

MTAWA

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12th October 2004

The Chairman
Smash Repair Inquiry
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

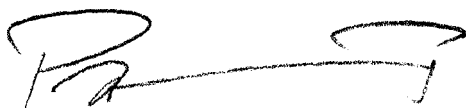
Dear Sir,

Submission: MTAWA

I have pleasure in submitting herewith evidence to the Productivity Commission Inquiry into relationships between the smash repair and insurance industries, prepared on behalf of the body repair industry in Western Australia.

Representatives of the MTAWA would be pleased to elaborate on any aspect of this submission if asked to do so.

Yours faithfully,



PETER J FITZPATRICK, AM
Executive Director



EXECUTIVE SUMMARY

On behalf of the smash repair industry in Western Australian, the Motor Trade Association of Western Australia has welcomed the Productivity Commission Inquiry into the industry; and accordingly has pleasure in submitting the attached submission.

In investigating the nature and effects of business arrangements in the smash repair industry, and particularly the arrangements which currently pertain between repairers and insurers, the MTA WA would expect that the Productivity Commission will be primarily guided by the interests of consumers.

To the extent that those interests are inevitably bound up with other business and commercial arrangements in the industry, with body repair operators being subject to unconscionable costing pressures and structures, the MTA WA would propose that the interests of consumers would be best protected and enhanced through fundamental redress of the operational constraints which adversely affect the industry.

In particular, it is a matter of concern to all involved with the smash repair industry that the proven operational costs can be achieved only by imaginative manipulation of stipulated time schedules; and the fact that operational viability in the smash repair industry is dependent upon such practices is in itself lamentable.

Not only is there flow-on detriment to the rights of consumers in selecting repairers of their choice and in having full confidence in the quality and nature of vehicle repairs, but the operational and structural problems of the industry are having a dilatory effect on the growth and retention of skilled manpower - which in itself poses future problems for the interest of the motoring public.

Those problems are addressed in detail in this submission; and remedial measures proposed by the MTA WA include:

- The introduction of a right for small business to collectively negotiate, including a right of collective boycott.
- The strengthening of section 51 AC (unconscionable conduct) of the *Trade Practices Act* to proscribe unilateral variation of contracts and the termination of contracts at will without just cause.
- The strengthening of section 46 (misuse of market power) of the *Trade Practices Act* to address concerns about the effectiveness of the current provision.
- The introduction of a mandatory Code of Conduct for automotive body repairs.
- Enactment of the MTAA's Charter of Fairness.
- Amendments to the Insurance Contracts Act.
- Introduction of "Anti-steering" Legislation.

Those recommendations, and the problems leading to them, are all substantiated as far as is possible. However, it is a regrettable fact that the MTA WA has found that many individual smash repair operators are loathe to be identified with any statement, observation or other evidence which could be linked to them in any way and thereby jeopardise a business relationship with insurers on whom they have become dependant.

For that reason, the MTA WA has urged that the Productivity Commission to conduct hearings in Perth in order to evaluate personal "live" evidence from individual smash repairers.

The Association would be pleased to add to the submission in any way, and to discuss further any of the points or recommendations contained herein.



SUBMISSION

to the

PRODUCTIVITY COMMISSION

Inquiry into the relationship between the smash repair industry and the motor vehicle insurance industry.

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1. SCOPE

By circular notice issued on 9th September 2004, the Productivity Commission advised that it was "to undertake a public inquiry into the relationship between the smash repair industry and the insurance industry. It is to report within 5 months on:

- The appropriateness and transparency of criteria used by insurance companies to confer "Preferred Smash Repairer" status on smash repairers;
- Financial relationships between smash repairers and insurance companies;
- Arrangements for consumers to have reasonable choice in the selection of repairers;
- The extent of adequacy and independence of dispute resolution systems between the smash repair industry, insurance companies, and consumers".

The specific terms of reference were attached to that advice circular; and this submission by the Motor Trade Association of Western Australia addresses those terms of reference in the context of the smash repair industry in Western Australia.

2. PREAMBLE

In the report of the Vehicle and Recreational Marine Craft Repair Insurance Industries released by the Industry Commission in 1995, the following recommendations were put to Government:

- Inappropriate behaviour by insurers should be referred to the Code Compliance Committee, the body proposed to be responsible for sanctioning insurers who breach the industry Code of Practice, which was advocated by the Report;
- Current time and hourly rate schedules should be abandoned, and quotations should reflect true times and costs;
- The insurance and repair industries should jointly convene a forum to determine processes needed to establish a Code of Conduct and a procedure for resolving disputes.

Evidence submitted to that inquiry satisfied the Industry Commission that the smash repair industry throughout Australia was subject to unconscionable conduct by the insurance industry, to the extent that the Commission agreed that the endemic problems in the industry should be resolved through a mutually-agreed Code of Conduct by which insurers and repairers would be bound. In particular, in advocating the Code of Conduct, the Commission was concerned to ensure that consumers' rights of choice in the selection of body repairer would be respected.

With it now being nearly 10 years since that Report, it is disappointing to note that all attempts by the body repair industry to engage the insurance industry in constructive co-operative negotiations for the establishment of a voluntary Code have been to no avail; with the body repair industry having therefore had no option but to unilaterally prepare a Code of Conduct to address the recommendations of the Industry Commission.

That Code of Practice, which has been endorsed by representative body repair associations throughout Australia, has been approved in principle by the Federal Government, and also by major consumer associations, including the ACA (Australian Consumer Association) and the ACCC (Australian Competition and Consumer Commission).

However, the insurance industry has consistently failed to endorse the Code, or even the concept of a Code; and has in fact attempted to negate the relevance of the Code prepared by the Motor Trade Associations throughout Australia on behalf of the body repair sector of industry.

It is expected that the negative attitude of the major insurers towards the restoration of equity in business relationships with the body repair industry will be reflected in representations and submissions to the Productivity Commission inquiry; and in that respect it is likely that the insurance industry will probably suggest that the viability difficulties confronting many body repair operators is an inevitable consequence of much-needed "rationalisation" in the industry, and is a result of competitive forces from which consumers benefit.

That contention would be reasonable, fair, and appropriate if there were in fact a "level playing field" in the insurance/smash repair industry, and if business relationships between insurers and smash repairers were subject to healthy market forces shaped by the normal dictates of supply and demand.

In this submission, the MTA WA will set out to prove to the Productivity Commission that prevailing market conditions in the industry are artificially disjointed and manipulated by the disproportionate power and influence wielded by the insurers.

Those abnormal market forces have now induced a state of commercial depression in the body repair industry, with potentially adverse implications for consumers, in that prevailing conditions in the industry are a disincentive to necessary investment in equipment and resources, as well as in skilled manpower, to ensure adaptation to the changing technological needs of repair work in the automotive industry.

In the preparation of this submission it was significant to note the reluctance of many individual body repair operators to provide substantiated evidence of market abuse by insurers for fear of possibly jeopardising a source of business upon which they are forced to rely. That any sector of industry should be so intimidated or cowed by some other sector of business is in itself lamentable; and it serves to emphasise the need for the Productivity Commission to receive verbal evidence from individual repairers in absolute confidence in order to substantiate claims and conditions applicable to many parts of the body repair industry in Western Australia.

3. MTAWA: REPRESENTATIVE SCOPE

In submitting evidence to the Productivity Commission, the MTAWA does so as the trade association representing all aspects of the automotive industry in Western Australia.

The Association has 1745 members, operating business enterprises in every sector of the retail motor trade throughout Western Australia, which employs approximately 45,000 people and generates 11 billion dollars through business activity each year.

In regard to the smash repair industry, the MTAWA acts specifically on behalf of its Body Repair Division, which has a current membership of 228 businesses. The Division's membership would constitute 65% of operating smash repair businesses in Western Australia.

For purposes of evidence presented in this submission, detailed discussions have been held with representative operators in the Perth metropolitan area, as well as with operators in all the major country centres in the State.

In addition, all Division members have been invited to present evidence either to the MTA or directly to the Productivity Commission.

However, it is a regrettable fact that the power and influence of insurers in the marketplace in which body repairers operate is such that there is widespread reluctance by repairers to provide individual substantiating evidence which could in any way possibly jeopardise a source of business on which they have come to depend.

Whilst all contentions cited in this submission reflect consistent advice from body repair operators throughout Western Australia, it would be necessary for the Commission to receive verbal evidence from local body repair operators in order to fully substantiate many of the reported abuses and distortions which are now a hallmark of the inequitable business relationships which colour the commercial arrangements between insurers and repairers in Western Australia.

4. COST STRUCTURES

Body repair operators throughout the Perth metropolitan area report that hourly labour rates paid to them by insurers invariably tend to be disproportionate to the real costs of business operation in the smash repair industry, and are maintained at prevailing low rates through the agreement of some operators to accept the conditions and fees stipulated by insurers in return for a ready and continuing source of business.

Prevailing hourly labour rates paid by insurers in the Perth Metropolitan area are about \$26, whilst the estimated cost of operating a viable smash repair business is in the range of \$60-\$90 an hour.

A benchmark study conducted four years ago by this Association found that a rate of \$62 an hour was the substantiated minimum required to operate a profitable business enterprise in the smash repair industry. Yet, despite that study, and despite the fact that insurers pay substantially greater hourly rates to tradesmen in the building, plumbing, electrical and other industries, there has been no substantial change for over 10 years to the very low hourly rates paid to smash repairers.

It is also significant to record that the SGIO (which is now a major component of the IAG insurer) had to acknowledge the industry's benchmark operational figures when that company itself ran 4 trial repair shops shortly afterwards based on "real time real money" arrangements.

The benchmark study of operating costs in the smash repair industry in 2000 is attached as Appendix 1.

The low hourly rate paid by insurers takes no account of the following additional costing areas which impact on the overall operational costs in the smash repair industry:

- General administrative costs and particularly those associated with providing quotations, both successful and unsuccessful.

Those costs are estimated to total approximately 13% of overall operating costs.

- Environmental costs associated with disposal of waste material in accordance with prevailing statutory requirements.

Whilst the RAC, Allianz, and HBF insurance companies are said to contribute to those costs, provided they are reasonable, the IAG group - and particularly SGIO - consistently refuse to accept such costs.

With SGIO publicly lauding its sponsorship association with environmental issues, it is particularly ironic that the company refuses to accept any costs incurred by repairers for clean-up and environmental disposal work.

Warranty work, with repairers usually having to honour warranties offered by insurers.

With many such warranties being "for life", associated contingent expenditure can constitute a significant liability - although it would be the insurer itself which ultimately bore responsibility for honouring a warranty should the repairer not be in a position to do so.

Furthermore, the warranty offered to their own policy-holder clients by the insurer does not necessarily correlate with the warranty which repairers themselves receive from parts' manufacturers and suppliers.

- In some country areas, and particularly in the Pilbara area of Western Australia, repairers are often expected by vehicle owners to collect from and deliver to local airfields or other central points. In addition terrain conditions in the Pilbara in particular often necessitate extensive cleaning of a vehicle before and after repair work.

In the metropolitan area, many repairers report that they are required by the insurer to provide courtesy vehicles and motor vehicle towing services as part of the insurer's service to policy holders.

In all cases, it is the repairer, rather than the insurer, who is expected to bear the cost, with the insurer making no contributory payment.

Similarly, repairers have to bear all costs associated with collection and delivery of a vehicle from an Accident Repair Centre.

In country centres outside of the Perth metropolitan area, repairers would usually have to source parts and equipment from Perth, or elsewhere in Australia.

Associated freight costs and time delays add to the repairer's operational costings; and those additional costs are not taken into account by insurers in their payment of hourly labour rates to repairers.

That contention would also be equally applicable to areas where the hourly labour rate is slightly higher than that prevailing in the Perth metropolitan area; and in that respect the rate commonly paid in the Goldfields is \$36, whilst in the Pilbara area - north of the 26th parallel - it is \$48 (in many major centres north of the 26th parallel, cost of living indices are considerably greater than those for the Perth metropolitan area).

The commercially unrealistic hourly labour rates paid to smash repairers by insurers are exacerbated by rates paid for paint and for parts mark-ups, which add to the business pressures adversely impacting on the smash repair industry.

Hourly paint rates were reduced by the insurers when the supply cost of paint was adjusted by manufacturers with the introduction of the New Taxation System in 2000.

However, although the average reduction applied by the paint manufacturers was 7.32%, the reduced hourly rate stipulated by SGIO (which subsequently became a major part of the IAG) was 9.68%, which in effect was an absolute reduction of 2.36%.

That reduction, which was in excess of the actual reduction in the cost of purchase, was applied by SGIO despite the fact that cost increases in the supply of paint over the previous 5 years had been absorbed by the smash repair industry, along with considerable increases in material costs, wages, insurance, workers compensation, business compliance costs and other operating expenses with there being no compensating increase in hourly labour rates.

Rates paid by insurers for paint have not been adjusted for 10 years.

A schedule of paint rates paid by SGIO in 2000 is attached as Appendix 2 together with a schedule of current paint rates paid by all major insurers.

With insurance companies being concerned with minimising the cost of repairs, and with body repairers being required to offer and honour warranties on their repair work, smash repairers report that they are being increasingly pressured into using non-genuine or generic parts as a cheaper alternative to genuine manufacturers parts.

There are also reports of pressure by insurance company representatives to repair damaged parts rather than replace them with new ones, even though - in the repairer's judgement - such repairs could jeopardise the safety and function or purpose of the part.

The practice of insurers forcing the smash repair industry to use non-genuine parts on repaired vehicles was recently described by an American judge (in an Illinois case against State Farm, which is one of the biggest vehicle insurers in the USA) as being a "calculated deception of the policy holder in a deliberate disregard of its express written promises contained in the policies issued".

With hourly labour rates payable by insurers being so artificially low, body repairers have had to rely on a mark-up on parts to augment their business income. Whilst that mark-up was commonly 25% on the price paid by repairer (accepted by the insurer as being a compensatory payment in view of the very low hourly rate paid by them) it was methodically reduced to 15%, which was the applicable rate immediately prior to the introduction of the GST.

Since then, insurers generally have reduced their mark-up, rates further, with most companies now paying between 12.5% and 14.5%. However, companies in the IAG now pay no mark-up at all, having tied their price to the parts' manufacturers' list price.

That amended payment policy effectively eroded even further the income margin of smash repair operators.

5. SKILLED MANPOWER

In a benchmark study by Project Software Solutions Pty Ltd four years ago, in 2000, the average tradesmen's wage was shown to be \$750 per week. With on-costs, and with productivity based on 38 hours a week, it was shown that it cost a business enterprise \$38.22 per hour just to cover a tradesman's wage; and that figure takes no account of other issues such as production time for the business, and a reasonable profit margin.

When that cost is seen in the context of an hourly labour rate of \$26 paid by insurers, not only is it evident that the hourly rate is completely inconsistent with business viability in the smash repair industry, but one of the reasons for the crisis in skilled manpower resources in the industry becomes readily apparent.

Not only is diminishing business profitability in itself a disincentive to the employment and training of skilled manpower, but the industry is also having to face competitive alternative areas of employment in the mining and other sectors which are not artificially constrained in the same way by commercially unrealistic agreements with third party enterprises.

The problem is made even worse in country areas of Western Australia, where potential employers in the smash repair industry have to contend with "life-style" issues, and also often particular accommodation difficulties (in areas of the Pilbara, for example), in addition to the abnormal cost pressures of business reliance on insurers.

In respect of the benchmark figures relating to the cost of employment, it is significant that the hourly labour rate paid by insurers in 2000 is the same as that paid in 2004, despite the fact that Award rates and other business expenses would have increased in that 4 year period.

Costing schedules used as an industry benchmark are attached as Appendix 3.

With the automotive industry becoming ever more technologically advanced, and with repair methods needing to adjust accordingly, it is of particular concern to the long-term future of the industry, and to the safety and repair of consumers' vehicles, that the pool of skilled manpower in the smash repair industry is consistently declining.

From the perspective of a business operator in the smash repair industry, it is also of concern that the residual value and goodwill of a body repair business is being similarly affected.

6. ASSESSORS

Body repair operators in all parts of the state advise that insurance company assessors "are often" unfamiliar with modern vehicle repair techniques and requirements, with that in itself tending to create difficulties and contentiousness in establishing fair times for various repair functions.

In that respect, there is no evidence of prerequisite training for assessors, nor of any requirement for prior practical experience in the industry.

The increasing prevalence of Accident Repair Centres, operating under the aegis of individual insurance companies, also tends to detract from the integrity and principles of bona-fide assessments, with all damaged vehicles simply being centrally "pooled", and quotations for repairs advertised on a web-site. It is invariably the lowest quotation, rather than the most realistic or best qualified, which is accepted.

There is also no effective, formal dispute resolution mechanism, with repairers simply having to accept an insurer's terms, conditions and rulings.

In that way, the rights of small business operators in the smash repair industry are sorely compromised, and are vulnerable to the financial interests of insurers.

7. CONSUMER CHOICE

It is of concern to body repairers, and ought also to be of concern to Government, that individual vehicle owners are consistently denied the exercise of choice in the selection of vehicle body repairer.

That denial of choice emanates from insurance policies issued by insurers, with repair work invariably being tied to the insurers' Preferred Smash Repairer (PSR) agreements.

Whilst this issue is explained further in the section of the submission dealing specifically with Preferred Smash Repairer agreements, it has particular relevance to warranty work, repeat work, and referral work, with individual body repairers consistently complaining that clients specifically requesting their business services are "forced" to use repairers who have entered into a PSR agreement with the insurer.

However, in country centres in Western Australia it is reported that insurers are more inclined to accept a vehicle owner's choice of repairer than would be the case in the Perth metropolitan area.

In that respect, it is contended by individual repairers that business loyalty and referral business in particular would be more pertinent to country areas than they would be in the metropolitan area, as far as insurers are concerned; and with rural centre population bases being comparatively small, insurers are said to be more likely to accommodate the wishes or preferences of individual policy holders.

Whilst insurers would often contend that vehicle owners do in fact have the right to choose repairers, that "right" is artificial and purely cosmetic. In reality, vehicle owners are consistently told by insurers that they themselves must either make personal payment for any cost differential in repair quotations, or else use the repairer stipulated by the insurer.

The denial of the rights of consumers to have their vehicles repaired by smash repair operators of their own choice has prompted 35 of the States of America to enact "anti-steering" legislation to preclude any one commercial entity from directing any person's business to a third party. In that way it has now become a statutory offence in those States for insurance companies to insist that a vehicle be repaired at any repair shop designated by them.

With consumer rights being similarly denied in most instances of insurer related repairs in Western Australia, legislation of that sort should be urgently considered by Government.

8. PREFERRED SMASH REPAIRER AGREEMENTS

Insurance companies profess to offer specialised service to their policy-holders by using only those body repair shops which have entered into a Preferred Smash Repairer (PSR) Agreement.

However, there is no available evidence of any set of, or publicised criteria for, PSR status, with the result that repairers who are not signatories to an Agreement are often subject to misrepresentative insinuations by insurance companies when insisting that repair work be done only by those who have signed Agreements.

Not only, is there a lack of transparency and prior disclosure in the context of individual insurance companies' Preferred Smash Repairer Agreements, but the Agreements can usually be terminated by an insurer without a commercially reasonable period of notice.

Despite claims to the contrary by insurers, the real essence of a Preferred Smash Repairer Agreement is preparedness by a repairer to agree to a regular source of work in return for very low fees and charges. There is no pre-set, laid down, or publicly-stated criteria relating to equipment, manpower, or experience as a pre-requisite to signing any such Agreement, and consequently many business operators who have invested considerable resources into ensuring their ability to provide a modern effective repair service, are denied work by the insurers.

In attempting to keep their own costs to a minimum, insurers are using the Preferred Smash Repairer Agreements to channel work through repairers who are prepared to accept the insurer's terms and conditions - albeit that stipulated hourly rates for labour are artificially low - and individual policyholders are being pressurised into accepting PSR repairers, with insurers claiming not to be able to guarantee the work of other repairers.

Such claims are nonsense, particularly as the Agreements are not based on any criteria of equipment, service, manpower or experience; and that contention would tend to be substantiated by the use of Accident Repair Centres, through which insurers simply use the lowest quotation for a repair.

Formal legal advice obtained by the MTA WA cautions against use of the PSR Agreements by body repairers describing the Agreements as "unconscionable".

That legal advice, and a copy of a PSR Agreement, are enclosed as Appendix 4.

9. RECOMMENDATIONS

To secure a fairer and more competitive trading environment for small business operators in the smash repair sector of industry, and to thereby address present constraints on small business viability and consumer rights, the MTA WA would urge the Productivity Commission to recommend:

9.1 The introduction of a right for small business to collectively negotiate, including a right of collective boycott.

To ensure that there is fairer and more equally competitive opportunity for equitable business dealings between repairers and insurers, proposed amendments to the *Trade Practices Act*, permitting small businesses to collectively negotiate effectively with large and powerful organisations, should be urgently enacted.

9.2 The strengthening of section 51AC (unconscionable conduct) of the *Trade Practices Act* to proscribe unilateral variation of contracts and the termination of contracts at will without just cause.

Too many small businesses in the smash repair sector of industry are subjected to "non-negotiable" contracts, unilateral variation of contracts, and the termination of contracts without just cause or proper notice. Section 51 AC of the TPA should be amended to proscribe such practices

9.3 The strengthening of section 46 (misuse of market power) of the *Trade Practices Act* to address concerns about the effectiveness of the current provision.

Section 46 needs to be amended to restore the original intentions of Parliament when it amended the section in 1986; that is, that the section applies more broadly than just to a dominant firm. The section also needs to be amended to ensure that it deals effectively with certain types of anticompetitive behaviour, including predatory pricing and the misuse of financial power.

9.4 The introduction of a **mandatory Code of Conduct** for automotive body repairs.

A Code prepared unilaterally by the MTA in accordance with recommendations of the 1995 Industry Commission Report, but without the willing co-operation of the insurers, has been submitted to Federal Government as a basis for the enactment of statutory measures, in default of its voluntary adoption by insurers and repairers alike.

With all attempts to engage the insurers in constructive preparatory discussions having failed, it is improbable that the insurers would now support or cooperate with a voluntary code, and the MTA WA would therefore advocate its statutory enforcement.

In particular, the Code prepared by the MTAA, and submitted to Government, addresses the serious need for the protection of individual consumer rights, by providing for freedom of choice in the selection of repairer.

It also provides for an effective dispute resolution mechanism in the event of disagreement between insurer and repairer.

A copy of the Code of Conduct is attached as Appendix 5.

9.5 Enactment of the MTAA's Charter of Fairness.

Enactment of the Small Business Charter of Fairness, prepared by the Motor Trades Association of Australia, and adopted in its entirety by the Federal Labour Party, would substantially reduce present inequities and imbalances in commercial arrangements between big and small businesses in Australia.

In the context of the smash repair industry, the Charter and the Code of Conduct would restore the right of small business operators to compete equally; to return a commercially feasible profit on their investments; and to provide an effective, safe and professional service to individual vehicle owners.

A copy of the Charter is attached as Appendix 6.

9.6 Amendments to the Insurance Contracts Act.

To ensure that individual vehicle owners are fully aware of their right of choice in selecting a body repairer, clarifying amendments should be made to the Insurance Contracts Act.

9.7 Introduction of "Anti-steering" Legislation

Individual consumer rights of choice should be protected by the enactment of effective "anti-steering" legislation, proscribing the direction of business by a third party business or service provider.

Legislation of that sort pertains in 35 of the States of the USA, and copies can be made available.