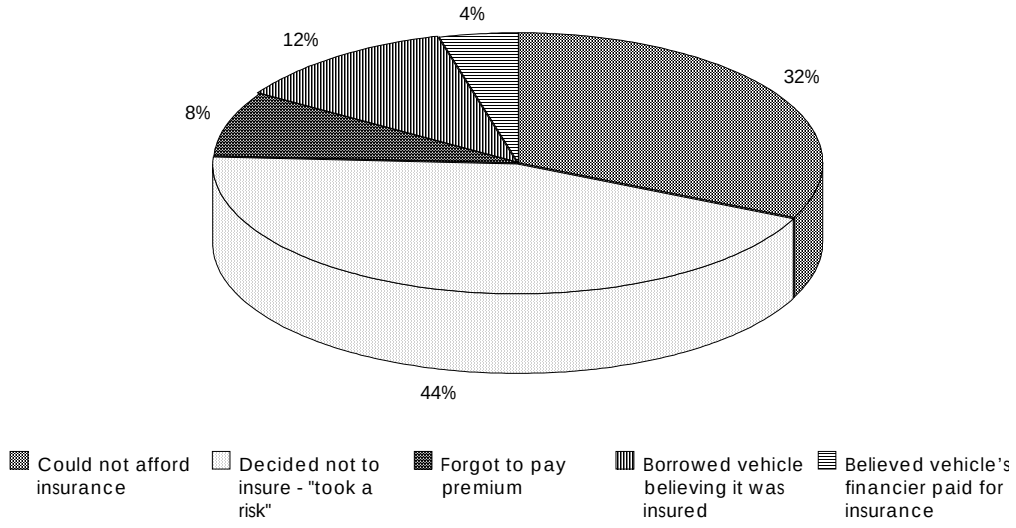
- It is unlikely that the introduction of a compulsory scheme would lead to a marked increase in professional fraud, irrespective of scheme coverage.
- There would appear to be relatively low cost avenues available to authorities to ensure high levels of compliance with a compulsory scheme.
- Provided high compliance levels can be obtained, the cost of providing protective cover for accidents involving uninsured drivers would be significantly less than the cost impost associated with providing protective cover for accidents involving unidentified drivers.
- As the level of compliance with a compulsory scheme falls, the benefits of a scheme decrease, and the cost associated with providing protective cover against damage caused by uninsured motorists (if required) increases.
- Knock-for-knock, barometer of responsibility and other arrangements used by many insurance companies to reduce costs and adversarial dealings would be unlikely to break down if a compulsory scheme was introduced.
- Limiting insurers underwriting flexibility (eg premium regulation and/or denying insurers the right to refuse to insure) would give rise to cross-subsidies between drivers and offset, if not outweigh, the benefits associated with introducing a compulsory scheme.
- Provided insurers continue to have underwriting flexibility, introducing additional risks to the insurance pool would not, in itself, give rise to increased premiums for motorists who had insurance under the existing voluntary arrangements.
- Administrative costs and complexities are highly susceptible to scheme design. Insurers and consumers are likely to incur some costs in complying with relevant arrangements. As these administrative and compliance costs increase, the benefits of removing the transfer (between innocent and financially unaccountable drivers) will dissipate.

8.2.2 Education

There is some evidence which suggests that a significant proportion of drivers involved in accidents and not covered by TPPD insurance do not intentionally drive without insurance cover. For instance, surveys of New South Wales motorists have found that between 4 and 10 per cent believe that CTP covers them for property damage. Based on a sample of files, CAFCA found that around one in four drivers who had incurred a debt as a result of an accident had either forgotten to pay the premium, borrowed a vehicle which they thought was

covered by insurance or thought the financier had paid for the insurance (see Figure 8.1).

Figure 8.1: Reasons for non-insurance



Source: CAFCA, sub. 25

Insurance companies have a commercial incentive to advertise the legal/financial liability of at-fault drivers and the protection provided by different types of insurance. However, the statistics outlined above suggest that additional education programs could be of benefit.

AAMI (1994, pp. 16–17) submitted to the South Australian Inquiry on compulsory TPPD:

> It must be conceded that the uninsured motorists figures indicate that the education initiatives taken thus far have not been successful ... Our market research shows that the public has little more than superficial knowledge about insurance generally, not just third party property damage ... Education needs to be ongoing and jointly pursued by government and the industry in a properly structured fashion.

In its response to the draft report, the ICA (sub. 89, p. 1) commented that:

> As a strong and workable alternative to compulsory TPPD insurance, [the] ICA believes that problems imposed on Australian society by the uninsured motorist can be addressed more efficiently and practically by a vigorous program of public eduction.

The ICA considered that an education program should aim to:

- emphasise the financial responsibility associated with driving a motor vehicle;

- explain the types of insurance available, distinguishing between CTP insurance and property damage insurance;
- illustrate the low cost of insurance; and
- advise how and where TPPD insurance can be purchased.

Eduction programs of the type proposed by the ICA would encourage individuals to check that the vehicle they drive has some form of TPPD cover. Vehicle owners may also reconsider their decision not to insure if the implications of being an at-fault driver without insurance are highlighted.

While acknowledging the potential benefits of an education program, consumer groups (ie CLCV, CAFCA and CCLS) considered that they were only a partial solution. They questioned whether education programs would make a significant difference to the number of motorists driving uninsured vehicles.

8.2.3 Licence revocation

It has been suggested that driver's licence revocation should be introduced to increase the accountability of drivers. For instance, a driver's licence could be cancelled for a certain period (eg for a number of years or until the debt is repaid) if a driver could not satisfy a damage claim. This would impose costs on otherwise financially unaccountable drivers and may induce them to purchase insurance and drive more safely.

While community groups considered that this option may serve as a useful adjunct to a compulsory scheme, they considered that, as a stand alone measure, it would not be particularly effective as it was really an "after the event" process. The CLCS also commented (transcript, p. 839):

> If it is worthwhile trying to prevent uninsured drivers being on the road, then it ought to be done at the registration phase when the maximum it will cost them to register is a few hundred dollars extra.

However, the objective of licence revocation would not just be to prevent uninsured people from driving or to penalise offenders. Rather, it would be to provide a signal that the community considers the problems associated with financially unaccountable drivers to be unacceptable. To this end, licence revocation can be viewed as a means of encouraging *all* drivers to comply with the existing requirements, just as it does with drink-driving. In this respect, the CCLS (transcript, p. 910) commented that it did not:

> ... have a particular difficulty with the penalty itself in the sense of revocation of the licence. It is a serious issue and ... sending a signal is appropriate.

However, there was some concern expressed by community groups that the penalty may be too severe. In contrast, the MTAA (sub. 93, p. 4) doubted:

> ... that this proposal [licence revocation] secures the appropriate level of redress that may be required as the penalty is insufficient.

The MTAA was supportive of licence revocation, provided the process adopted provided proper checks and balances and consideration was given to due process and natural justice.

8.2.4 Increased rate flexibility under CTP schemes

As noted in Section 8.2.1, a possible benefit of a compulsory TPPD insurance scheme is a decline in accident rates because the threat of higher premiums, which would generally be associated with an accident, would induce people to drive more safely. Another means of introducing this incentive is via the CTP arrangements currently applying in all states and territories. For this incentive to be effective, premiums would need to reflect the risks associated with insuring individual classes of driver. However, CTP rates are regulated in all jurisdictions and, as a consequence, insurers have very limited flexibility in rate setting. For instance, New South Wales regulations require CTP premiums to be within 10 per cent of the rate determined by the Motor Accidents Authority. In addition to blunting the potential incentives to drive more safely, such regulation also has the effect of "taxing" low risk drivers to pay for high risk drivers.

Further examination of the CTP schemes operating in Australian states and territories is beyond the scope of this inquiry. However, because of the important implications of the rate regulations which apply, the Commission considers that the CTP schemes should be subject to review.

8.3 The Commission's view

Financially unaccountable drivers impose costs on other drivers and may themselves suffer significant financial hardship as a consequence of a motor vehicle accident. A number of options have been raised with a view to overcoming these problems. By far the most extensive of these options is the suggestion that governments should introduce arrangements that make it compulsory for motorists to have TPPD insurance. By comparison, the other measures that have been proposed — education, licence revocation and increased rate flexibility under CTP schemes — are more partial in nature.

The proposition that governments introduce compulsory TPPD schemes to overcome the problems associated with financially unaccountable drivers has generated considerable debate. Overseas experience indicates that there are many possible forms a scheme could take. Unfortunately, proponents of such schemes in Australia have not detailed the type of scheme that they would prefer. In the absence of particulars of scheme design, much of the debate about the merits of a compulsory scheme has been at cross purposes and has not focused on ways of reducing costs. This has clouded and handicapped the debate. In this respect, the Commission considers that many of the concerns raised by insurers are overstated and others would be overcome if the compulsory scheme was designed appropriately.

The Commission has isolated what it considers would be the necessary preconditions of a scheme in order for it to be effective and efficient. These features include:

- ensuring high, but not necessarily total, levels of compliance with the compulsory requirements;
- maintaining insurers' underwriting flexibility (eg freedom to set premiums and refuse to insure);
- allowing insurers to continue to utilise co-insurance, deductibles and investigative techniques as methods of deterring/detecting fraud and frivolous claims; and
- ensuring there are strict penalties for insurers that deal with third parties in an unacceptably adversarial manner.

In addition to the features listed above, it would be necessary to contain administrative and compliance costs so that they do not exceed the benefits associated with a compulsory scheme.

In the Commission's view, a scheme that kept government involvement to a minimum would be low cost and effective. One low cost option would involve government legislation being restricted to a requirement that vehicle owners insure their vehicle and penalties for non-compliance, with compliance being be monitored by the police in the course of performing road traffic duties.

There would be benefits to the community from a "light-handed" compulsory TPPD insurance scheme that simply imposed an obligation on vehicle owners to obtain TPPD insurance, with compliance being monitored by police.

A "light-handed" approach would not address all the concerns raised by proponents of a compulsory TPPD insurance scheme (eg consumer groups). Moreover, insurers are adamant that at least one of the preconditions,

maintaining insurers' underwriting flexibility, would be violated as part of the political processes involved in establishing and maintaining the scheme. They cited the experience with Australian CTP insurance and compulsory TPPD schemes overseas where the compulsory nature of insurance has given rise to calls for premium regulation to ensure that insurance is "available to all". If this were to occur, the benefits associated with a scheme would be significantly undermined, possibly to the point where the scheme imposed net costs on the community.

It would be inappropriate for state/territory governments to introduce a compulsory TPPD scheme in any form that limited insurers' underwriting flexibility.

The problems associated with financially unaccountable drivers are not large. They could be addressed by the "light-handed" compulsory TPPD scheme described by the Commission. However, with or without such a scheme, governments should consider using other measures. For instance, governments could support efforts by the insurance industry to undertake education programs advising motorists of their legal/financial liabilities for property damage arising from vehicle accidents. One low cost avenue would be to include relevant information provided by insurers as part of vehicle registration and drivers' licence renewal material. Vehicle registration and drivers' licence renewal (application) forms could require vehicle owners/motorists to acknowledge that they understand their potential legal/financial responsibilities when driving an uninsured vehicle.

The incentives for uninsured motorists to take out TPPD insurance would be increased if governments gave registration authorities the ability to revoke the drivers' licences of at-fault financially unaccountable drivers. While governments should initially advertise the implications of this policy, one would expect insurers to draw the policy to the public's attention with a view to attracting business from vehicle owners who did not insure their vehicles.

The insurance industry, with the support of motor traffic authorities, and in consultation with consumer groups, should develop a targeted education program aimed at advising motorists of their legal/financial responsibilities in the event of an accident where they were responsible. Motor traffic authorities should redesign registration and drivers' licence documentation with a view to ensuring that drivers are better informed of their responsibilities. Governments should also give registration authorities the ability to revoke the licences of at-fault financially unaccountable drivers.

A INQUIRY PROCESS

A.1 Inquiry participants

Organisations and individuals who made submissions to the inquiry are listed below. Participants marked * presented submissions at public hearings. The remainder made written submissions only.

Participants	Submission No.
3M Australia Pty Limited*	86
ACT Consumer Affairs Bureau and Department of Urban Services, Roads and Transport Section	48
Allied Panelcare Pty Ltd*	39, 45
Amex Panels Pty Ltd	29, 107
Association of Risk and Insurance Managers of Australasia Limited*	17
Australian Academy of Design*	111
Australian Associated Motor Insurers Limited*	30, 95, 96
Australian Automobile Association*	41, 61
Australian Automotive Aftermarket Association Ltd	64
Australian Industrial Property Organisation	49
Australian Industrial Truck Association	69
Australian Institute of Loss Adjusters Ltd	7
Australian Manufacturing Workers' Union	114
Australian Paint Manufacturers' Federation Inc	65
Australian Road Research Board Ltd	66, 108
Automotive, Food, Metal and Engineering Union, Vehicle Division	14
Bayley, Mr John	105
Bemak Assessing & Investigations Pty Ltd	28
Bloffwitch, Mr Bob, MLA.	42

Woods Williams Pty Ltd 76

A.2 Visits and discussions

Location	Individual, Company or Organisation
New South Wales	Australian Consumers Association
	Australian Law Reform Commission
	Boating Industry Association of NSW
	G.I.O. Australia Ltd
	Institute of Automotive and Mechanical Engineers (Inc)
	Motor Vehicle Repair Industry Council
	NRMA Insurance Limited
	New South Wales Department of Consumer Affairs
Victoria	Amex Panels Pty Ltd
	Australian Associated Motor Insurers Limited
	Australian Automotive Aftermarket Association Ltd
	Boating Industry Association of Victoria Limited
	Club Marine Limited
	Ford Motor Company of Australia
	Insurance Council of Australia Limited
	Manufacturers Mutual Insurance Ltd
	National Road Transport Commission
	RACV Insurance Pty Ltd
	Sirius Insurance
	Toyota Motor Corporation Australia Limited
	Vicroads
	Victoria Police
	Victorian Automobile Chamber of Commerce, Towing Operators Division

Queensland	Criminal Justice Commission
	Queensland Department of Consumer Affairs
	Queensland Department of Transport
	RACQ Insurance Pty Limited
	Suncorp Insurance and Finance
Western Australia	Car Craft Panel & Paint Pty Ltd
	Ministry of Fair Trading
	Mr Bob Bloffwitch MLA, Chairman of the Motor Vehicle Repair Industry Review Committee
	Royal Automobile Club of Western Australia Inc
Australian Capital Territory	Australian Automobile Association
	Australian Law Reform Commission
	Federal Bureau of Consumer Affairs
	Federal Chamber of Automotive Industries
	Federal Office of Road Safety
	Federation of Automotive Products Manufacturers
	Insurance and Superannuation Commission
	Motor Trades Association of Australia
	Trade Practices Commission

Overseas Visits

United Kingdom	Department of Trade and Industry
	Office of Fair Trading
	Royal Automobile Club
OECD	Insurance Committee

B INDUSTRY AND MARKET STATISTICS

This appendix provides some summary statistical tables of the motor vehicle insurance and repair industries. The tables are as follows:

Table B.1: Motor vehicle retailing and services, Australia, 1991–92

Table B.2: Concentration of total premiums, private sector direct underwriters, by state, 1993

Table B.3: Private direct insurers writing business, by class, by state, year ending 30 June 1993

Table B.4: General insurance industry financial aggregates, Australia, 1981–92

Table B.5: General insurance industry financial aggregates, Australia, 1981–91

Table B.6: General insurance industry market shares, Australia, 1992

Table B.7: Motor vehicle insurance industry, selected statistics, Australia, 1984–93

Table B.8: Marine insurance industry, selected statistics, Australia, 1984–93

Table B.9: Indexes of selected motoring components of CPI, 1984–94

Table B.10: Average weekly household expenditure on motor vehicles and motor vehicle operating costs, Australia, 1988–89

Table B.11: Comparative costs of common parts, by vehicle type

Table B.12: Average cost of servicing a common family sedan, by type of repair establishment

Table B.13: Motor Vehicle Repair Industry Disputes Committee of NSW, orders and determinations, 1993–94

Table B.14: Motor Vehicle Repair Industry Disputes Committee of NSW, cause of dispute by repair type in disputes where repairer determined at fault, 1993–94

Table B.15: Motor vehicle theft, Australia, 1975–92

Table B.16: Contributing factors to vehicle accidents, Queensland, 1991–93

Table B.17: Number of registered designs for vehicles and parts, Australia, 1987–93

Table B.1: Motor vehicle retailing and services, Australia, 1991–92

Description	*Locations*	*Persons employed*	*Wages and salaries*	*Turnover*	*Turnover per person employed*
	No.	No.	$m	$m	$
Car retailing	4 028	51 464	1 315	22 525	437 679
Motor cycle dealing	848	3 548	52	607	171 010
Trailer and caravan dealing	302	1 308	21	225	172 168
Total motor vehicle retailing	5 178	56 320	1 387	23 357	414 714
Automotive fuel retailing	7 845	52 216	600	11 404	218 407
Automotive electrical services	1 818	7 109	101	491	69 129
Smash repairing	6 701	32 995	561	2 197	66 590
Tyre retailing	2 138	11 220	228	1 985	176 902
Automotive repairs and service n.e.c	13 992	55 338	752	4 259	76 970
Total motor vehicle services	32 494	158 878	2 241	20 337	128 005
Total motor vehicle retailing and services	37 672	215 198	3 629	43 694	203 040

Source: ABS (1994) Cat. No. 8622.0

Table B.2: Concentration of total premiums, private sector direct underwriters, by state, 1993 (per cent)

State	*Commercial motor vehicle insurers*		*Domestic motor vehicle insurers*		*Marine hull insurers*	
	Top 5	*Top 10*	*Top 5*	*Top 10*	*Top 5*	*Top 10*
NSW	37	63	86	94	53	73
Vic	48	69	73	87	79	90
Qld	51	74	64	81	63	85
WA	49	76	67	84	63	86
SA	47	74	52	76	63	84
Tas	70	93	65	86	74	94
ACT	75	98	90	98	91	100
NT	67	92	68	93	91	98
Australia	36	63	63	77	55	87

Source: ISC

Table B.3: Private direct insurers writing business, by class, by state, year ending 30 June 1993 (number)

State	*Commercial motor vehicle insurers*	*Domestic motor vehicle insurers*	*Marine hull insurers*
NSW	49	51	48
Vic	45	52	41
Qld	38	46	37
WA	36	44	38
SA	38	43	34
Tas	24	33	25
ACT	14	19	13
NT	16	16	17

Source: ISC

Table B.4: General insurance industry financial aggregates, Australia, 1981–92 ($ million)

Year	*Direct premium*	*Earned premium*	*Under-writing results*	*Invest-ment and other income*	*Taxation*	*Net profit after tax*	*Surplus of assets over liabilities*
1981	4 939	3 559	(610)	749	57	82	2 674
1982	6 109	4 286	(836)	932	18	78	3 061
1983	7 116	5 202	(818)	1 172	103	251	3 316
1984	7 958	5 982	(1 320)	1 351	144	(95)	3 080
1985	8 387	6 668	(1 727)	1 957	156	107	3 171
1986	9 352	7 409	(2 580)	2 251	178	(475)	2 080
1987	10 236	8 057	(3 204)	4 234	219	827	3 168
1988	11 110	9 031	(1 035)	2 117	350	858	4 151
1989	12 249	10 095	(2 979)	2 512	233	(411)	2 927
1990	14 337	11 963	536	2 519	153	3 014	4 588
1991	14 390	12 351	(1 413)	2 739	94	1 294	6 671
1992	13 505	13 281	(1 797)	3 473	58	1 697	5 890

Note: Brackets indicate negative outcomes.
Source: AIA (1992; 1993)

Table B.5: General insurance industry financial aggregates, Australia, 1981–91 (per cent)

	Total industry				*Total private*			
	Claims expenses to earned premiums	*Underwriting expenses to earned premiums*	*Underwriting results to earned premiums*	*Net profits to net average funds*	*Claims expenses to earned premiums*	*Underwriting expenses to earned premiums*	*Underwriting results to earned premiums*	*Net profits to net average funds*
1981	93.6	23.5	(17.1)	3.1	89.7	31.3	(21.0)	(7.3)
1982	96.5	23.0	(19.5)	2.5	87.0	30.0	(17.0)	0.0
1983	93.7	22.0	(15.7)	7.6	82.4	28.5	10.9	10.0
1984	100.9	21.1	(22.1)	(3.1)	83.5	27.1	(10.6)	9.9
1985	104.8	21.1	(25.9)	3.4	86.7	26.3	(13.0)	10.0
1986	112.8	22.0	(34.8)	(22.8)	89.2	29.0	(18.2)	11.1
1987	117.0	22.6	(39.7)	26.1	85.4	29.4	(14.8)	10.1
1988	88.1	23.3	(11.5)	20.7	78.7	33.2	(12.0)	9.3
1989	104.8	24.8	(29.5)	(14.0)	78.1	34.2	(12.4)	13.6
1990	70.4	25.2	4.5	65.7	85.1	31.0	(16.1)	5.5
1991	86.4	25.1	(11.4)	19.4	83.6	31.6	(15.2)	6.4

Source: AIA (1992)

Table B.6: General insurance industry market shares, Australia, 1992[a]

Class of insurance	*Total direct premium*	*Private sector companies*				*Government offices*	
		Australian owned		*Foreign owned*			
	$m	$m	% of total	$m	% of total	$m	% of total
Fire	973	341	35.0	593	60.9	39	4.0
House owners	1 501	689	45.9	640	42.6	172	11.5
Contractors	59	23	39.0	34	57.6	2	3.4
Marine	223	96	43.0	118	52.9	9	4.0
Motor	2 977	1 856	62.3	927	31.1	194	6.5
Compulsory third party	2 142	634	29.6	250	11.7	1 258	58.7
Employers' liability	3 210	249	7.8	47	1.5	2 914	90.8
Public liability	793	447	56.4	323	40.7	23	2.9
Other	930	277	29.8	591	63.5	62	6.7
Total	12 808	4 613	36.0	3 522	27.5	4 673	36.5

a Excluding reinsurers and mortgage insurers

Source: AIA (1993)

Table B.7: Motor vehicle insurance industry, selected statistics, Australia, 1984–93 ($'000)

	1983–84	*1984–85*	*1985–86*	*1986–87*	*1987–88*	*1988–89*	*1989–90*	*1990–91*	*1991–92*	*1992–93*
Private Sector										
Earned Premiums	962 882	1 045 670	1 223 726	1 410 941	1 702 676	1 828 868	2 046 145	2 153 388	2 289 320	2 572 203
Claims incurred	756 556	856 065	1 175 845	1 376 202	1 405 674	1 580 916	1 912 945	1 985 251	1 924 258	2 068 060
Expenses	236 476	251 731	319 784	364 970	436 630	477 013	543 768	563 336	586 521	582 945
Underwriting result	(30 159)	(62 126)	(217 903)	(330 231)	(184 628)	(229 061)	(410,560)	(395 170)	(221 459)	(78 801)
Loss Ratio (%)	79	82	96	98	85	86	93	92	84	80
Expense Ratio (%)	25	24	26	26	26	26	27	26	26	23
Commission	57 493	59 756	79 026	88 638	106 834	109 442	118 932	126 168	138 863	158 236
% Commission	6	6	6	6	6	6	6	6	6	6
Public Sector										
Earned Premiums	248 090	262 109	276 456	317 946	380 218	418 852	439 316	464 742	465 290	174 564
Claims incurred	191 063	216 977	258 592	280 244	306 974	338 859	392 586	414 364	427 890	169 099
Expenses	55 172	62 471	70 946	80 900	91 990	100 226	110 021	81 621	55 979	39 604
Underwriting result	1 855	(17,339)	(53 082)	(43 199)	(18 752)	(20 234)	(63 290)	(51 365)	(18 580)	(34 138)
Loss Ratio (%)	77	83	94	88	81	81	89	89	92	97
Expense Ratio (%)	22	24	26	25	24	24	25	18	12	23
Commission	6 089	6 287	7 022	8 953	18 095	19 056	19 731	18 101	21 075	7 640
% Commission	2	2	3	3	5	5	4	4	5	4

Note: Public sector insurers voluntarily submit unaudited data for statistical purposes only.
Source: ISC (sub. 55)

Table B.8: Marine insurance industry, selected statistics, Australia, year ending 30 June, 1984–93 ($'000)

	1983–84	*1984–85*	*1985–86*	*1986–87*	*1987–88*	*1988–89*	*1989–90*	*1990–91*	*1991–92*	*1992–93*
Private Sector										
Earned Premiums	124 871	135 767	156 718	190 267	204 253	222 505	229 947	226 323	218 786	234 627
Claims incurred	81 383	87 200	104 221	124 623	137 740	152 244	164 761	191 120	177 981	186 038
Expenses	36 123	43 038	46 858	59 830	64 966	72 893	76 736	78 060	69 422	68 884
Underwriting result	7 366	5 528	5 639	5 814	1 547	(2 632)	(11 551)	(42 857)	(28 617)	(20 296))
Loss Ratio (%)	65	64	67	65	67	68	72	84	81	79
Expense Ratio (%)	29	32	30	31	32	33	33	34	32	29
Commission	10 012	14 459	17 548	22 440	23 742	29 165	34 305	36 856	37 032	38 608
% Commission	8	11	11	12	12	13	15	16	17	16
Public Sector										
Earned Premiums	7 282	7 980	7 159	7 203	8 421	10 390	10 485	11 817	9 622	10 154
Claims incurred	5 189	5 652	4 699	4 027	7 745	8 748	4 662	9 815	11 377	na.
Expenses	2 647	2 944	2 947	2 370	3 254	4 225	4 649	1 487	3 255	4 713
Underwriting result	(555)	(616)	(486)	806	2 578	(2 583)	1 174	(1 152)	(5 010)	4 688
Loss Ratio (%)	71	71	66	56	92	84	44	83	118	na
Expense Ratio (%)	36	37	41	33	39	41	44	13	34	466
Commission	392	920	695	424	539	614	667	160	294	860
% Commission	5	12	10	6	6	6	6	1	3	8

na Not available.

Note: Public sector insurers voluntarily submit unaudited data for statistical purposes only.

Source: ISC (sub. 55)

Table B.9: Indexes of selected motoring components of CPI, 1984–94[a] (1989–90 = 100)

CPI component	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*
Vehicle insurance	55.1	58.4	69.1	82.3	88.4	94.7	103.3	105.5	108.2	107.9	116.7
Vehicle servicing repairs and parts	67.2	71.3	79.1	86.8	92.3	97.0	103.9	108.9	109.9	111.4	113.3
Motoring charges	75.6	80.9	85.8	95.0	95.4	98.5	102.9	110.9	117.4	128.2	131.8
Motor vehicles	57.6	63.1	73.3	84.5	92.6	98.0	100.3	102.5	105.6	111.6	115.6
All groups	66.0	70.4	76.8	90.0	89.4	96.1	103.1	106.5	107.5	109.5	111.5

a Weighted average of eight capital cities.
Source: ABS (1995) Cat. No. 6401.0

Table B.10: Average weekly household expenditure on motor vehicles and motor vehicle operating costs, Australia, 1988–89 ($ per week)

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*NT*	*ACT*	*Aust-ralia*
Compulsory registration and insurance of motor vehicles	8.00	5.95	6.51	5.50	6.18	5.84	4.66	7.86	6.74
Other insurance	5.61	5.54	3.78	4.72	4.61	3.66	3.27	5.77	5.04
Compulsory registration and insurance of motor cycles, caravans and trailers	0.25	0.16	0.31	0.28	0.32	0.20	0.17	0.21	0.24
Other insurance of motor cycles, caravans and trailers	0.06	0.10	0.08	0.12	0.11	0.03	0.04	0.05	0.08
Motor vehicle electrical accessories (purchased separately)	0.29	0.17	0.25	0.66	0.42	np	np	np	0.29
Vehicle parts (purchased separately)	3.86	3.39	2.93	3.59	3.58	2.59	2.26	3.56	3.48
Vehicle accessories (purchased separately)	0.65	0.93	0.52	0.56	0.49	0.29	3.51	0.90	0.69
Crash repairs	0.34	1.33	0.73	np	0.69	np	np	np	0.66
Vehicle servicing (including parts and labour)	8.28	8.12	8.21	5.90	6.41	5.94	10.4	10.72	7.82
Motor vehicle purchase	19.47	20.89	17.89	23.44	17.95	17.25	18.45	22.39	19.77

np Not published.

Source: ABS (1994) Cat. No. 6535.0

Table B.11: Comparative costs of common parts, by vehicle type ($A)

Part	*Mercedes - Benz 500SL*	*Holden Commodore*	*Ford Falcon*	*Mitsubishi Magna*	*Mazda 626 V6*
Engine	39 087	16 050	11 815	10 166	26 530
Radiator assembly	4 852	1 396	1 568	1 096	2 950
Muffler	738	223	112	328	404
Bonnet panel	2 110	300	364	300	537
Bonnet lock cable	41	16	15	11	28
Bumper cap (front)	2 444	223	187	192	809
Bumper total (front)	2 632	364	250	422	1 297
Grille	2 304	29	64	99	214
Headlamps	2 909	458	381	1 478	1 700
Front guard panel	352	165	147	217	374
Left front door (total)	3 622	1 479	1 194	2 413	4 254
Left rear quarter panel	1 043	200	204	253	589
Tail lamps	772	212	334	364	739
Bumper total (rear)	1 938	403	459	641	1 386
Boot floor	6 085	1 175	1 048	804	354
Fuel filler cap	9	na	na	11	31
Fuel filler flap	59	8	na	71	42
Boot lid or liftgate	1 011	282	354	253	831
Mudflap (rear)	na	na	16	28	80
Door mirror (right)	707	65	65	186	275
Door glass (right)	283	102	120	68	146
Windscreen glass	808	276	297	255	371
Washer bottle and cap	65	28	12	32	196
Wiper arm (left)	118	16	19	51	67
Wiper blade (left)	197	27	43	78	41
Licence plate light	10	27	12	57	82
High mount stoplight	692	17	34	57	448

na Not available.
Source: Taylor (1994, p. 11)

Table B.12: Average cost of servicing a common family sedan, by type of repair establishment[a] ($)

Type of establishment	*Item*	*Costs*		
		Lowest price	*Highest price*	*Average price*
Service Station				
	Parts	147.20	290.85	200.51
	Labour	65.00	270.00	173.04
	Total cost	254.80	530.85	373.55
Mechanical Workshop				
	Parts	166.48	272.47	203.37
	Labour	68.00	293.00	158.49
	Total cost	268.18	522.00	361.86
Mobile mechanic				
	Parts	141.40	251.06	186.05
	Labour	135.40	180.00	158.88
	Total cost	276.80	408.56	344.93
Dealership				
	Parts	204.74	276.02	226.47
	Labour	205.00	372.50	302.17
	Total cost	412.65	596.02	528.64

a The prices are based on an engine tune and service, brake service and automatic transmission service for a 1984 six cylinder automatic sedan. The results are based on a survey of 96 Perth vehicle servicing businesses.

Source: Western Australia Ministry of Consumer Affairs

Table B.13: Motor Vehicle Repair Industry Disputes Committee of NSW, orders and determinations, 1993–94

	Metropolitan	*Country*	*Total*	*Value*[a]
	No.	No.	No.	$
Orders				
Repairer to refund money	124	49	173	156 128.12
Repairer to carry out further work	7	5	12	9 350.00
Reduced account	0	1	1	450.00
Total	131	55	186	
Dismissed	109	32	141	
Owner to pay	14	8	22	16 009.44
Dispute withdrawn by owner	5	1	6	
Total	128	41	169	
Determination only	4	0	4	
Total orders and determinations	263	96	359	

a The value is recorded at repairer's cost which is considerably less than retail cost.

Source: MVRIC (1994)

Table B.14: Motor Vehicle Repair Industry Dispute Committee of NSW, cause of dispute by repair type in disputes where repairer determined at fault, 1993–94

Type of Repair		
	%	No.
Engine	11.63	27
Transmission	32.32	75
Brakes	4.3	10
Auto electrical	3.89	9
Suspension/Steering	3.01	7
Differential	3.89	9
Tune-up	3.89	9
Truck (commercial)	0.43	1
Exhaust	2.15	5
Motor cycle	0.43	1
Other	3.89	9
Panel and paint	29.74	69
Total	100.0	231
Basis of disagreement		
Standard of repair	6.5	
Fair cost of repair	93.5	

Source: MVRIC (1994)

Table B.15: Motor vehicle theft, Australia, 1975–92 (number)

Year	*Motor vehicle thefts*	*Motor vehicle thefts per 100 000 population*	*Motor vehicles registered*	*Motor vehicles registered per 100 000 population*	*Thefts per 100 000 motor vehicles registered*
1975–76	51 358	369	6 394 267	45 950	803
1976–77	56 772	403	6 684 227	47 493	849
1977–78	64 266	451	6 935 306	48 638	927
1978–79	68 726	476	7 186 386	49 830	956
1979–80	70 096	480	7 444 940	50 937	941
1980–81	76 455	512	7 725 926	51 771	990
1981–82	86 955	573	8 006 914	52 732	1 086
1982–83	95 796	622	8 279 494	53 786	1 157
1983–84	99 146	636	8 526 853	54 732	1 163
1984–85	103 164	653	8 774 213	55 574	1 176
1985–86	120 570	753	9 023 619	56 333	1 336
1986–87	134 218	826	9 290 805	57 178	1 445
1987–88	123 176	745	9 459 400	57 219	1 302
1988–89	127 194	756	9 675 300	57 568	1 315
1989–90	136 783	801	9 943 550	58 196	1 376
1990–91	139 493	807	10 004 400	57 709	1 394
1991–92	120 083	687	10 099 953	57 771	1 189

Source: Institute of Criminology communication

Table B.16: Contributing factors to vehicle accidents, Queensland, 1991–93 (per cent)

Contributing factor	*Reported crashes*	*Fatal accidents*
Disobeyed traffic rules	40.7	34.6
Inattention	23.7	6.4
Age or experience	11.4	25.0
Other	10.8	10.2
Rain/wet road	10.6	10.4
Alcohol/drugs	7.6	28.3
Other driver condition	7.1	10.9
Road conditions	6.2	8.7
Vehicle defects	4.2	5.8
Speed	3.6	18.1
Fatigue	1.6	3.9
Negligence	1.5	4.5
No street lighting	0.8	4.2

Note: Accidents can have a number of contributing factors, therefore each column *does not* reflect the figures and percentages of the entire table.

Source: Queensland Department of Transport (1991; 1992; 1993)

Table B.17: Number of registered designs for vehicles and parts, Australia, 1987–93 (number)

	1987	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*Total*
Motor cars, buses and trucks	11	11	9	3	2	5	4	45
Wheels for vehicles	5	6	17	9	2	29	3	71
Vehicle body panels and fairings	29	29	12	11	3	15	31	130
Bumper bars, crash bars and similar protective parts	7	2	2	4	8	2	9	34
Ornamentation for vehicles including badges, emblems, stripes and fins	0	0	0	0	0	0	1	1
Lights for vehicles	3	3	3	13	3	3	4	32
Vehicle lamp housings, frames, rims, bodies and protectors	5	1	11	9	6	9	11	52
Vehicle windows and windscreens	24	3	6	11	15	6	7	72
Windscreen washers and wipers	2	3	0	0	2	3	4	14
Vehicle mirrors and mounts	3	1	1	1	3	3	0	12
Brakes and brake parts	1	0	9	2	2	2	1	17
Vehicle exhaust systems and pipes	3	0	1	0	4	3	0	11
Engines (includes mufflers)	16	10	8	5	8	2	4	53
Miscellaneous parts (including suspension parts and chassis)	28	12	16	27	13	6	24	126
Total	137	81	95	95	71	88	103	670

Source: Australian Industrial Property Organisation

C ASSISTANCE TO REPLACEMENT PARTS

Tariff assistance afforded the production of replacement parts for motor vehicles, towed vehicles and recreational marine craft increases the price of both imported and locally produced parts. The higher prices impose additional costs on consumers of repair services.

Replacement parts industries also benefit from various budgetary assistance measures that are generally available to the manufacturing sector. However, these schemes increase the returns to parts producers without directly influencing the price of the parts to users.

Local production of replacement parts for passenger motor vehicles is also influenced by the special assistance arrangements applying to vehicles and original equipment parts under the passenger motor vehicle (PMV) plan. These special assistance arrangements (such as entitlements to duty free imports) are likely to partially offset the effect of tariff protection on prices, although the net effect on replacement parts of these arrangements is likely to be small.

This appendix: provides a summary of the tariff rates applicable to the replacement parts under reference; outlines the elements of the PMV plan that may have implications for the price and availability of replacement parts for PMVs; and lists some of the major Commonwealth budgetary assistance programs which may provide assistance to specific parts manufacturing firms.

C.1 Tariff assistance

The Customs Tariff affords assistance to local producers of replacement parts by directly increasing the price of competing imports on the local market, thus permitting sales of domestically produced parts at prices higher than would occur in the absence of the tariff.

Over the last decade, tariff protection has been reduced substantially. For example, replacement parts for PMVs were generally subject to tariff rates of 25, 35 or 37.5 per cent in 1984. These rates have now been reduced to 15 per cent.

The scope for competition from imported parts will increase in line with the Government's program of tariff reductions. Under the general tariff phasing announced in the March 1991 Industry Statement (DPM&C 1991), tariff rates applying to virtually all imports not covered by sectoral plans are to be reduced

to a maximum of 5 per cent by 1 July 1996.[1] However, replacement parts for PMVs are an important exception to the Government's program of tariff reductions (see below).

The tariff rates applying to vehicle and recreational marine craft parts covered by the terms of reference can be conveniently grouped under three headings: passenger motor vehicles; other vehicles; and recreational marine craft. Although many individual tariff items are covered under each of these headings, four different tariff rates and phasing schedules cover all relevant imports. Current tariff rates and phasing rates through to 2000 are summarised in Table C.1.

Table C.1: Tariff rates and nominal rates of protection for replacement parts[a]
(per cent)

Description	*1994*		*1995*		*1996*		*1997–2000*	
	Tariff rate	*Nominal rate*	*Tariff rate*	*Nominal rate*	*Tariff rate*	*Nominal rate*	*Tariff rate*	*Nominal rate*
Passenger motor vehicle replacement parts	15.0	14.0	15.0	14.0	15.0	14.0	15.0	14.0
Marine outboard engines	8.0	7.6	7.0	6.6	5.0	4.7	5.0	4.7
Diesel inboard motors	Free	0	Free	0	Free	0	Free	0
Agricultural vehicle replacement parts	Free	0	Free	0	Free	0	Free	0
Other replacement parts[b]	10.0	9.3	8.0	7.4	5.0	4.6	5.0	4.6

a Rates applying to general source imports.

b Excludes certain lamps classified to tariff heading 8539 that enter free of duty or are subject to rates of 8 per cent phasing to 5 per cent on 1 July 1996.

Source: IC estimates and Australian Customs Service, Customs Tariff, Schedule 3

The tariff rate itself does not indicate the extent to which the cost of imported parts are raised by the tariff. This is because tariffs are levied on the free-on-board (fob) value of the imported parts, before freight, insurance and other importing costs are added. To measure the increase in the landed price of

1 At the November 1994 Bogor meeting of APEC (Asia Pacific Economic Cooperation), Australia made a commitment to eliminate barriers to trade (including all tariffs) and investment with APEC and non-APEC economies by 2010. Developing economies in APEC have agreed to open their markets by 2020 (see Keating 1994).

imports resulting from the imposition of the tariff (ie the nominal rate of tariff protection) the tariff rate needs to be deflated to a landed-duty-free (ldf) basis. The nominal rate is derived by multiplying each tariff rate by the ratio of the value of imports on an fob basis to their value on an ldf basis. The fob/ldf ratio for all manufacturing imports averages around 0.9. The Commission has also used a rate of 0.9 for its estimates of assistance to PMV component production (see IC 1990).

If domestically produced parts are considered to be very close substitutes for the imported parts, the nominal rate of tariff protection will also indicate the assistance *available* to domestic producers (ie the extent to which they can raise their prices). Domestic parts producers will not always price up to the landed-duty-paid price of imported equivalents. Some parts will be produced in Australia at a price disadvantage lower than the tariff. In these cases, where domestic competition exists, the tariff assistance available may not be fully used. However, as tariff assistance is phased down, the likelihood of assistance being unused diminishes. In other cases, domestic producers may be able to price parts at levels higher than the ldp price of imports because of non-price competitive advantages such as greater flexibility and surety of supply.

Estimated nominal rates of tariff protection based on average fob/ldf ratios for the four broad categories of imports (and on the assumption that assistance available is fully used) are shown in Table C.1.

Table C.1 is based on the tariff rates applying to general source imports. Imports from New Zealand, Papua New Guinea and the Forum Island countries enter duty free. There are also preferential arrangements for imports from Canada, with imports of replacement parts from this source entering at rates equal to, or below, the developing country preferential rate.

Developing Country preferences are being phased out for all but the least developed countries and territories. The phased removal of the margin of preference for all imports from the four Asian "tigers" — Hong Kong, Republic of Korea, Singapore and Taiwan Province — commenced on 1 July 1992. With the exception of the least developed countries and territories, preferences are being progressively phased out from 1 July 1994. Countries that remain eligible for developing country preferences receive a 5 percentage points preference margin. However, at present, it is unlikely that any of these countries would be significant exporters of replacement parts.

Some replacement parts can be imported free of duty under the provisions of the Tariff Concession System (TCS).[2] The criteria for concessional entry under the TCS is basically whether "goods serving similar functions" are available or able to be produced in Australia. This criterion is interpreted in terms of whether the imported goods for which concessional entry is requested are substitutes directly competing in a local market. Because of the special assistance arrangements under the PMV plan (see below), it was the Government's intention that the automotive sector be excluded from the commercial tariff concession system. However, replacement parts have been imported under concession orders.[3]

Passenger motor vehicles

The tariff rate on replacement parts for PMVs is not covered by the general program of tariff reductions and is to be maintained at the current rate of 15 per cent through to 2000.[4] Any imported parts of a type (or of a kind) that are capable of being used in PMVs (eg many parts used in light commercial or off-road vehicles) are subject to the 15 per cent rate, regardless of the actual or intended use of the part. In order to qualify for the lower rate of duty, importers must be able to demonstrate that a particular component — because of its size, specification or part number — is designated for use only in non-PMV applications, and that it cannot be used to directly substitute for a PMV replacement part. Thus, the production of replacement parts for PMVs (and some generic components) will continue to be afforded significant tariff protection and will increasingly be advantaged relative to most other manufacturing activities.

The tariff on original equipment (OE) components for PMVs is substantially higher. As at January 1995, the tariff rate was 27.5 per cent and is being phased down by 2.5 percentage points each year to 15 per cent by 2000. The OE tariff rate also indirectly determines the level of assistance afforded plan producers by the automatic 15 per cent by-law entitlement and export facilitation arrangements under the PMV plan (see below).

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[2] In addition, under the duty drawback scheme, exporters can claim a refund of duty paid on imported components that are subsequently incorporated in exported goods. Firms that regularly export products which incorporate components the firm has imported may apply for exemption from tariff duties under the Tariff Export Concession Scheme.

[3] The Government recently announced amendments to Schedule 2 of Customs Regulation 185 (generally known as the Excluded Goods Schedule) to ensure that any goods of a kind used as replacement components in passenger motor vehicles are excluded from the Tariff Concession System (see ACS 1994).

[4] Post 2000 assistance arrangements for passenger motor vehicles are to be reviewed in 1996.

Other vehicles

Replacement parts for agricultural vehicles and trailers are free of duty.

Tariffs on replacement parts for all other vehicles (not of a type or of a kind capable of being used in PMV) are currently subject to tariff rates of 10 per cent and are to be phased to 5 per cent by July 1996 in accordance with the general post 1992 tariff reduction program.[5] "Other vehicles" includes trucks, buses, tractors, motor cycles and other road-going motor vehicles. It also includes towed vehicles, such as trailers and caravans.

Marine craft

Only very few parts for recreational marine craft are separately identified in the Customs Tariff. Diesel inboard motors may be imported free of duty. Outboard motors are dutiable at 8 per cent from July 1994 and will phase down to 5 per cent by 1996. Other separately identified parts for marine craft, such as anchors and grapnels, and lead keels, are currently dutiable at 10 per cent and will phase down to 5 per cent by 1996.

All other parts for recreational marine craft are included in the same tariff classifications as complete vessels and are dutiable at 10 per cent, reducing to 5 per cent.

C.2 Special PMV assistance arrangements

In addition to tariff protection, the assistance arrangements under the current PMV plan include an automatic 15 per cent duty free by-law entitlement for vehicle producers and export facilitation for passenger vehicle and component producers and for vehicle importers. Whilst the plan does not directly assist the production of replacement parts, most specialist component producers supplying OE also supply the aftermarket with genuine and, in some cases, their own branded replacement parts. Assessing the net impact of the plan on the price and availability of replacement parts is complex. However, some relevant considerations are discussed below.

Under the automatic duty free entitlement provision, PMV producers are able to import, free of duty, vehicles or OE components up to a value of 15 per cent of the wholesale value of their production. Under previous PMV plans, producers were required to source locally at least 85 per cent of the wholesale value of the

[5] Imports of certain lamps classified to tariff heading 8539 are currently free of duty or subject to rates of 8 per cent, phasing to 5 per cent on 1 July 1996.

vehicles they produced for sale in Australia. Penalties for non-compliance were initially in the form of duties which escalated over time, making it prohibitively costly for plan producers to fail to meet the requirements for any length of time. From January 1989, the system of penalty duties was replaced by a non-escalating duty equal to the tariff on PMV imports. Therefore, under the current arrangements it will be profitable for vehicle producers to import additional components (in excess of their 15 per cent duty free entitlement) as long as the cost penalty on local components exceeds the tariff.

The export facilitation scheme provides vehicle producers which arrange or undertake exports with additional duty-free entitlements or "export credits". Eligible exports (subject to a value added test) include: Australian vehicles; components; automotive tooling; and automotive design and production services. There is no ceiling on the amount of export credits that can be earned. Vehicle producers are encouraged by the scheme to select and export those components or vehicles which the local industry produces most efficiently. In return they receive a duty rebate on the import of components or vehicles.

Similar arrangements apply to component producers and vehicle importers. Export credits earned under the export facilitation provisions applying to specialist component producers and to vehicle importers can be sold or transferred to vehicle producers or used to increase local content in original equipment supplied to vehicle producers. Credits transferred or sold to vehicle producers can be treated in the same fashion as export credits earned under the vehicle producers' arrangements.

Export facilitation makes available a subsidy to exports. That is, it will pay firms to subsidise exports, provided that the subsidy is less than the value of the resulting duty saving on imports. The maximum export subsidy available to vehicles and components under export facilitation is equal to the duty that applies to vehicles or components imported without by-law concession or the use of export credits (ie currently 27.5 per cent). Scheduled tariff reductions will significantly reduce the value of the duty free entitlement and export credits by the year 2000.

The encouragement of local vehicle assembly through the various elements of the PMV plan could be expected to have some spillover benefits for the local component sector. With local assembly of vehicles, a market exists for a broad range of components which provides the producers of those components with a volume base on which they can build both export sales and sales of replacement parts. In general, the special PMV assistance arrangements encourage the most efficient OE parts producers and discourage the less efficient producers. This is likely to lead to a reduction in industry average costs for OE and — since OE suppliers are also the major local manufacturers of aftermarket parts — also the

production of replacement parts. To the extent that cost savings are passed on to consumers, the net effect of the arrangements on replacement parts may be to partially offset the price raising effect of tariff protection.

Considered in isolation, the effect of the plan producer's automatic 15 per cent duty free by-law entitlement would be to reduce specialist component producers' sales of OE components as it enables local vehicle producers to reduce the local content in their vehicles without penalty. It is likely this would also result in reduced sales of replacement parts, as suppliers of OE usually also secure the contract to supply genuine replacement components. However, as the automatic duty free entitlement results in parts being resourced from countries with lower production costs, it is likely to exert some downward pressure on the prices of replacement parts.

The export facilitation provisions for plan producers result in some resourcing of original components from imports. This could lead to reduced sales of locally produced replacement parts. On the other hand, for some OE parts that continue to be sourced domestically, export facilitation can lead to exports sales and cost savings from resulting economies of scale. To the extent that replacement parts produced in these OE production runs also benefit from the cost savings, there could be some price reductions for the relevant components. However, given that most components currently exported are for vehicles not sold in Australia or sold in limited volumes, any benefit in terms of domestic replacement part prices is likely to be relatively small.

The export facilitation provisions available to specialist component producers and importers are also likely to increase exports of OE and replacement parts, with consequent cost savings. On the other hand, the specialist component provisions could also result in some diversion of productive capacity from replacement parts for the domestic market to subsidised exports of OE and replacement parts. Considered in isolation, this effect could tend to place upward pressure on prices of replacement parts to be used locally.[6]

C.3 Commonwealth budgetary assistance

The assistance arrangements for the replacement parts industries extend to numerous budgetary schemes generally available to manufacturing.

Table C.2 lists the main Commonwealth budgetary schemes that are available to manufacturers of replacement parts. It is not expected that particular firms

[6] Any upward pressure exerted on prices could be offset, to some extent, by general production efficiencies that result from an expansion in manufacturers' total operations and cost savings on subcomponents common to parts sold domestically and exported.

would utilise all, or even many, of the schemes available to parts manufacturers, nor is it likely that the majority of funding for particular programs would assist parts manufacturers. However, some schemes, such as the National Industry Extension Service and export enhancement programs, would be used more frequently by parts manufacturers than other budgetary assistance measures. As an example, in 1992–93 around $2.6 million in grants was paid to 41 vehicle producing firms under the Export Market Development Grants (EMDG) scheme.[7] This represented just over 4 per cent of total EMDG grants to manufacturing industries.

Table C.2: Commonwealth budgetary schemes of relevance to replacement parts industries ($ million)

Scheme	*Total expenditure*	
	Actual 1992–93	*Revised estimate 1993–94*
Cooperative Research Centres[a]	10.7	23.5
CSIRO Institute of Industrial Technology	67.6	63.0
Industry Innovation Programs[b]	43.5	40.0
National Industry Extension Service	16.4	22.0
Export assistance		
AUSTRADE – Export Market Development Grants Scheme[a]	60.7	83.9
– Export promotion operating expenses[a]	50.2	54.1
– International Trade Enhancement Scheme	20.8	32.0
Enterprise Development Program	[c]	11.7
Export Access Program	4.2	6.1
Interest subsidy for financing eligible export transactions (EFIC)[a]	6.9	6.3

a Manufacturing industry expenditure only.

b Includes the Grants for Industry Research and Development and the Technology Development Programs.

c The Enterprise Development Program was first funded in 1993–94.

Sources: Commonwealth Budget Papers (various years) and IC estimates

[7] Includes grants to establishments classified to Australian Standard Industrial Classification, industries 3231–3234.

D TOW TRUCK ARRANGEMENTS IN AUSTRALIAN STATES AND TERRITORIES

This appendix provides summary tables outlining key regulatory/administrative arrangements applying to the tow truck sector in each state and territory. The majority of the information relates to accident towing of passenger motor vehicles and is based on information provided by the relevant authorities in each jurisdiction. A number of jurisdictions (ie New South Wales, Victoria, Queensland, Western Australia and South Australia) are considering changes to the arrangements. The tables are:

Table D.1: Tow truck legislation, by state and territory, 1994

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Relevant legislation and regulation	*Tow Truck Act 1989*	*Transport Act 1983* (Div 8 and Sec 171-185A) and *Transport (Interim) (Tow Truck) Regulations 1983*	*Tow Truck Act 1973*	*Road Traffic Act 1974* *(Tow Truck Regulations 1975)*	*Motor Vehicle Act 1959* and Regulations *(Accident Towing Roster Scheme Regulations)*	*Traffic Act 1925*, Part III, (Section 58) *Traffic (Public Vehicles) Regulations 1967*	No legislation, but operators subject to negotiated agreement[a]	*Traffic Act 1994*, *Motor Vehicle Act 1992* and regulations
Aims and objectives	Licensing and certification of tow truck operators to control undesirable behaviour	Control undesirable behaviour, orderly allocation of trucks to accident scenes	Control undesirable, intimidating and offensive behaviour by tow truck drivers at accident scene	ndp	Reduce smash chasing, drop-fees, spotters' fees, harassment of vehicle owners and violence	(1) Regulate towing services in the public interest (2) Determine the suitability and fitness of applicants for towing licences	Curtail perceived "cowboy" element in industry	Ensure vehicles meet safety standards[b]
Type of towing subject to legislation	Accident, breakdown and trade[c]	Accident and trade (trade covers all non-accident towing)	Accident, but restricted to Brisbane, Gold Coast & other major provincial areas	Accident, trade, breakdown and clearway	Accident and trade[d]	Accident, trade, breakdown and clearway	Accident	Accident

Table D.1: Tow truck legislation, by state and territory, 1994 (continued)

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Body responsible for administration	Tow Truck Industry Council (TTIC)	Vicroads	Queensland Transport	Police Department responsible for enforcement	Registrar of Motor Vehicles administers Act and regulations with assistance of Towing Authority and Accident Towing Roster Review Committee	Transport Commission within Department of Transport and Works	Australian Federal Police, Motor Trades Association and the ACT Towing Association	Department of Transport and Works in consultation with Motor Trades Association (Tow Truck Division), Office of Consumer Affairs and Fair Trading and Police

ndp No details provided.

a Agreement negotiated between Australian Federal Police (AFP), Motor Trades Association (MTA) and the ACT Towing Association (ATA).

b A code of practice is being developed which is intended to reduce harassment at accident scenes.

c Proposed amendments to legislation to de–regulate breakdown and trade towing are likely to be before the New South Wales Parliament this year.

d For trade work, only a tow truck certificate is required.

Table D.2: Tow truck licensing (accident towing only)

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Tow truck licence (plates) required	Yes	Yes	Yes, within defined areas (see Table D.1)	Yes	Yes	Yes	No	No
Licence plates currently issued	1596 (accident) 130 (breakdown and trade)	Approx 800	175 licensed operators operating 368 licensed trucks (total Queensland)[a]	Approx 350 (all towing)	125 (accident identification plates)	95 (all towing)	n/a	n/a
Limitations on number of licences	No	Yes	No	No	Yes (defined area within Adelaide)	Yes	n/a	n/a
Current value of plates	n/a	Accident: Melbourne $80 000; Country $30 000. Trade: Melbourne $30 000; Country $12 000.	n/a	n/a	Plates sold for goodwill value of business[b]	Plates sold for goodwill value of business	n/a	n/a

n/a Not applicable

a Licensed owners can have any number of trucks listed against that licence.

b Positions on the roster can be transferred by the Registrar if the business is sold and if the purchaser qualifies for a position.

Table D.3: Personnel licensing

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Special licence required to:								
- own truck;	Yes	No[a]	Yes	No	No[b]	Yes	No	No
- drive/operate truck;	Yes	n/a	Yes	No	Yes	No	No	No
- assistant operator.	No	No	Yes	No	No	No	No	No
Criteria applied to obtain licence:								
- owner[c]	Fit and proper person[d]	n/a[e]	Fit and proper person	n/a	Fit and proper person[f]	Fit and proper person	n/a	n/a
- operator;	Fit and proper person, education courses	n/a	Fit and proper person	n/a	Fit and proper person, practical tests	n/a	n/a	n/a
- operator assistant.	n/a	n/a	Fit and proper person	n/a	n/a	n/a	n/a	n/a

n/a Not applicable

Table D.3: Personnel licensing (continued)

a In Victoria, operator includes owner and driver.
b Only those with positions on the accident roster can be issued with accident plates.
c Excludes standards/requirements applying to equipment.
d A business licence is required to own and operate the towing business. The towing business must maintain a holding yard and meet local government requirements.
e Fit and proper person requirements were revoked in late 1993, but are due to be reinstated in 1995. Other proposed requirements include passing appropriate test or holding appropriate qualifications.
f Other criteria applying to entry on roster (see Table D.4) include requirements that owners employ not less than four persons whose combined hours of work per week amount to not less than 160 hours per week and own two trucks for first position on roster.

Table D. 4: Allocation/roster system

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Allocation/ roster system operative	No	Yes	No	No, but RAAWA has contract for tows in specific metropolitan areas	Yes	Yes	Informal system	Yes
Allocation/ roster system coverage	Scope under legislation but not invoked	Melbourne metropolitan area	n/a	n/a	Adelaide metropolitan area	All Tasmania	ACT	Darwin region
Number of trucks servicing system	n/a	386	n/a	n/a	65 (general roster), 4 (heavy roster)[a]	95 (between the 4 Police Districts)	Approx 60	15
Restrictions on entry to roster	n/a	Yes	n/a	No, but only RAAWA operators can perform tows in contracted area	Yes	Yes	No [b]	No
Zones used	n/a	Yes	n/a	n/a	Yes	Yes	No	No

Table D.4: Allocation/roster system (continued)

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
No. of zones	n/a	49	n/a	n/a	15 general zones 2 heavy vehicle zones	4 Police Districts	One	One
Body responsible for tow allocation	n/a	RACV has contract to allocate tows	n/a	Police Department	Police Department	Police Department	Police	Contracted private firm

n/a Not applicable

a Relates to number of positions on roster, not trucks.

b No restriction on entry, but operators must comply with provisions of negotiated agreement.

Table D.5: Accident towing fees by jurisdiction, 1994

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Towing fees regulated	Yes	Yes	No[a]	No	Yes	No	Yes	No
Current rates - from accident;	$94.50 (first 8 km towing)	$95 (first 8 km towing)	$160	ndp	$76.50 plus $61 per hour at scene in excess of 30 mins	$35 up to 15 km	$94.50	Approx $70.00
- distance charges;	$3.40 per km for travel over 8 km (metro-politan)[b] $1.70 per km for travel over 16 km (non-metropolitan)	$1.55 per km greater than 8 km	No fee	ndp	$1.20 per km for travel over 10 km	na	$3.40 per km for travel over 8 km	Approx. $2.00 per km

Table D.5: Accident towing fees by jurisdiction, 1994 (continued)

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
- surcharge outside business hours	20 per cent	Not controlled	No fee	ndp	$99.10 plus $81.40 per hour at scene in excess of 30 mins plus $15.00 surcharge after midnight and $1.20 for travel over 10 km	No fee	20 per cent	Approx $20.00
Body responsible for setting fees	TTIC sets maximum fees	Vicroads	Price agreed between insurance and towing industries	n/a	Prices Commissioner, Dept of Consumer and Business Affairs	n/a	Under negotiated agreement, fees used in NSW are adopted.	n/a
Basis for setting fees	ndp	Operating costs	n/a	n/a	CPI increases and operating costs	n/a	n/a	n/a

na Not available
n/a Not applicable
ndp No details provided
a Legislation requires that towing fees be “a reasonable fee”.
b Includes Sydney, Newcastle and Wollongong.

Table D.6: Tow truck sector, other selected features

	NSW	*Vic*	*Qld*	*WA*	*SA*	*Tas*	*ACT*	*NT*
Drop-fees permitted	No[a]	No	No	Yes	No	No	No	No
Spotters' fees permitted	Yes	No	No	Yes	No	No	No	No
Proportion of repair shops which:								
- own and operate tow trucks;	> 80 per cent	na	na	na	95 per cent[b]	na	na	60–80 per cent
- lease tow trucks	40–60 per cent	na	na	na	na	na	na	> 20 per cent
Number of accident tows (including areas where allocation schemes do not apply)	63 000 per year	Under allocation system; 31 000 per year	54 000 per year	na	Under allocation system; 10 500 per year	na	na	Under allocation system; 80 per month in Darwin area

na Not available

a Proposed amendments to the legislation will decriminalise the payment and receipt of drop-fees.

b 95% of the businesses holding roster positions own repair shops.

E INTERNATIONAL THIRD PARTY PROPERTY DAMAGE INSURANCE SCHEMES

Compulsory Third Party Property Damage (TPPD) insurance schemes operate in most OECD countries. This appendix provides an overview of selected features of 13 of these schemes, based primarily on a Commission survey. The appendix is organised into sections on compulsory TPPD insurance schemes operating in Canada (Section E.1), the United States (Section E.2) and Europe (Section E.3). Within each section, a table and short "briefs" provide information on schemes in particular jurisdictions.

E.1 Canada

Motor vehicle insurance in Canada is controlled by regional governments. Consequently, there is significant variation in the design of compulsory insurance schemes across the country (see Table E.1). For example, in Saskatchewan, Manitoba and British Columbia, compulsory TPPD insurance is provided by a sole government owned insurer. In the remainder of the provinces surveyed, compulsory TPPD insurance is provided mainly by private insurers in a competitive environment.

Approximately half of the schemes surveyed use fault to determine liability for damages. Saskatchewan, Manitoba and British Columbia operate variations on a no-fault scheme where there is compulsory first party and third party insurance, and questions about fault in an accident are largely irrelevant to claims.

Most jurisdictions provide compensation for damage caused by uninsured and unidentified motorists, except Manitoba which makes no provision for unidentifieds.

Premiums are largely determined by the market in approximately half of the jurisdictions surveyed. Elsewhere they are regulated.

Quebec

Quebec's current compulsory TPPD insurance scheme was introduced in 1978 to "speed up settlements and reduce administration costs". The scheme is overseen by the Inspector General of Financial Institutions, which may require that insurance companies file the statistical and other information relating to

their insurance experience, including the driving records of their insureds. Insurance companies must pay a share of the costs (based on their share of gross premiums collected in Quebec) incurred in the collection and processing of this information by the Inspector's agent.

Under legislation, insurers are required to have a mechanism that enables every motor vehicle owner to find an authorised insurer with whom they may insure. Insurance companies rate their insureds according to their age, residence, driving experience and accident experience. Rates manuals (ie underwriting criteria) are lodged with the Inspector.

Legislation also requires insurers to establish a direct compensation agreement to:

- compensate for property damage sustained by an insured;
- appraise damage sustained to motor vehicles;
- apportion liability between the owner of each motor vehicle involved;
- establish an arbitration board to decide disagreements between insurers; and
- set out subrogation rights between insurers (which insurers have subsequently volunteered to renounce among themselves).

The Societe de l'Assurance Automobile du Quebec advised that this agreement has increased the effectiveness of third party property damage compensation, reduced administration costs and practically eliminated law suits.

Yukon

A compulsory TPPD insurance scheme was introduced in the Yukon to "provide for equitable insurance coverage". The scheme is similar to that which operates in Quebec, except that in the Yukon third party personal injury and personal property schemes are integrated and the minimum liability coverage required is $C200 000 (the same as most other Canadian provinces surveyed). The scheme is administered by the Office of the Superintendent of Insurance. Monthly payment plans are offered by most insurers.

Saskatchewan

A compulsory TPPD insurance scheme was introduced in Saskatchewan in 1944 to "provide all Saskatchewan motorists with compulsory insurance protection at an affordable cost". A government owned monopoly — the Saskatchewan

Government Insurance Office — provides universal first[1] and third party property damage insurance on a break even basis. Private insurance companies compete with the government insurer to provide a range of insurance packages not included in the compulsory cover, such as excess waiver insurance.

The fault principle is rendered virtually redundant. Fault affects only the recoverability of a $500 excess by an innocent driver and also determines claims which fall outside the compulsory scheme, for instance where a building collapses and damages a car.

Premiums are set by the scheme's administrators according to the scheme's loss experience for each risk group. For drivers who cannot afford insurance, there are financing options to lessen the burden of one-time payments.

There is no provision for compensation for property damage caused by unidentified motorists under the third party provision of the scheme. Innocent insureds must instead depend on their (compulsory) first party insurance for coverage, which is subject to a deductible (eg excess). A nominal defendant fund was introduced to compensate innocent third parties for damages sustained in cases where the operator or owner of the at-fault vehicle is uninsured. The monopoly insurer can recover against identified, at-fault parties and can apply to a court for the revocation of driving privileges of a person who has an extremely poor claims record.

Administration of the compulsory scheme is integrated through the driver's licence and vehicle registration system. To register a vehicle or to obtain a driver's licence, an insurance certificate must be presented. The premium payable for each type of insurance certificate varies. The price of a driver's certificate is fixed, but a bad driving record (ie frequent claims or frequent convictions for traffic offences) results in a surcharge. The premium on an operator's certificate is calculated according to a vehicle's "damageability", which is a function of its make, model, age, engine capacity and primary use.

According to the Saskatchewan Government Insurance Office, modifications to the current scheme will be implemented in January 1995 to further reduce the role of fault to provide better coverage with limited access to the court system.

[1] First party coverage is waived if there is a violation of road laws, for example if limits on permissible blood alcohol levels are exceeded or if the vehicle is unregistered.

Table E.1: TPPD insurance schemes in selected Canadian provinces and territories

	Quebec	*Yukon*	*Saskatchewan*	*Manitoba*	*Nova Scotia*	*Alberta*	*British Columbia*
Type of TPPD scheme	compulsory	compulsory	compulsory	compulsory	compulsory	compulsory	compulsory
Description of market	mainly private insurers in competition	mainly private insurers in competition	monopoly provision by government owned insurer	monopoly provision by government owned insurer	mainly private insurers in competition	mainly private insurers in competition	monopoly provision by government owned insurer
Third party personal injury and property damage schemes integrated	no	yes	no	yes	yes	yes	yes
Vehicle, vehicle owner or driver insured	both vehicle and driver	both vehicle and driver	both vehicle and driver	both vehicle and driver	both vehicle and driver	owner only	both vehicle and driver
Determinant of liability	fault	fault	modified no-fault	universal no-fault	na	fault	no-fault
Administrating authority for other than prudential reasons	yes	yes	yes	yes	yes	yes	yes
Basis for determination of premiums	mainly by the market	mainly by the market	set by administrators	regulatory body	mainly by the market	mainly by the market	regulated
Premiums regulated to provide for drivers who cannot afford TPPD insurance or are refused such insurance	no	no	no	no	yes	yes	yes
Insurers prohibited from refusing insurance	yes	yes	no	yes	no	no	yes

Table E.1: TPPD insurance schemes in selected Canadian provinces and territories (continued)

	Quebec	*Yukon*	*Saskatchewan*	*Manitoba*	*Nova Scotia*	*Alberta*	*British Columbia*
Stage in process where proof of insurance/financial responsibility must be shown	vehicle registration	vehicle registration	at all times	at all times	at all times	vehicle registration	at all times
Limits on liability/extent of coverage required	$C50 000 – $C2 million minimum[a,b]	na	$C200 000 minimum[b]	$C200 000 minimum[b]	$C200 000 minimum[b]	$C200 000 minimum[b]	$C200 000 minimum[b]
Provision for compensation for property damage caused by:							
a) uninsured motorists	yes	yes	yes	yes	yes	yes	yes
b) unidentified motorists	yes	yes	yes[c]	no	yes	yes	yes
Rights of subrogation	yes[d]	yes	yes	no	yes	yes	yes
Use of deductibles (eg excesses) or coinsurance (eg no claim bonuses)	for insurers to decide	deductibles	none	na	coinsurance but no deductibles	none	none
Mechanisms to limit fraud other than deductibles/coinsurance	investigation	investigation	investigation	investigation	investigation	investigation	investigation
Percentage of vehicles/drivers which are uninsured	5–10	na	5–10	0	10	0	na

na not available

a $50 000 minimum for private passenger vehicles, $1 million minimum for buses and $2 million minimum for carriers of dangerous materials.

b Includes both personal property and bodily injury liability.

c Provision is made through compulsory comprehensive cover.

d Insurers have voluntarily renounced subrogation among themselves.

Source: Information supplied to the Commission by authorities listed in Section E.5

Manitoba

Prior to 1994, compulsory TPPD insurance in Manitoba was provided under a modified no-fault scheme — similar to the Saskatchewan model — providing universal first and third party property damage coverage. Fault was relevant only in determining whether a party could recover an excess or for compensation for events not covered by the compulsory scheme. Early in 1994, the role of fault was abolished, so that it became a universal no-fault scheme (ie fault-sensitive excess requirements were abolished). According to the Manitoba Public Insurance Commission (the government owned monopoly insurer), this alteration was made to reduce claim costs. A special investigation unit investigates suspicious claims relating to total loss by fire or by theft.

Nova Scotia

Compulsory TPPD insurance was introduced in Nova Scotia in 1982. A Facility Association ensures that insurance is available to everyone. Risks which are unacceptable to the insurer are placed through this association and the results are pro-rated over the industry. Facility Association premiums are high and regulated by the Nova Scotia Utility and Review Board on the basis of the pool's past experience. Otherwise, TPPD insurance premiums are determined mainly by the market, but overseen by the Nova Scotia Utility and Review Board. Premium rates are structured on the number of accident free driving years, with the best rates for those with 6 or more successive accident free driving years. In addition to this, claims adjusting vigilance and investigations by the Insurance Crime Prevention Bureau limit the incidence of TPPD insurance fraud.

Compensation for property damage caused by uninsured motorists is provided by an industry funded body, Judgment Recovery (N.S.) Ltd, once the innocent claimant has obtained a court judgment. The same body compensates innocent third parties for damage caused by unidentified motorists, although in these situations the Registrar of Motor Vehicles acts as nominee.

As many as 10 per cent of vehicles are not insured. However, the Nova Scotia Department of Housing & Consumer Affairs noted that it is difficult to be accurate since evidence of insurance only has to be shown when stopped by the police or when involved in an accident.

Alberta

Compulsory TPPD insurance was introduced in Alberta in 1972. The Superintendent of Insurance oversees market conduct and policy forms. The Automobile Insurance Board is responsible for premiums rate approval and conducts actuarial reviews of insurance companies' past results.

Drivers are classed by age bands, marital status and gender. Those who can not find insurance are placed in a Facility pool (similar to the Nova Scotia model) which all licensed auto insurers underwrite. Part of vehicle registration fees goes into a government accident claim fund to provide compensation for property damage caused by uninsured and unidentified drivers.

British Columbia

A compulsory TPPD insurance scheme has operated in British Columbia since March 1974. Compulsory insurance coverage is only available from the government owned insurer — the Insurance Commission of British Columbia (ICBC). ICBC is also responsible for motor vehicle registrations. When a motorist purchases vehicle registration and insurance (simultaneously) they receive an Owner's Certificate (which comprises a Certificate of Registration and the Owner's Certificate of Insurance and Vehicle Licence). When an Owner's Certificate expires (usually after 12 months) a motorist has no vehicle licence or insurance until it is renewed.

Licence plates and decals indicate the day, month and year of the expiry of registration and insurance. If a vehicle has plates with a valid decal, police know the motorist has TPPD insurance coverage. However, if a motorist is "pulled over" by police for any reason they must produce proof of coverage and a driver's licence.

Premiums are calculated by the Actuarial Department of ICBC (on a break even basis) by classification and approved by the Provincial Government. ICBC provides TPPD insurance to 95 per cent of the market at cost. Innocent third parties who sustain damage caused by an unidentified driver are compensated under the scheme, although such claims are subject to an excess of as much as $350. If a motorist has an unpaid debt with ICBC or the Motor Vehicle Branch, unpaid fines, or if a vehicle has not passed inspection, then they may not obtain or renew their insurance, vehicle registration or drivers licence.

While bodily injury and property damage insurance schemes are integrated, bodily injury has priority and, if required, the first 90 per cent of any judgment is reserved for bodily injury.

E.2 United States

The regulation of motor vehicle insurance in the United States, as in Canada, is a matter for individual states. The Commission was able to obtain information relating to only three states. Nevertheless, the three differ greatly and provide an indication of the extent to which schemes vary in that country. Key elements of these schemes are described in Table E.2.

A mixture of compulsory TPPD insurance and financial responsibility schemes operate throughout the United States. Some states have recently converted from financial responsibility to compulsory TPPD insurance schemes (eg Maine and Florida).

According to the Federation of Community Legal Centres (FCLC 1989), methods for demonstrating financial responsibility vary between states. Legislation specifies the minimum level of financial responsibility which an owner/driver must be able to provide. Usually, the onus is on the driver of a vehicle to lodge a minimum bond, insurance policy or security deposit with relevant transport authorities. Maximum financial responsibility for damage or destruction of property in respect of any one accident is usually limited to between $5000 and $10 000. Fleet owners are often granted status as self insurers and thereby fulfil financial responsibility requirements themselves.

Several states require all owners and drivers to be able to furnish proof of financial responsibility at all times, rendering it (effectively) a compulsory insurance requirement. However, some states require that motorists provide proof of financial responsibility only after being "pulled over" by police. If an individual cannot meet this requirement, they face revocation of vehicle registration and driver's licence. This type of regulation does not protect the innocent uninsured driver against the person who is not financially responsible.

On the whole, government intervention in compulsory TPPD schemes in the United States appears to be less than it is in Canada, although in some states insurer solvency regulations have been altered to allow government to regulate the provision of insurance (eg California) (OECD 1993; Smith & Wright 1992). Insurance is nearly always supplied by private insurers acting in a competitive market, not by government owned monopolies. Premiums are determined by market forces and set on the basis of risk factors such as driver's age, vehicle type and claims history. However, in some states (eg Maine and Florida) authorities regulate premiums to provide for drivers who cannot afford compulsory TPPD insurance. In this regard, Harrington and Doerpinghaus (1993) note that a number of states have established requirements that result in involuntary uninsureds who have not had an accident or traffic conviction being

charged premiums similar or identical to voluntary insureds, so that the premiums may not reflect the expected loss of providing insurance coverage.

Most jurisdictions have fault-sensitive schemes which require at-fault motorists (or their insurers) to bear the cost of damage they cause to others. Retention of the fault principle means that motor vehicle property disputes are often resolved through the court system. Unlike Australia, litigants are responsible for their own legal expenses and the losing party does not face additional court expenses. In some states, such as California, claims may be heard through the Small Claims Courts where the right to legal representation is limited. Other states, such as Pennsylvania, resolve disputes through arbitration programs designed to minimise delays and legal costs.

Protection of innocent third parties against damage by an unidentified or uninsured motorist varies across jurisdictions. Only a few states make no provision for such cover. In these states, the party suffering damage must either claim on their own first party insurance cover or bear the cost themselves.

Maine

A compulsory TPPD insurance scheme was introduced in Maine in January 1993. The new scheme replaced the financial responsibility legislation that existed previously. The State Bureau of Insurance regulates auto insurance laws (ie both personal injury and property damage). Insurers are required to file their proposed rates with the Bureau at least 30 days in advance of the intended effective date. The Bureau then has the authority to approve or disapprove those rates. Rates must be fair, not excessive and not unfairly discriminatory. An automobile insurance plan exists for those who are unable to obtain TPPD insurance coverage.

Under legislation, a Joint Underwriting Association (pool) exists for high risk drivers. This is similar to the Facility Association which operates in Nova Scotia and Alberta in Canada. Depending on the population of a county, there is often preinsurance inspection of vehicles in an attempt to limit the incidence of TPPD insurance fraud.

Florida

Compulsory TPPD insurance was introduced in Florida in 1991 to “address the large numbers of uninsured motorists”. Prior to this, the State had financial responsibility requirements. Most vehicle insurance is overseen by the Florida Department of Highway, Safety and Motor Vehicles. The Department verifies compliance when vehicles are registered.

Table E.2: TPPD schemes in selected United States jurisdictions

	Maine	*Illinois*	*Florida*
Type of TPPD scheme	compulsory	financial responsibility	compulsory
Description of market	mainly private insurers in competition	mainly private insurers in competition	mainly private insurers in competition
Third party personal injury and property damage schemes integrated	yes	yes[a]	no
Vehicle, vehicle owner or driver insured	vehicle only	both vehicle and driver	both vehicle and driver
Determinant of liability	fault	fault	fault
Administrating authority for other than prudential reasons	yes	no	yes
Basis for determination of premiums	regulated	mainly by the market	mainly by the market
Premiums regulated to provide for drivers who cannot afford TPPD insurance or are refused such insurance	yes	no	yes
Insurers prohibited from refusing insurance	no	no	no
Stage in process where proof of insurance / financial responsibility must be shown	to obtain vehicle registration	only after having experienced a specified event[b]	to obtain vehicle registration
Extent of coverage required	US$10 000 minimum	na	na
Provision for compensation for property damage caused by:			
a) uninsured motorists	no	yes	no
b) unidentified motorists	no	yes	no
Rights of subrogation	yes	yes	yes
Use of deductibles (eg excesses) or coinsurance (eg no claim bonuses)	none	very little	no deductibles in excess of $500
Mechanisms to limit fraud other than deductibles/coinsurance	none	none	may be preinsurance inspection
Percentage of vehicles/drivers which are uninsured	na	< 6	30

a Financial responsibility laws apply to both.

b Such as random driver's license inspection, arrest for drunk or reckless driving etc.

Source: Information supplied to the Commission by authorities listed in Section E.5

Illinois

A financial responsibility TPPD insurance scheme has operated in Illinois since the 1920s. Proof of financial responsibility must be furnished only after the driver has experienced a specified event, such as a random driver's licence inspection, arrest for drunk or reckless driving or involvement in a collision in which they are the at-fault driver. The Department of Insurance claims that problems such as drivers not being able to meet financial responsibility requirements (ie by self-insuring or taking out insurance) have not emerged in Illinois. First party uninsured and unidentified motorist property damage coverage is mandatory.

E.3 Europe

Member countries of the European Economic Community agreed on the desirability of compulsory TPPD insurance and the need for universal principles under treaties of 1959 and 1973. A directive issued by the European Parliament in 1983 gave member countries 5 years to standardise their TPPD insurance schemes. All registered vehicles were required to be insured up to a specified minimum level for third party property damage (and also personal injury) and to offer reciprocal arrangements for vehicles from other member countries. The directive also required that members establish nominal defendant bodies to provide compensation for property damage (and bodily injury) caused by unidentified and uninsured motorists (FCLC 1989).

All European countries — with the exception of Great Britain — have had compulsory TPPD insurance schemes for some time. The Commission received survey responses from three of them: Great Britain, Germany and France. The key elements of schemes in these jurisdictions are outlined in Table E.3.As was the case for most jurisdictions surveyed, first party coverage for losses through fire or theft, or damage to the insured's own vehicle when they are at-fault, is voluntary.

Britain

Compulsory TPPD was introduced in Britain in 1988 to fulfil the requirements of the second Motor Insurance Directive (No. 84/5/EEC). An unofficial agreement within the industry (through the Association of British Insurers) was reached so that insurers do not refuse coverage. Premiums are not regulated.

Claims for compensation for property damage caused by uninsured drivers are met by the Motor Insurers' Bureau under an Agreement with the Secretary of

State for Transport. There is a 12 month time limit for bringing claims against the fund.

An upper limit has been placed on liability for property damage and certain categories of damage are excluded, for example personal belongings in the motor vehicle and public property, such as roads and bridges. Claimants are required to pay an excess for any property damage claim, the amount of which is determined by individual private insurers.

Germany

A compulsory TPPD insurance scheme has operated in Germany since 1939 to "ensure that motorists are able to meet their obligations to others in the event of an accident". The *Compulsory Insurance Act 1965* specifies minimum levels of coverage for third party property damage (and personal injury) insurance. It is a fault-based scheme where innocent motorists also bear some financial accountability.

Insurance is provided by a large number of government authorised, private corporations. Traditionally, there has been a high level of government regulation in terms of premium setting and contract obligations. However, since July 1994, compulsory TPPD insurance premiums have been determined mainly by the market, although the supervisory authority (Federal Council) ensures that premiums are "adequate" and supervises insurance companies with a view to "safeguarding the interests of the insured", especially to ensure ongoing compliance with contracts. Special no claim bonuses apply to motorists with claim-free driving records.

Proof of a current insurance policy must be shown to renew vehicle registration each year. Insurance companies are obliged to notify registration authorities if an insurance policy expires or is cancelled during the registration period. If necessary, the authority may cancel vehicle registration and impound the registration plates. The onus is on the vehicle owner to insure all potential drivers, although the compulsory scheme does cover unauthorised drivers.

While there is scope for an innocent party to proceed against the at-fault party, most property damage claims are settled directly between the innocent party and the at-fault party's insurer. Disputes over liability which cannot be resolved by arbitration or negotiation proceed to the courts. In practice, very few disputes over liability proceed to court.

Table E.3: TPPD insurance schemes in selected European countries

	Germany	*Britain*	*Sweden*
Type of TPPD scheme	compulsory	compulsory	compulsory
Description of market	mainly private insurers in competition	entirely private insurers in competition	mainly private insurers in competition
Third party personal injury and property damage schemes integrated	yes	yes	yes
Vehicle, vehicle owner or driver insured	driver only	driver only	both vehicle and driver
Determinant of liability	fault[a]	fault	universal no-fault
Administrating authority for other than prudential reasons	yes	no	no
Basis for determination of compulsory premiums	mainly by the market[b]	entirely by the market	within a band determined by regulation
Premiums regulated to provide for drivers who cannot afford TPPD insurance or are refused such insurance	no	no	no
Insurers prohibited from refusing insurance	yes	no	no
Stage in process where proof of insurance/financial responsibility must be shown	to obtain vehicle registration	to obtain vehicle excise licence	at all times
Limit on liability/extent of coverage required	unspecified minimum	£250 000 minimum	SKR 300 million
Provision for compensation for property damage caused by:			
a) uninsured motorists	yes	yes	yes
b) unidentified motorists	yes	no	yes
Rights of subrogation	yes	yes	yes
Use of deductibles (eg excesses) or coinsurance (eg no claim bonuses)	deductibles and coinsurance	for insurers to decide	coinsurance
Mechanisms to limit fraud other than deductibles/coinsurance	none	for insurers to decide	na
Percentage of vehicles/drivers which are uninsured	0	6	na

a Innocent insureds also bear some financially responsibility.

b The supervisory authority ensures that premiums are "adequate".

Source: Information supplied to the Commission by authorities listed in Section E.5

A compensation fund — known as the "Society to help accident victims" — was established under legislation to protect innocent motorists against damage by uninsured, underinsured and unidentified vehicles. Innocent motorists must show that they have proceeded unsuccessfully against the at-fault party before they can lodge a claim with the Society. The Society then has the right to recover against any person on whose behalf it has paid a claim. All claims are subject to a three year limitation period.

Sweden

Legislation requires motor vehicle owners to obtain third party injury and property insurance from any of a number of private insurance corporations. The Government itself is not involved in the provision of insurance.

All vehicles are required to be covered against third party property damage liability and first party personal injury at all times. These compulsory insurance provisions provide only basic cover and many drivers choose to purchase additional components to cover theft, breakdown, legal expenses, glass breakage, fire damage and first party property damage. A liability ceiling of SKR 300 million (approximately A$55 million) per event applies to both personal injury and property damage.

Premiums are set within bands set by regulation based on claims history, the type of vehicle to be insured, estimated annual driving distance and the zone in which the vehicle is based. No provision exists for drivers who cannot afford compulsory insurance — "they just have to refrain from driving". A no claim bonus system allows up to a 75 per cent rebate after seven years claim free driving — providing a high safety incentive. New vehicles are sold with three years of insurance premiums pre-paid.

Although described as universal or no-fault, fault remains relevant for personal injury claims. The standard for determining whether a motorist is at-fault is much higher than required under the Australian common law system — something like gross negligence or recklessness must be proven. Damage caused by an uninsured or unidentified vehicle can be compensated through a nominal defendant fund to which all motor vehicle insurance companies contribute.

Disputes over liability and quantum of property damage disputes are not uncommon. The majority are usually settled by negotiation between insurers. Disputes between an insurer and its insured are heard by independent boards of review established by the industry, comprising experts and independent arbitrators. Further recourse can be had to a government board of review if

necessary. Disputes can sometimes be resolved through the Court system, although this is rare.

E.4 Summary

Generally, the schemes surveyed take one of two forms: compulsory TPPD insurance or financial responsibility. Compulsory TPPD insurance schemes are the more common of the two and usually require that motorists present proof that they have taken out TPPD insurance to obtain vehicle registration and often on demand thereafter (for example, to obtain a driver's licence, during random breathalyser or other inspections, or upon arrest for a traffic violation). Financial responsibility schemes, on the other hand, are less imposing. Motorists need not take out TPPD insurance, only prove that if they were involved in an accident and found to be at-fault they could adequately compensate innocent third parties for the damage the cause. Proof that a motorist is financially responsible is often required only after they have experienced a specified event (eg random driver's licence inspection or arrest for drunk or reckless driving).

In most jurisdictions, the principle of fault is used to determine who is liable for damages. That is, the at-fault driver is obliged to honour their TPPD liability. However, under some schemes the role of fault is diminished by the extensive use of voluntary first party property damage insurance. Occasionally, a scheme operates under a modified no-fault scheme whereby fault determines who is responsible for the payment of an excess, but both first and third party damages are covered. Universal no-fault schemes — where all first and third party damages are covered regardless of who caused an accident and there are no excesses — are rare.

Most schemes offer compensation to innocent parties for property damage caused by uninsured and/or unidentified motorists. Usually, this is done in one of two ways: through a centrally administered nominal defendant fund (which is usually funded by the industry and/or a portion of vehicle registration fees); or through mandatory insurance coverage for property damage caused by uninsured and unidentified motorists. Only two jurisdictions surveyed by the Commission (ie Maine and Florida in the United States) make no provision for these motorists. In Britain and Manitoba, provision is made for uninsured motorists but not unidentified motorists.

Most of the jurisdictions surveyed make provision for drivers who cannot afford compulsory insurance or cannot meet financial responsibility requirements. For example, premiums are sometimes regulated to avoid these situations. In several cases, insurance companies cannot refuse insurance. Some jurisdictions

have introduced legislation requiring insurers to establish a mechanism which enables every motor vehicle owner to find an authorised insurer with whom they may take out property damage insurance. In other jurisdictions, a separate insurance pool has been established (known as a "Facility Association" or "Joint Underwriting Association Pool") to ensure that insurance is made available to high risk drivers. Risks that are unacceptable to insurers are placed in this pool and the costs are usually divided proportionately over the industry. In Britain, there is an unofficial agreement within the industry (through the Association of British Insurers) to offer cover to everyone.

The schemes vary with respect to who or what is covered. Sometimes it is attached to the vehicle only (eg Maine), sometimes the driver only (eg Germany and Britain), but mostly to both vehicle and driver. Personal injury and personal property damage schemes are integrated in two-thirds of jurisdictions surveyed.

Although it is compulsory, in practice there is nearly always a pool of uninsureds. The size of this pool varies between 4 to 10 per cent of drivers or vehicles in most jurisdictions surveyed.

E.5 Sources

The Commission received information for this appendix from the following organisations:

Canada

Alberta:	Office of the Superintendent of Insurance, Alberta Treasury
British Columbia:	Financial Institutions Commission, Ministry of Finance and Corporate Relations
British Columbia:	Insurance Corporation of British Columbia
Manitoba:	Manitoba Public Insurance Commission
New Brunswick:	Department of Justice, Insurance Branch
Nova Scotia:	Department of Housing and Consumer Affairs
Quebec:	Societe de l'Assurance Automobile du Quebec
Saskatchewan:	Saskatchewan Government Insurance
Yukon:	Office of the Superintendent of Insurance

United States

Florida:	Office of the Treasurer, Department of Insurance
Illinois:	Department of Insurance
Maine:	State Bureau of Insurance

Europe

Britain:	Department of Transport, Road Safety 3 Division
France:	Commission de Controle des Assurances
Sweden:	Financial Supervisory Authority

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