

**PRODUCTIVITY COMMISSION INQUIRY INTO THE COMMERCIAL RELATIONSHIP
BETWEEN THE SMASH REPAIR INDUSTRY AND THE INSURANCE INDUSTRY**

KEY MESSAGES

The Victorian Government reiterates the Small Business Ministerial Council's resolution to support, at a minimum a national voluntary Code of Conduct in relation to the commercial dealings between insurers and smash repairers, with particular reference to:

- transparent criteria for preferred smash repairer status;
- effective dispute resolution;
- insurers providing adequate time to smash repairers to consider and make an informed decision on contracts;
- an improved quoting method to reduce pressure on smash repairers to misquote the number of hours worked to improve their overall payment; and
- requiring invoices to be paid within 30 days of receipt.

The Victorian Government has identified key concerns including information asymmetries that should be considered further by the Productivity Commission. This applies particularly in the areas of the preferred repairer scheme, quoting, dispute resolution and late payments.

Specifically, the Victorian Government recommends that consideration be given to:

- implementing a national wide accreditation system for repairers;
- improving quoting mechanisms;
- examining the role of vehicle manufacturers;
- crash testing of common repairs; and
- improving the dispute resolution mechanism for consumers and smash repairers.

Some of these matters would be partially addressed by the national Code of Conduct. However, preliminary advice suggests that other solutions are also required which should be generated in consultation with the industry, such as accreditation.

Analysis of the preferred repairer scheme suggests consumers do not appear to be disadvantaged as long as they retain the right to a choice of repairers. However, the Victorian Government considers that the scheme warrants further analysis with regard to its effect on smash repairers.

1. OVERVIEW

The Victorian Government considers that some of the issues raised by the Productivity Commission inquiry into the commercial relationship between smash repairers and the insurance industry such as payment times and dispute resolution would be best addressed by a national voluntary code of conduct.

The code of conduct should contain performance indicators to measure its effectiveness. If, at the end of a specified period of time it is found that parties are not complying with the code, then serious consideration should be given to making the code mandatory under the *Trade Practices Act 1974*.

In addition, the Victorian Government's consultations suggest that other issues exist which require further solutions and these should be generated in consultation with the industry.

1.1 Key issues for further consideration by the Productivity Commission

The Productivity Commission should give consideration to the following issues:

1.1.1 Preferred repairer scheme

The extent to which customer choice could be impeded by a range of insurer practices, including:

- being advised that the consumer choice of repairer is not acceptable, with the impression conveyed that the chosen repairer does not meet appropriate competency levels;
- threatening policy cancellation in order to coerce the consumer into using the preferred repairer;
- offering cash settlements and forcing the consumer to deal directly with the repairer and forfeit lifetime guarantee; and
- deliberate delaying of assessment by insurers and payment for work performed.

1.1.2 Misuse of market power

The issue of market imbalance, given the evidence to date and the situation where by two insurers have more than 50% of the Victorian motor vehicle insurance market and operate their own repair centres. Market imbalance should especially be examined in cases where an insurer begins capping the preferred repairer scheme.

1.1.3 Industry Rationalisation

The extent to which preferred repairers schemes effectively force industry rationalisation but not in a transparent and measurable manner, with the possibility for this rationalisation to be based on price to the exclusion of considerations of quality.

1.1.4 Standards of Accreditation

The implementation of a National accreditation system. This system could be a progressive one, such a star rating denoting the level of competency, technology awareness and level of training. This system could also comprise an independent audit of quality of repairs every year, which may assist in maintaining confidence in claims of high quality repairs.

1.1.5 Quoting

The issue of who owns the warranty in respect of smash repairs, and therefore has the duty of care. This is critical in light of the situation where the repairer carries the warranty and is then required to pay for subsequent repairs if the work is found to be substandard, despite having followed instructions from the insurer.

The conduct of repairers and insurers in regard to quoting, specifically through the investigation of methods that more accurately describe repair times, for which the hourly rate may then be the subject of negotiation.

Initiatives which might overcome some of the information symmetries inherent in smash repair work, with consideration given to:

- setting minimum standards for types of repairs;
- initial and ongoing training and accreditation of assessors/and or inspectors; and
- a system of independent assessors/inspectors.

The role of vehicle manufactures in providing technical information relevant to the quality of repairs, so as to help ensure safety is not comprised due to differing opinions over methods of repair in the absence of adequate manufacturer's information.

The issue of crash testing to determine the safety of common repairs.

1.1.6 Dispute Resolution

Investigate best practice approaches to alternative dispute resolution (ADA) employed in both business to consumer relationships and business to business relationships.

The structure and dispute resolution procedure in the Victorian Office of the Small Business Commissioner. This may be an appropriate model for a centralised dispute resolution body.

1.1.7 Late Payments

The possibility of a best practice approach to the issue of prompt payments through an industry wide code of conduct, so as to ensure the current momentum to prompt payment is sustained and that the industry does not become complacent with regard to prompt payment.

Including in a code of conduct a mechanism where by disputes over authorised works or other issues leading to the delay in payments are subject to a formal dispute resolution process.

2. INTRODUCTION

2.1 Purpose of this submission

The Victorian Government welcomes the Productivity Commission's (PC) inquiry. It hopes it will resolve issues of transparency and certainty in the smash repairer industry.

Various attempts have been made over the years to regulate dealings between repairers and insurers, including the proposal to introduce an industry-wide voluntary Code of Conduct, as noted in the Victorian Government's background paper at Attachment A. In the absence of an industry-wide code, some insurance companies have developed their own schemes.

Victoria notes that this current inquiry is one of several attempts to address issues in the smash repair industry at the national level. Previous attempts have included: an inquiry by the former Industry Commission (now the Productivity Commission) in 1995; consideration by the Ministerial Councils of Small Business and Consumer Affairs in 2004 and 2003 respectively; a Federal Private Member's Bill (the *Late Payment of Commercial Debts (Interest) Bill 2003*); and work undertaken by the Australian Competition and Consumer Commission (ACCC) in September 2003.

The Victorian Government also notes that the 2003 ACCC inquiry into the industry found no evidence of breaches of the *Trade Practices Act 1974*, but did find conduct perceived to be unfair and unreasonable that could impact on the development of commercial relations between smash repairers and insurers.

On 1 August 2003, the Ministerial Council of Consumer Affairs met to consider various items, including 'Industry relationship between smash repairers and insurers and impacts on consumers'. The Joint Communiqué of the meeting states that:

"Ministers considered the importance of resolving the ongoing problems that have arisen in the structural relationship between the smash repair industry and the insurance industry at a national level... The ACCC was commended for its efforts to resolve these issues and Ministers affirmed support for a solution at the national level."

In July 2004, the Small Business Ministerial Council considered smash repair and insurance industry issues and unanimously supported Victoria's call for a voluntary Code of Conduct in relation to the commercial dealings between insurers and smash repairers, with particular reference to:

- lack of certainty arising from non-transparent criteria for preferred smash repairer status;
- provision of effective dispute resolution procedures;
- ensuring that insurers provide smash repairers with adequate time to consider and make an informed decision on contracts;
- pressure on smash repairers to misquote number of hours worked to improve their overall payment; and
- ensuring that invoices are paid within 30 days of receipt.

Victoria's submission to the Productivity Commission is provided within the context of the Government's support for a national approach to addressing continuing concerns regarding the relationship between insurers and repairers. Access by consumers to quality smash repairs at the appropriate price is inevitably impacted by the relationship between insurers

and smash repairers. Accordingly, the submission addresses the history of this relationship, and its impact on the services and prices for the consumer. The submission has regard to the clarity, certainty, fairness and transparency of the relationship between insurers and smash repairers in four key areas of concern:

- the preferred repairer scheme;
- the quoting system;
- dispute resolution; and
- late payments.

2.2 Recent Victorian Government initiatives

The Commonwealth *Trade Practices Act 1974* is the primary legislative vehicle to address anti-competitive or unfair market practices. In its submission to the Dawson Review into the *Trade Practices Act 1974* and, more recently, to the Senate Inquiry into the Effectiveness of the *Trade Practices Act 1974* in Protecting Small Business, Victoria argued that the misuse of market power provisions within the Act should be strengthened.

At the State level, Victoria is contributing to a supportive business environment that is conducive to investment and jobs growth by developing a range of initiatives aimed at promoting a transparent, competitive and fair environment for small businesses. These include:

- drawing down of the unconscionable conduct provisions of the *Trade Practices Act 1974* into the *Fair Trading Act 1999*; and
- establishing the Office of the Small Business Commissioner to investigate complaints by small businesses that are adversely affected by unfair market practices.

The Office of the Small Business Commissioner (OSBC), established under the *Small Business Commissioner Act 2003*, began operating in Victoria on 1 May 2003. An Australian-first, the OSBC ensures Victorian small businesses can raise grievances about unfair practices by major competitors and government. The OSBC has received several complaints from smash repairers.

The OSBC also promotes informed decision-making by small businesses in order to minimise disputes with other businesses. Since its inception, the OSBC has resolved over 70 per cent of disputes brought to its attention. This resolution process has saved the parties involved in these disputes the significantly higher costs associated with more formal legal processes.

2.3 Industry consultations

On 29 August 2004, the Minister for Small Business, the Hon Marsha Thomson MP and the Minister for Consumer Affairs, Mr John Lenders MP, announced that Mr Luke Donnellan MP, Member for Narre Warren North, would coordinate consultations with interested parties on issues in the smash repair industry. These consultations have informed the Victorian Government's submission to the PC's Inquiry.

As part of the consultation process, a background paper prepared by the Victorian Government was sent to key industry associations, insurance companies, smash repairers and other interested parties (including car manufacturers).

These organisations were invited to meet with Mr Donnellan and/or to submit a written submission. Mr Donnellan and representatives from the Department of Innovation, Industry

and Regional Development and the Department of Justice (Consumer Affairs Victoria) met with insurers and smash repairers and their representatives in metropolitan Melbourne and some areas of regional Victoria. Due to the very restrictive timelines, more extensive consultation across regional Victoria could not be undertaken. (See Attachment B for a list and summary of consultations.)

Many discussions and submissions were conducted and provided on a confidential basis and are not detailed in this submission. However, concerns raised during the consultation process are broadly covered in the submission's discussion of the key issues. The Victorian Automobile Chamber of Commerce (VACC) also surveyed its members and the survey's results have been incorporated into this submission.

The Victorian consultations focused on the PC's terms of reference and the positive steps that can be taken to improve the industry in terms of outcomes for smash repairers, insurers and consumers.

3. PRINCIPAL FEATURES OF THE SMASH REPAIR INDUSTRY

Indications are that smash repairers in Australia are predominantly small businesses.¹ They have, perhaps unkindly, been described as a cottage industry² and there are very few, if any, corporate conglomerates of the type that dominate the smash repair industry in the United States.³

There is a mixture of efficient and inefficient repairers in Victoria, with efficient repairers constantly striving to improve and/or update their repair methodologies and business practices.⁴

Insurers operating in the motor vehicle insurance industry in Australia are large, efficient and well organised. Certainly, all of the key insurers in the Victorian motor vehicle market – RACV Insurance Pty Ltd, Allianz Australia Insurance Ltd,⁵ AAMI Ltd⁶ and IAG⁷ – are companies listed on the stock exchange whose primary objective is to provide a return to their shareholders. A possible exception is RACV Insurance Pty Ltd, which is a wholly owned subsidiary of a mutual company, the Royal Automobile Club of Victoria (RACV) Ltd.⁸ It may be argued that, because a mutual company has complete control over RACV Insurance Pty Ltd, it could require the insurer to act in the best interests of RACV members. However, the Directors of RACV Insurance Pty Ltd are unlikely to initiate programs that

¹ Comparable estimates of the number, size and scale of panel repair shops in Australia and overseas are hard to obtain. AAMI provided some estimates about the number, size and scale of panel shops in Australia and overseas to the ACCC during the roundtable discussions that took place in 2003. These data indicate that there are around 1,925 vehicles per body shop in Australia, compared with 2,453 in the US and 4,717 in the UK. The ACCC indicated that concerns have been raised about the relevance of this data but it is indirectly supported by data from the ABS (ABS 8622.0 Retail Industry, Australia, released in 2000) which shows that over 60% of businesses (by income) providing motor vehicle servicing (including repair shops) employed less than 20 persons (full-time) in 1998-99. It should be noted but that the contribution of these businesses to total income had declined from over 80% in 1991-92.

² On the ABC Radio National program, *Repairing the Smash Repair Industry*, that was run on Sunday 15 September 2002, Mr Rick Jackson from the insurer IAG noted that the repair industry is under-going huge changes, not just in Australia, but globally. Mr Jackson noted that these changes are putting pressures on what has "... been a cottage industry for a long, long while".

³ The insurer AAMI argued that the market structure in the United States is due in part at least to the fact that most North American states have instituted anti-steering legislation that prevents insurers from 'steering' their customers towards a particular repairer.

⁴ Mr Rick Jackson from the insurer IAG (see footnote 2) also argued that there is more to running a repair business than having good technical skills. Repairers themselves acknowledged this. However, Mr Jackson acknowledged that some repairers are getting better by getting bigger while others are specialising.

⁵ Allianz Australia Insurance Ltd is a subsidiary of Allianz Australia Ltd, which is owned by the Allianz Group, an international group of insurance companies. Allianz AG is the holding company for this group and is based in Munich. Manufacturers Mutual Insurance (MMI) Ltd became a wholly owned subsidiary of Alliance AG in 1998. Allianz Australia and HIH Insurance formed a joint venture operation in 2001. This joint venture was managed by Allianz Australia Advantage (AAA). In March of that year, Allianz Australia bought out HIH's interest in the joint venture after HIH collapsed. HIH had previously acquired a number of insurance businesses including FAI Insurance in 1999. As HIH's provisional liquidator, Allianz Australia Ltd confirmed that it would cover the associated insurance policies including car insurance policies issued by FAI Insurance.

⁶ AAMI (Australian Associated Motor Insurers) Ltd, is a listed company that initially specialised in motor vehicle insurance and has branched out into the home insurance market. AAMI evolved out of a company called Club Motor Insurance Agency, established in 1993 as a specialist motor vehicle insurer for members of the RACV.

⁷ Insurance Australia Group (IAG) Limited (formally NRMA Insurance Limited, and before that, part of the NRMA until its demutualisation) has a number of operating subsidiaries which use the NRMA name in NSW, the ACT, the NT, Queensland and Tasmania, SGIC in SA, and State and NZI in New Zealand. IAG provides car insurance in Victoria through CGU (which it acquired in January 2003). CGU had previously acquired the motor vehicle insurance business of the VACC. IAG has also formed a strategic alliance with the RACV and, through its subsidiary Insurance Manufacturers of Australia Limited, underwrites motor vehicle, home and other general insurance products for distribution by the RACV under the RACV brand in Victoria. IAG also sells motor cycle insurance around Australia through Swann Insurance.

⁸ See the RACV's Full Financial Report for 2004. RACV Insurance Pty Ltd is 100 per cent owned by RACV Ltd.

produce benefits unless those benefits are not readily observable by members holding insurance policies with RACV.

The Australian smash repair industry faces many challenges. For example, on the demand side there is evidence that sales of new motor vehicles has slowed, albeit from record levels⁹, and there are fewer and less serious accidents per thousand cars. This reduction in the number of accidents has occurred for several reasons, including increased vehicle safety, reductions in metropolitan road speeds, enhanced enforcement measures, and even the drought (less rainfall means drier roads and fewer accidents). At the same time, technological improvements in motor vehicle manufacture and automotive repair techniques have dramatically increased the complexity of repair work.

Concurrently, insurers have contributed to pressures to control costs in the industry in response to pressures on premiums. This is not necessarily a bad outcome provided that the market signals driving change in the smash repair industry are reflective of customer needs.

There are two separate, but related, markets involving the owner of a vehicle requiring repairs. The first is the market for smash repair parts and service, involving the repairer and the owner. The second is for insurance services involving the vehicle owner and his or her insurer.¹⁰ Accordingly, the role of the owner of the vehicle to be repaired is at the heart of the relationship between smash repairers and insurers.

This role has evolved over time. Many smash repairers consider that the owner of the damaged vehicle is their customer. This was largely true before the 1990s, when insurers would typically require only that customers seek out quotes from different repairers (usually three) and the insurer would agree to pay the smash repairer that offered the lowest quote. Since that time, the industry has moved towards a preferred repairer scheme, where the insurer enters into a contractual relationship with smash repairers to become part of an approved network of repairers.

Consumer Affairs Victoria commissioned Professor Joshua Gans from the Melbourne Business School to prepare a report on approved repairer schemes (a copy of his full report is at Attachment C). This report examined preferred repairer schemes used by larger insurers and compared these schemes with the following hypothetical cases in which insurance companies do not have preferred repairers:

- insurers let consumers choose their own repairer;
- insurers require consumers to gain the requisite number of quotes and then let them choose from the lowest costs ones; and

⁹ ABS 9314.0, *Sales of New Motor Vehicles, Australia*, August 2004. The trend estimate for sales of new motor vehicles fell slightly to 78,510 in August 2004 compared with July 2004 (78,548). When compared with August 2003 (78,683), the trend estimate has shown a decrease of 0.2 per cent. Sales of new passenger vehicles recorded a trend decrease for the fourth consecutive month, declining 0.4 per cent for August 2004. Sports utility vehicle sales increased 1.8 per cent, continuing the increasing trend since September 2003. Sales of other new vehicles decreased 0.6 per cent in August 2004. Queensland, South Australia, Western Australia, and Tasmania recorded increases in the trend estimate for sales of new motor vehicles in August 2004. All other states and territories (including Victoria) recorded decreases.

¹⁰ Sometimes the customer might elect not to activate their insurance policy. For example, this may occur where the damage is minimal and the policy includes an excess. In this instance, there is only one market. This market may provide some work to sustain some smash repairers who wish to operate outside of the preferred repairer schemes; however, it would be unlikely that a large number of smash repairers could operate in this way.

- insurers offer consumers a cash settlement and let them bear the repair costs themselves.

Professor Gans concluded that, while larger insurers may be in a strong bargaining position with respect to smash repairers, preferred repairer schemes ultimately raise consumer value. This is because insurance companies are generally in a better position than consumers to evaluate smash repair services. Consumer warranties on repair services offered by insurance companies also correct a market failure that would otherwise exist.

Moreover, the introduction of these schemes does not appear to have unduly restricted consumer choice. There is a degree of competition in automotive insurance. In addition, insurers offer a cash settlement option that gives consumers the choice they would have originally had. Professor Gans concluded that, from an economic perspective, there does not appear to be a case for government intervention to protect consumers with regard to preferred repairer practices.

However, these conclusions are predicated on the ability of warranties to overcome information asymmetries. This is considered further in this submission.

In this context, this submission considers the question of whether the preferred repairer schemes produce better market outcomes than the old system of insurers paying based on quotes and whether anything needs to be done to improve the preferred repairer schemes for repairers.

In addition, quoting mechanisms and dispute resolution procedures are analysed to determine whether the industry is achieving a best practice approach. The issue of late payments is also discussed in the context of cash flow issues for small business.

These issues are discussed in terms of their impact on insurance companies, smash repairers and consumers.

4. MAIN ISSUES WITHIN THE INSURER/REPAIRER/CONSUMER RELATIONSHIP

4.1 The preferred repairer scheme

Under the preferred repairer scheme, each insurance company has a set of preferred or accredited repairers. Some smash repairers argue that such schemes are evidence of a misuse of market power and should be outlawed. The consumer's relationship is generally with the insurance company. The issue is whether preferred repairer schemes unnecessarily disadvantage either the consumer or the (usually excluded) smash repairer.

4.1.1 How the scheme works

Preferred repairer schemes operate through a contractual relationship between insurers and certain smash repairers. Whilst the schemes differ for each insurer, they generally involve directing repairs to a limited numbers of repairers. These repairers participate in the schemes subject to the insurer's criteria.

4.1.2 Impact on insurance company

Insurers claim that these schemes allow them to have direct and ongoing relationships with repairers, giving them direct control over the quality, cost and timing of repairs.

Insurers reap the efficiency gains provided by these ongoing relationships with repairers, enabling them to provide cheaper premiums to consumers. In addition, the insurers claim that they can guarantee quality by employing qualified assessors to evaluate the performance of their preferred repairers against their chosen criteria, something that would be impracticable and costly for the average individual customer to do. As evidence of this, the insurance industry claims that up to 80 per cent of vehicle owners prefer to let the insurer choose a repairer for them.

Each insurer has its own criteria for preferred repair schemes. However, these criteria commonly include customer service standards and levels of repair costs over a specified period of time.

The manner in which insurers operate differs. For example:

- the preferred repairer schemes may operate in tandem with their customer exercising a choice of repairers; or
- customer choice is limited to a chosen repairer being able to tender for a repair along with a preferred repairer; or
- repairs are allocated through a multi-quote system; or
- cash settlement¹¹ will occur if the customer pursues his or her own choice of repairer option or if the insurer and the chosen repairer cannot reach agreement.

Some insurers claim that they do not impose a cap on the number of preferred repairers, while maintaining their right to refuse accreditation to a repairer they do not consider suitable. Moreover, most insurers claim that some repairers choose not to join a preferred repairer scheme.

¹¹ Cash settlement occurs when the customer uses the smash repairer of his or her choice but the insurer believes that the customer can get the work done in line with the terms of the customer's insurance policy for a lesser amount. In this case, the insurer pays the lesser amount directly to the customer who has the work done at his or her preferred repairer and pays the difference.

4.1.3 Impact on smash repairers

Repairers claim that the criteria and processes to join a preferred repairer scheme lack transparency. Repairers also claim that preferred repairer schemes place an artificial cap on the supply of repairers, limiting the competitiveness of the industry.

For repairers operating outside a preferred repairer network, there are obvious concerns regarding the availability of work, given the large percentage of customers who are insured with the major insurers. These repairers (who may be preferred by the consumer) claim that they are rarely successful when asked to competitively tender.

A related issue is that even for those within the preferred repairer schemes, security of work is not guaranteed. During the Victorian Government's consultations, most preferred repairers spoke to Mr Donnellan on condition of total anonymity due to fear of reprisal. Most claimed that if their insurer discovered that information had been presented for the purposes of assisting the Government in preparing this submission, they would be removed from the scheme with minimum notice and no explanation.

Indeed, most preferred repairers have limited security of tenure, meaning that the insurer may remove their preferred status with only 30 days notice. The insurers maintain that they have the right to ensure that repairs meet high standards and that repairers continue to be assessed as 'fit and proper persons'. Insurers claim that, in order to maintain consumer confidence in their quality assurance, they must have the right to remove repairers from the scheme at their discretion. Some long-term preferred repairers argued that their preferred status was removed because they did not wish to sign a new contract on legal advice.

A further issue is that, as part of the conditions for preferred repairers, some insurers require that their repairers 'win' 50 per cent of all tenders presented. Such a requirement obviously provides an incentive for repairers to provide quotes below their marginal costs to maintain volume. Alternatively, repairers may simply find themselves unable to compete and leave the industry.

Industry churn is a common feature of an efficient industry. As discussed in the introduction, there appears to be an oversupply of repairers in the industry. While one insurer contended there is no quality difference between their preferred and non-preferred repairers (and this is simply a method of offering greater convenience to customers), other insurers contend that the introduction of these schemes was a market reaction to supply forces, enabling insurers to segregate the more efficient repairers from the inefficient, poor quality repairers. The ACCC has stated that:

"The establishment of the preferred repairer scheme has introduced a number of significant benefits for consumers. The ACCC recognises that insurers have a commercial right to limit membership of these schemes depending on each insurer's needs and requirements".¹²

However, there have been allegations of insurers placing these 'better' repairers in situations where they are forced to compete with a 'substandard' repairer who is able to repair at lower costs, knowing that the 'better' repairer will reduce costs in order to win the tender. This appears to be contrary to the intentions of the scheme. It also raises questions about the

¹² Australian Competition and Consumer Commission (2003), *Discussion on the relationship between the Australian motor body/smash repair industry and the general insurance sector, Issues Paper*, page 9

criteria used to determine preferred status and challenges the insurers' claims that preferred schemes ensure quality.

Within preferred schemes, concerns have been raised by repairers over the manner in which work is allocated or in which repairers are chosen to tender for repairs. Many repairers feel that there is no weighting given to the abilities and technological capacity of a repairer to undertake the work, giving rise to quality problems and also undermining the insurer's assurance of quality.

The scheme has also been criticised by some repairers because it 'interferes' with the way they run their businesses. To the extent that it encourages efficiency, this is good for consumers; but it may also be inefficient if it fails to adequately accommodate some of specialist repairers who might tackle more complex and difficult repair work.

It has also been alleged that insurers engage in preferred repairer schemes to 'weed out' unwanted repairers and that this constitutes a misuse of market power. Other conduct that may fit into this category includes 'penalising' repairers by paying them late, failing to be transparent in setting out how repairers can participate in preferred repairer schemes and failing to explain why repairers have been removed from, or not included in, the scheme.

4.1.4 Impact on consumers

From a consumer perspective, the preferred repairer schemes offer many benefits – provided the customer does not wish to exercise a choice of repairer. It is arguable that many consumers are not concerned with choice of repairer: given the relative infrequency of accidents, most consumers have no loyalty to a particular repairer.

Preferred repairer schemes provide benefits for consumers in terms of streamlined information services and in the financial risk of poor quality repairs being borne by insurers and repairers.

The Victorian Government is concerned specifically with those customers who want to exercise a choice of repairer. Evidence has been provided to the Government of consumers being advised by their insurers that their choice of repairer was not acceptable, giving the customer a misleading impression of the competency of their chosen repairers. Effectively, the customer was either coerced into using the preferred repairer (by the threat of policy cancellations) or offered a cash settlement where the consumer is required to deal directly with the repairer and forfeits the lifetime guarantee on repairs.

Further evidence to the Government indicates that some insurers delay assessment and payment for work performed in order to 'punish' the customer for using a repairer outside the network.

The Government is unable to determine the extent to which these practices occur in the industry. However, these matters have significant repercussions for consumers and merit further investigation.

4.1.5 The repercussions of the preferred repairer schemes for the industry in general

- Transparency of criteria for preferred repairer schemes

Insurers consider that the preferred repairer scheme provides a market-based solution to an information asymmetry issue. Essentially, the repairer is in a better position than the insurer or the consumer to know more about the quality of their work. Insurers contend that the scheme allows them to improve the average quality of their work,

place resources where they are needed and reduce the monitoring cost involved in assessing services.

The efficient use of this scheme places pressure on the least efficient businesses and removes excess capacity in the market, delivering benefits to consumers in terms of price efficiency and lower premiums.

However, there are concerns regarding the criteria that are used to determine membership of the schemes. Such criteria should be appropriate, transparent and measurable, especially with regard to quality where the insurer states that their preferred repairers provide better quality. It would appear that the ability to measure quality outcomes is a crucial aspect of the scheme **not** addressed by the industry.

- Misuse of market power

There is also an issue of the alleged 'market power' of the insurers. In Victoria, two insurers have more than 50 per cent of the motor vehicle insurance market, one of which operate their own repair centres, which are clearly part of their preferred repair networks. As insurers have responsibilities to shareholders as well as their customers, it is not unreasonable to conclude that preference may be given to these centres. This naturally leads to allegations of misuse of market power, which can be dealt with under the provisions of the *Trade Practices Act 1974*.

The Victorian Government considers that there is potential for misuse of market power, given the dominance of the market by a small number of insurers. This could lead to insurers reducing the amount they are willing to pay for a service, with sellers (such as repairers) in no position to reject such a price decrease due to their reliance on the dominant buyer. This is especially problematic where there is an excess capacity of sellers (or repairers.)

This problem may not apply where there is an abundance of competition in the insurance market: that is beyond the scope of this submission to determine. However, there appears to be sufficient evidence to support further consideration of the issue of market imbalance, particularly if an insurer begins capping the preferred repairer scheme.

- Consumer choice

There is limited hard evidence that insurers participate in the type of conduct outlined above. The important question is whether the system is beneficial for consumers. It is possible that insurers engage in these types of behaviour because of valid, but unarticulated, reasons for not wanting to deal with certain repairers. If this is the case, consumers may be better off as a result of these practices. Of course, it would be preferable – and fairer for repairers – for these reasons to be made explicit.

It has been argued that the preferred repairer schemes correct the information asymmetry issue for the consumer. Problems emerge when the insurer has differing motives to the consumer. For example, the consumer's primary aim is to properly repair his or her vehicle at a fair and reasonable cost, and repair safety may be a higher motive than cost. However, for the insurer, the incentive may be to increase profits to meet shareholder obligations, and the motive is to achieve lower costs rather than quality repairs (although there is no reason to suggest that it is in the insurer's interest to authorise sub-standard repairs). In these instances, information asymmetry

becomes a problem as the consumer cannot apply appropriate pressure for repair safety in the absence of technical knowledge or information.

One market solution has been for insurers to offer warranties, in some cases lifetime warranties, as noted in Professor Gans' paper. In addition, insurers might bear the costs of future repairs through the application of either the implied warranties imposed in respect of goods by sections 71(1) and 71(2) of the *Trade Practices Act 1974* and in respect of services by sections 74(1) and 74(2) of the *Trade Practices Act 1974*. Similar provisions now exist in sections 31I and 32IA (in respect of goods) and sections 32J and 32JA (in respect of services) of Victoria's *Fair Trading Act 1999*. Protections might also exist in tort law if faulty repairs give rise to litigation.

The notion of warranties providing consumers with protection in relation to search goods (where the quality of the product can be tested before purchasing) and experience goods (where quality can only be determined after experiencing the product) is well established in economics. However, warranties often have limitations when 'moral hazard' arises (for example, where it could be argued that a vehicle owner's driving style affects the quality of the repairs carried out) or where quality is difficult or impossible or very expensive to objectively measure for a court or other dispute resolution mechanism. This especially applies in the case of credence goods (where the quality of the product is difficult to determine, even after purchase and use). In the case of credence goods, the seller acts as an expert determining the customer's requirements and this information asymmetry creates a potential incentive for sellers to reduce quality. Credence goods "face the informational issue with a vengeance"¹³ and often require government intervention to redress information asymmetry. Many goods cannot readily be classified as search, experience or credence goods; rather, they possess attributes of two or more of these categories. Smash repairs are an ideal example and this explains why warranties might work well for some types of repairs, but not others.

To the extent that the preferred repairer schemes are unable to accommodate the different needs of certain groups of consumers, we might expect to see the evolution of alternative types of insurance schemes to accommodate niche markets. An alternative type of hybrid scheme is one which charges different premium levels: for example, one level for customers who do not want a choice of repairer and another, higher premium level for those customers that do want a choice. As the number of customers in these niche markets grows, we might expect to see preferred repairer schemes become more sophisticated as they try to compete for these sub-markets.

Overall, the Victorian Government recognises that the preferred repairer schemes may offer benefits provided that customer choice is not compromised. However, it remains a concern that, in using these schemes, insurers effectively force industry rationalisation – but not in a transparent and measurable manner. As the insurers' primary responsibility may be to shareholders or other persons whose aim is profit maximisation, there is an incentive for such rationalisation to be based on price, to the exclusion of considerations of quality.

¹³ Professor Jean Tirole, *The Theory of Industrial Organisation*, MIT Press, Fourth Printing, 1990, page 106. A good discussion of the information asymmetry problem is presented on pages 100-115.

- Role of Manufacturers

Another dimension to the issue of preferred repairer schemes is that manufacturers of more expensive vehicles have tended to try to involve their customers in what are sometimes called 'cradle to grave' programs. Through these programs, manufacturers supply the customer with a new car every two to three years, together with every aspect of the customer's motoring needs: insurance, road-side assistance, servicing and, if necessary, accident repairs. These manufacturers generally use a limited number of repairers and provide their preferred repairers with the necessary technology, equipment and knowledge to service and repair their vehicles.

4.1.6 Suggested avenues for further consideration - Standards of Accreditation

Insurers claim that preferred repairer schemes act as de-facto accreditation systems in the absence of an industry wide independent accreditation system, however there is no evidence to suggest that insurers assess the skills of the repairers.

Given that the market does not provide sufficient 'signals' as to a repairer's capability and that this measure is left to the discretion of the insurer, the Victorian Government considers that strong consideration should be given to the implementation of a national accreditation system. This system could be a progressive system, such as a star rating denoting the level of competency, technology awareness and level of training. This system could also comprise an independent audit of quality of repairs every year, which may assist in maintaining confidence in claims of high quality of repairs.

An accreditation system may also remove the stigma for those repairers who choose not be part of a preferred scheme and eliminate any innuendo regarding their lack of competency. A national system of accreditation may also address the information imbalance for insurers and customers in choosing a repairer, giving some guarantee of quality and eliminating the practice of cash settlements (which effectively eliminate the insurer's responsibility to their customer).

Under such an accreditation system, the insurers could maintain their preferred scheme of repairers, continuing to offer customers improved service and efficiency. However, transparency would be improved.

Through its consultations, the Victorian Government believes that both sides of the industry are generally supportive of an accreditation system for repairers.

Given the timeframe, the Victorian Government is unable to provide a definitive model for how this accreditation may work. For example, further consideration is required by the Commission on whether an individual or premises should receive accreditation. Consideration also needs to be given to the standards and criteria used for accreditation. The Government notes that there already exists a standard that provides guidance on quality for the motor vehicle maintenance and repair industry: standard AS/NZS ISO 9002:1994¹⁴. The Commission should consider whether this standard is adequate for the industry in 2004.

¹⁴ AS/NZ ISO 9001:1994 is the standard for Quality Management Systems. The definition of quality in this standard refers to all those features of a product or service that are required by a customer. AS 3905.11-1998 is a guideline for smaller businesses, workshops and customers that describes workshop practices and how they relate to AS/NZ ISO 9001:1994.

The Government considers that any accreditation system should be part of a national framework. The Commission should also consider what type of body is best placed to oversee the accreditation system – an independent authority or a Federal Government department. The Commission should also explore a rigorous cost benefit analysis of any proposed scheme, including an assessment of who should bear the costs of the scheme, to ensure that the eventual framework is one in which the benefits to the industry and community outweigh the costs of implementation.

4.2 Quoting

4.2.1 Funny money, funny time

Repairers claim that insurers will only pay an hourly rate of around \$23 – a rate that has not changed for many years. However, insurers allege that repairers over-quote the time taken for repairs. This system is otherwise known as ‘funny money, funny time’.

There are several issues surrounding the practice of ‘funny money, funny time’. Many in the industry have told the Victorian Government that \$50 to \$60 is closer to the average hourly rate required by repairers to meet their costs of capital, labour and levies. Many insurers contend that they do **not** use hourly rates and are more concerned with the overall cost of the repair. These insurers say they allocate work to their preferred repairers based on total cost, proposed repair method and efficiency.

However, the Government has been informed of many instances where the original quotes were allegedly altered by insurance assessors, clearly marking an hourly rate of between \$21 and \$23, which is generally accepted as being significantly less than the labour costs of running a repair shop. It should be noted that this alteration of quotes generally only applies in respect of the repair of parts, not the replacement of parts.

In the Government’s consultations, one insurer was frank about the use of the ‘funny money, funny time’ system and the difficulty of applying a standardised unit of time to a repair. The insurer explained the difficulties in determining the time it would take to repair the panel of a car door. This particular task requires a significant degree of judgement and because of the uncertainty inherent in the system, time allocated for the repair could be higher than required. The insurer claimed that, overall, smash repairers overestimate repair time, so insurers have taken to using hourly rates that are lower than they would be if quotes were based on more realistic times. Accordingly, it has become common practice of repairers to over-quote on the hours taken to carry out the repair work.

The insurer also claimed that notwithstanding the ‘funny money, funny time’ system, it is still generally more efficient to repair parts than to replace them, and repairers prefer to carry out repairs because of the larger profits involved. This also helps to keep the average repair price low and ensures that both the insurer and repairer benefit.

However, there appears to be another element to this system. Many preferred repairers have claimed that all repairers are unconstrained in relation to charging true or premium pricing for third-party repairers. This means that a repairer working for one insurer pads out the fee for third party insurance work carried out for a second insurer. According to the allegation, this enables the repairer to under-quote on the work they do for the first insurer.

At first glance, this arrangement does not seem to be economically efficient because the same outcome could be achieved if repairers all quoted the true hours for all work undertaken. However, it is claimed to be one of the ‘rewards’ of winning 50 per cent of the tenders and these repairers can always win work away from repairers that the insurer does not want in their preferred scheme. Eventually, by setting a repairer up to fail in this way, the

insurer can drop them from their list of approved repairers because they have failed to secure enough work.

While these allegations are unsubstantiated and most insurers deny this practice, it is conceivable that such conduct could occur as not all third party repairs are assessed by insurers. If true, the concern is that these practices are being used as a means of selecting repairers rather than an open and transparent system.

4.2.2 Role of assessors

Assessors play a critical role in the industry and are given considerable scope to determine the appropriate pricing and method of repairs.

The Victorian Government spoke to a variety of assessors during its industry consultations. Many provided anecdotes about an industry where the preferred method of repair was determined principally by cost factors, followed by safety and quality.

The insurers state that their assessors are experienced smash repairers with an intricate understanding of the industry. However, the Government was told that there are also many assessors who are new to the industry (such as apprentices) and who do not possess the necessary industry skills. Notwithstanding the individual assessor's professional opinions, it is evident that most assessors will comply with the business practices of their insurance company, which offers in-house training.

Many repairers consider that assessors act under the insurer's directions to reduce costs to a level that leaves the repairer little choice other than to provide substandard repair work. Many insurers state that quality is not compromised by their policies. However, the Government has sighted a performance plan provided to an assessor that implicitly rewards the assessor for reducing a quote. The Government has also been informed of allegations of kick-backs to assessors by repairers to allow for more generous times.

Given the level of autonomy given to assessors and the antagonism which appears to currently exist within the industry, it is reasonable to conclude that the repairer and the assessor often disagree on the method of repair, particularly if the repairs are assessed via digital photos alone.

Across the industry, there is general disagreement on the effectiveness of online quoting using digital photos of damage. Repairers claim that this method makes it impossible to assess adequately the damage to the internal structure of the car. Insurers claim this system adds to the efficiency of assessing and it is up to the assessor to consider the repairer's opinion on the extent of the damage. For example, an assessor may recommend that the insurer leave the quote open to cover any undiscovered damage.

4.2.3 Repair warranties

The assessor may often direct the repairer to apply certain methods to achieve a cost saving. This is a concern to repairers, given their liability for the warranty of repairs. For example, if the insurer supports a customer complaint that further work is required by another repairer, the original repairer is financially liable for the additional work. This applies even if the original repair method was undertaken on the assessor's instructions. Some insurers claim that the insurer is liable in these situations; however, anecdotal evidence suggests this is not common practice.

Disagreements over the method of repairs are compounded by the apparent reluctance of some car manufactures to provide the industry with detailed information on the engineering

specifications of their vehicles. In these circumstances, repair methods become 'judgment calls' by repairers and assessors. Repairers contend that they should have the final say, as they owe the duty of care to the customer to ensure that the car is repaired to 'pre-accident condition' (however subjective that term). Some insurers consider that, as the provider of the financial guarantees for the lifetime warranty (which expires once the consumer sells the car), they possess the duty of care and thus the discretion to decide the method of repair.

4.2.4 Use of parts

Original genuine parts or OEMs¹⁵, which are parts supplied by the vehicle manufacturer and carry the manufacturers guarantee, are provided at relatively high prices. However, non-genuine parts are now available. These parallel, non-badged parts, along with second hand and recycled parts, are extensively used in the industry.

There is genuine disagreement on the relative merits of each of these types of parts. Some insurers' policies state that repairers are to use only original genuine parts. If a genuine part is unavailable, then a recycled original part can be used. Others contend that original parts are to be used only during the manufacturer's warranty period; after that period expires, recycled parts are permitted. Still other insurers' policies state that parallel parts may be used more extensively.

Many repairers assert that they are being directed to use non-genuine parts in order to lower costs, at the expense of safety. They contend that they will be put at risk because they are not repairing the car to 'pre-accident condition', as many insurers' policies state they must.

Insurers that allow the use of non-genuine parts contend original parts have an unreasonably large mark up, from which the repairers can gain. Repairers contend that this is an issue for the manufacturers.

The introduction of dedicated suppliers to the insurers, who are able to provide discounted rates for parts, has led to subsequent pressure by some insurers for repairers to source all parts from these dedicated suppliers. Repairers claim this activity comprises third line forcing; insurers consider it a competitive advantage which repairers are not obliged to utilise.

The issues of warranty, duty of care and liability are unclear in relation to the supply and fitting of parts. As noted in the ACCC paper, much of the parts repair work is conducted by a sub-contractor who then invoices the repairer, not the insurer, thus leaving the liability with the repairer.

4.2.5 What are the repercussions of this issue for the industry in general?

At the core of this issue is the subjective nature of the assessment of 'quality'. As noted in the Industry Commission's report:¹⁶

"Quality means different things to different people. Some define it in terms of standard of work ... consumers are generally also interested in getting 'good value' for the money spent on repairs.

¹⁵ Parts that are made by the Original Equipment Manufacturer (OEM).

¹⁶ Industry Commission (1995), *Vehicle and Recreational Marine Craft and Insurance Industries*

“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 ...”

Central to this issue is the limited technical expertise of customers and the extent to which they can make informed choices regarding the cost/quality trade off. This decision is essentially left to the insurer, who may not have the incentive to pursue higher quality repairs and may be primarily motivated to keep the costs of repairs low.

Of the many different types of repair work that might be carried out, consumers are probably least informed on those which relate to the structural integrity of their vehicle or those which lead to problems in the longer term. For example, some types of materials used in critical parts of modern vehicles need to be welded using specialist techniques or the repaired part loses virtually all of its strength. In addition, the use of non-standard windscreens can reduce structural integrity in the roofs of some vehicles by up to 30 per cent. Most consumers would be unable to assess the quality of these sorts of repairs.

Similarly, sub-standard vehicle paint jobs may look acceptable initially but may not last as long as they should. Since the consumer is unlikely to know how long the paint work should have lasted, they may not know that they have a legitimate complaint.

While most insurance policies state that a vehicle will be repaired back to its ‘pre-accident condition’, it is often very difficult for an expert to objectively assess what this means for practical purposes, let alone a typical consumer. Most insurance companies in Australia claim that only OEM parts will be used in repair work¹⁷; however, most customers would never be able to tell the difference between an OEM part and an aftermarket part.

In most cases, only a technical expert can tell if there is a problem with a particular part or repair technique and there are very few truly independent private assessors who are funded by the consumer and who might act in the consumer's best interests.¹⁸

This information asymmetry may ultimately lower the quality of repairs. Disagreement over the repair method is therefore a significant issue for the industry. This situation is compounded by the original manufacturer's apparent reluctance to provide access to intellectual property. Whilst manufacturers are entitled to some element of protection, it is an obvious concern if this lack of information leads to a deterioration of quality in repairs.

The Victorian Government considers that there is a degree of market failure due to information asymmetry on the part of consumers regarding the impact of these practices on safety and on the pricing and quality signals of the market. The information imbalance is exacerbated, in part, by the conduct of assessors who may be directed to artificially lower quotes.

Further, the issue of who owns the warranty – and therefore the duty of care – requires more detailed analysis. This is critical in light of the situation where the repairer carries the warranty and is then required to pay for subsequent repairs if the work is found to be sub-

¹⁷ This is despite the fact that existing studies are inconclusive as to whether aftermarket parts constitute a safety issue. For a summary of these studies, see the United States General Accounting Office (GAO) Report to Congressional Requesters, *Motor Vehicle Safety: NHTSA's Ability to Detect and Recall Defective Replacement Crash Parts in Limited*, published by the GAO in January of 2001.

¹⁸ There are some private inspection companies, but repairers claim that the most are either paid for, owned by or get the majority of their work from insurers and are not truly independent.

standard, despite having followed instructions from the insurer. In the case of at least one insurer it appears that the lifetime guarantee is always borne by the repairer whilst they are operating.

The Government is not aware of any crash testing on common repairs and thus matters of safety and quality remain unresolved. There are also no national standards for parts and repair techniques in Australia. In Victoria, repairers and assessors are not required to be licensed or accredited.¹⁹

It might be argued that repair faults do not matter unless they affect the resale value of the vehicle or, worse still, result in injury or death. In a submission to the Victorian Parliament Road Safety Committee, Mr Michael Paine²⁰ suggested that vehicle defects contribute to crashes to a much greater extent than is suggested by police statistics, because police investigations focus on assigning 'blame' and tend to overlook the contribution of defects to crash severity. The same report suggests that vehicle factors, particularly defects, are "causal, possibly causal or contributory" in at least 12 per cent of all crashes.

While no attempt was made to determine what proportion of these vehicle defects might be due to poor smash repairs, the report concluded that "vehicles involved in crashes are much more likely to have serious defects than the general population. In these cases the defects did not necessarily 'cause' the crash (they might simply be an indicator of a high risk operator). However, serious defects are likely to come into play during the demanding circumstances of a crash and make the crash more severe".

The report found that decentralised inspections programs such as the NSW Authorised Inspection Station Scheme tend to be convenient for vehicle owners and popular with the motor repair industry. However, the program is considered too cumbersome to manage and inspections are too thinly spread to ensure that quality inspections are always conducted. In particular, vehicles in poor condition tend to gravitate to less scrupulous inspection stations.

Centralised inspection programs using dedicated specialised equipment (as in the Australian Capital Territory) produce higher quality results. These are likely to be very expensive, but need not be applied to all vehicles every year. For example, they might not be required for vehicles aged less than five years unless they have been in a serious accident.

Victoria currently has no annual government operated inspection programs. Inspections are carried out on vehicles that have been modified or vehicles that have been transferred privately from interstate. Road worthy certificates (obtainable through licensed private inspectors) are required for all vehicles that are sold; again, these involve relatively cursory inspections that may not identify effectively poor repairs or non-standard parts.

¹⁹ There is a licensing system in NSW, but it has been widely criticised as being expensive and largely ineffective.

²⁰ *Vehicle Roadworthiness and Accidents*, a submission by Michael Paine to the Victorian Parliament Road Safety Committee, 19 April 2000. This document may be found on the internet at <http://www1.tpgi.com.au/users/mpaine/defects.html>. Mr Paine is the principle of Vehicle Design and Research (VDR) Pty Ltd which provides consultancy services to the road transport industry, vehicle constructors, vehicle insurers and government. Mr Paine is a Chartered Professional Engineer with over 25 years post-graduate experience in the automotive field and in computer systems and programming. Information about VDR and Mr Paine is available on the internet at <http://www1.tpgi.com.au/users/mpaine/vdr.html>.

4.2.6 Suggested avenues for further consideration

The Victorian Government considers the conduct of repairers and insurers in regard to quoting one of the most pressing issues facing the industry, and one that should be given high priority for consideration by the Commission. Given that this issue is not new to the industry and was the subject of discussion in both the ACCC and Industry Commission reports, it is disappointing that no resolution has been achieved to date.

One solution advocated has been a 'real time, real money' approach. Under this approach realistic estimates for hours and costs are developed and used at the time of quoting. However, some insurers claim that this will lead to a greater emphasis on replacement of parts rather than repair, which will in turn increase payouts and premiums.

The Victorian Government has not had adequate time to investigate the 'real time, real money' process used in most European countries. However, the Commission could conduct such an investigation and specifically, investigate methods that more accurately describe repair times, for which the hourly rate may then be the subject of negotiation.

Any agreed system should be open and transparent to encourage investment in technology for improved time efficiency and to promote quality and confidence in the process.

Initiatives should also be examined to overcome some of the information asymmetries inherent in smash repair work, irrespective of whether there are preferred repairer schemes or not. Consideration might be given to: setting minimum standards for types of repairs (in terms of repair times as well as techniques); initial and on-going training and accreditation of assessors and/or inspectors; and/or a system of independent assessors/inspectors.

The Victorian Government also encourages the Commission to examine the role of vehicle manufacturers in providing technical information relevant to the quality of repairs. The Commission should make necessary investigations to ensure that safety is not compromised due to the differing opinions over methods of repair in the absence of adequate manufacturer's information.

The Victorian Government also suggests that the Commission give consideration to the issue of crash testing to determine the safety of common repairs.

4.3 Dispute resolution

Under current Federal regulations, all general insurers (including insurers of motor vehicles) participate in the industry dispute resolution scheme. Each insurer has dispute resolution processes in place to cover disputes involving their customer. These usually involve an internal process, followed by the option of the dispute being heard by the Insurance Enquiries Complaints (IEC) process.

The IEC Scheme addresses complaints made by customers against insurers. The outcome of the IEC process is binding on the insurer but not on the customer, who is then free to pursue the matter in court.

The advent of preferred provider schemes, which mean that the insurer takes responsibility for the quality of repair work, together with the fact that insurers now have access to the IEC, may partly explain why Consumer Affairs Victoria receives so few queries and complaints about smash repairs.

The current scheme works well for complaints about service, because most aspects of service quality (such as clean rest-rooms or whether taxis are provided to and from a

repairer's premises) are easy for customers to assess for themselves. It can also address those aspects of repair work, such as a poor paint job or other obvious faults such as poor steering that are immediately apparent to consumers. Insurers also have a strong interest in resolving these types of complaints because they cannot afford to have low quality work affect their reputation and/or to result in legal claims against them. However, there are reasons to suspect that some types of less evident poor quality repairs might not impact on insurers such as the use of the wrong type of windscreen.

Further problems may also arise if the aggrieved repairer or customer does not have confidence in the dispute resolution process.

Therefore, while the industry claims that not many customer complaints are received, this does not necessarily mean that the dispute resolution process is workable and 'industry best practice'. There is also conflicting advice as to whether third parties (those not at fault in an accident) have access to the scheme.

However, unlike customer dispute resolution, individual insurers have their own dispute resolution/mediation mechanisms for smash repairers. The Victorian Government is not aware of an opportunity for the repairer to present the dispute to any third party other than the courts or the ACCC.

For repairers, the lack of a formal, centralised, consistent process when disputes arise over quoting and method of repair can affect their working relationship with insurers and jeopardise the quality of repairs. In Victoria, the Small Business Commissioner provides this function.

There also appears to be some lack of clarity in the industry as to whether repairers who are chosen by the customer can access the insurer's dispute resolution process.

4.3.1 What are the repercussions of this issue for the industry in general?

The aim of alternative dispute resolution (ADR) is to provide a low cost, non-judicial way of solving industry disputes.

There are various models of ADR, including formal Ombudsmen set up by governments to consider business-to-business disputes or independent schemes such as the Victorian Energy and Water Ombudsman, which exists for business-to-customer disputes. The appropriateness of a particular scheme depends on the industry incentive structures, information asymmetries, and whether government involvement is required.

ADR is most effective when it is in the stakeholders' interest to make it work and when all parties acknowledge that their different incentives and interests may require an independent third person to act as an adjudicator.

A lack of a proper and meaningful dispute resolution framework in circumstances where incentives and interests are not aligned often leads to resentment, frustration and possibly expensive court action. In the insurance industry, it is difficult to align the interests of shareholders and consumers, and an effective ADR system may reduce the associated pressures and disagreements within the industry. Often it is in the industries where the parties can least afford costly processes that ADR is most successful.

One of the features of the smash repair insurance industry is the lack of investigation of a best practice dispute resolution model. When pressed, most insurers explained that there were not enough consumer complaints to merit any change to the current structure.

However, experience shows that increasing consumer knowledge and awareness may increase the number of complaints received.

The Victorian Government is not aware of any statistics that demonstrate adequate customer knowledge of the dispute resolution framework currently in place in the smash repair industry. Without a formal, established, best practice approach to dispute resolution within a clear framework for managing complaints, major concerns will not be addressed in a manner that encourages confidence in the process.

Some insurers have expressed concerns that repairers have vexatious demands. However, the Victorian model for the Small Business Commissioner (or an Ombudsman model) successfully provides for these issues to be dealt with effectively.

4.3.2 Suggested avenues for consideration

The Victorian Government suggests that the Commission should investigate best practice approaches to ADR employed in both business-to-consumer relationships and business-to-business relationships.

The Victorian Government urges the Commission to note the structure and dispute resolution procedure in the Victorian Office of the Small Business Commissioner. This may be an appropriate model for a centralised dispute resolution body. The recently announced intention to establish a Federal Small Business Commissioner provides one potential opportunity.

In addition, the Commission should ensure that an appropriate education campaign accompanies any ADR process.

4.4 Late Payments

According to the August 2004 Sensis Business Index survey, cash flow was the third most important business concern. The most recent Executive Connection Confidence Index also found that 32 per cent of businesses viewed late payments as a bigger problem now than a year ago.

Cash flow is a significant issue for small business in Victoria. It is widely acknowledged that there is a substantial imbalance in the bargaining power between small and big businesses, and this imbalance generates difficulties for smaller businesses in enforcing prompt payments of debts. Essentially, there is genuine fear of jeopardising future contracts.

The Government is aware that this has long been an issue in the smash repair industry. Claims of insurers taking up to 90 days to settle an account have been common, and this can sometimes be extended if the repairer is not a part of the insurer's preferred repairer scheme.

Insurers state that most repairers are paid within 30 days. If they are members of the insurer's preferred scheme and have electronic direct debit facility, payment can occur much sooner. Insurers have indicated that late payments may occur when there are disputes over the services provided, such as non-authorised works.

The Victorian Automobile Chamber of Commerce regularly undertakes surveys of payment times, highlighting the issue for smash repairers, with the February 2004²¹ survey stating that 25 per cent are paid beyond the standard 30 day period. The Government also notes the criticism these surveys have received from insurers in terms of methodology and sample size.

In the Government's recent consultations, late payment was mentioned a number of times as an issue. However, most insurers and smash repairers have noted that payment times have substantially improved over recent years. This is not to say that there is no longer an issue as the Government sighted examples of debts not settled for over 120 days. However, the Government notes that insurers' payment times have improved with the introduction of automated payment mechanisms.

4.4.1 What are the repercussions of late payments for the industry in general?

The Government notes that late payments are still an issue of high importance to smash repairers, especially for those who are not part of a preferred scheme.

4.4.2 Suggested avenues for consideration

Given the importance of late payments, the Victorian Government suggests that the Productivity Commission investigate the possibility of a best practice approach to the issue through an industry wide Code of Conduct. This would ensure that the current momentum is sustained and that the industry does not become complacent with regard to prompt payment.

It is also important for any Code of Conduct to provide a mechanism whereby disputes over authorised works or other issues leading to the delay for payments are subject to a formal dispute resolution process.

For example, the Victorian Government is leading the way in ensuring fair payments for small business by introducing a fair payments clause into government contracts. From 1 November 2004, all Victorian Government departments will be required to insert a fair payments clause into new contracts valued at less than \$3 million. The clause requires payment of debts within 30 days of receipt of invoices for goods and services supplied. To ensure this occurs, governments department will be obliged to pay penalty interest rates on payments that are not made within 30 days.

The Commission could investigate the feasibility of including this type of model within the Code of Conduct.

²¹ Victorian Automobile Chamber of Commerce (2004) *Insurer Payments to Repairers Audit*