ESURE RESPONSE TO THE CC'S PROVISIONAL FINDINGS

PART I – INTRODUCTION AND SUMMARY

1.1 esure welcomes this opportunity to respond to the Competition Commission's ("**CC's**") Provisional Findings report (the "**Provisional Findings**"). This response should be considered together with esure's earlier response to the CC's Notice of Possible Remedies (the "**Remedies Response**"), dated 22 January 2014.

1.2 esure agrees with the central conclusion in the Provisional Findings that credit hire is the cause of the vast majority of the CC's identified adverse effect on competition ("**AEC**") under Theory of Harm 1. This, in esure's view, is the central source of any AEC that exists in the private motor insurance ("**PMI**") industry and, as stated in esure's Remedies Response, the CC ought to focus its work on remedies on this aspect.

1.3 esure has targeted its response to the Provisional Findings on two particular areas where the CC finds an AEC but where the CC's evidence does not support its findings:

(i) the identified AEC under Theory of Harm 1 in relation to overcosting of repairs and write-offs conflates insurer-to-insurer subrogated repairs/write-offs and repairs/write-offs managed by claims management companies ("**CMCs**") without any evidential foundation for doing so. Consequently, the CC fails to recognise the significantly higher costs arising from CMC-managed repairs and write-offs and the benefits arising from insurers' incentives to increase repair and write-off efficiencies. Furthermore, the CC fails to properly assess the likelihood of any net benefit arising from insurer-to-insurer subrogated repairs/write-offs being passed through to consumers as lower premia; and

(ii) the identified AEC in relation to Theory of Harm 2 ignores much of the evidence available to the CC and is instead entirely based upon the MSXI Vehicle Inspection Report (the "**MSXI Report**"), which is methodologically and evidentially flawed so as to not provide any sound evidential foundation. In particular, the MSXI Report suffers from significant sample bias and fails, through its many methodological shortcomings, to correctly assess both the condition of the vehicle prior to the relevant accident and the condition to which the vehicle was restored following the relevant repair. This has led to a significant overstatement of the degree to which vehicles are not restored to their pre-accident condition ("**PAC**") following an accident.

1.4 The absence of evidence to support the above two AECs ostensibly identified by the CC is extremely concerning. In these circumstances it is only appropriate for the CC to now reconsider the above AECs in light of the evidence (namely the absence thereof) capable of supporting such findings.

1.5 esure looks forward to the opportunity to discuss with the CC the issues covered in this response and its Remedies Response at the upcoming remedies hearing.

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PART II – THEORY OF HARM 1 (REPAIRS AND WRITE-OFFS)

1. Introduction and summary

1.1 As esure has submitted previously to the CC, the majority of overcosting in relation to non-fault repairs is accounted for by CMC-managed repairs.[1] Having reviewed the CC's Provisional Findings, the evidence presented by the CC therein confirms this is the case. In particular, the fact that the cost of an average CMC-managed repair is approximately **£230** higher than an average insurer-to-insurer subrogated repair[2] provides clear evidentiary support for an AEC in respect of the cost of subrogated credit repairs (but not subrogated repairs more generally).[3]

1.2 By contrast, esure's review of the CC's estimates of overcosting in the case of insurer-to-insurer subrogated repairs confirms that the degree of overcosting is extremely limited and unlikely to lead to consumer detriment. As is set out in further detail in section 2 below, the net revenues to non-fault insurers in insurer-to-insurer subrogated repairs, once the costs to the non-fault insurer of managing the claim are taken into account, are estimated by the CC at **£7** per repair claim:[4] however, even this figure overstates any harm to consumers.

(i) First, such "overcosting"[5] can only be expected to arise from non-fault insurers being able to benefit partially from repair/write-off efficiencies generated within their repair network: without such supply chain management efficiencies, the overall costs of repairs (for both non-fault and at-fault claims) would likely be higher.

(ii) Moreover, as the CC recognises, a further fundamental difference between insurer-to-insurer subrogated claims and CMC-managed claims is that competition between insurers will cause non-fault insurers to pass on any revenue benefits associated with "overcosting" to consumers in the form of lower price premia. As set out in section 4 below, esure disputes the CC's analysis of different pass-through rates of net costs and net revenues as between at-fault and non-fault insurers.

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[1] See also esure's response to the CC's Remedies Notice (§3.82).

[2] Provisional Findings, §6.22.

[3] As noted at §1.5, this also extends to cover CMC-managed write-offs.

[4] Please note that this figure should not be taken to be equivalent to the CC's calculation of AEC of £7 per policy premium.

[5] Throughout the response, the term "overcosting" has been used to refer to the CC's provisional finding that non-fault insurers retain positive net revenues when managing non-fault claims which are subrogated to at-fault insurers.

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1.3 The only additional cost identified by the CC associated with insurer-to-insurer subrogated repairs arises from the frictional cost to the at-fault insurer of settling and querying subrogated claims: however, (i) these frictional costs have not been explicitly quantified; and (ii) the CC itself recognises that they are likely to be much higher in relation to CMC-managed repairs (and write-offs).

1.4 Having regard to the above, the CC's determination of an AEC extending to insurer-to-insurer subrogation does not properly reflect the evidence available to it, and fails to take into account the positive effects of the efficiencies generated through insurer-managed repairs, namely the extent to which these are passed on to consumers.

1.5 It should be noted, in connection with this response, that esure considers repairs and write-offs to be inherently linked and part of the same post-accident process. As a result, the same competitive dynamics apply in both cases. Like with repairs, the CC finds that the majority of overcosting in connection with write-offs arises from CMC-managed write-offs (as opposed to insurer-to-insurer subrogated write-offs). In this respect the CC's findings on overcosting of repairs and write-offs can be considered together.

1.6 For these reasons, and as is also set out in esure's response to the Remedies Notice (see, for example, §3.81 *et seq*), esure considers that the most effective remedies will be those which target overcosting resulting from credit-repair and CMC managed write-offs. Potential solutions to an unevidenced AEC in relation to insurer-to-insurer subrogation risk undermining incentives for an efficient repairer network and would distort competition between insurers.

2. Fundamental differences between CMC-managed and insurer-managed repairs/write-offs

2.1 Plainly, esure does not have access to the broad set of data that would allow it to verify in detail the CC's findings on overcosting, but its own experience is in line with the CC's findings that the average cost of repairs managed by CMCs are significantly higher than repairs managed by the non-fault insurer.

2.2 While it is not able to verify the underlying data, esure has reviewed the CC's calculation of the impact of separation on insurer costs. In particular:

(i) the CC estimates that repairs managed by non-fault insurers result in an extra cost of **£95** per repair to the at-fault insurer compared to a substantially higher additional cost attributable to CMCs, at **£325** per repair.[6]

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[6] See Provisional Findings §6.21

(ii) Moreover, while the CC estimates that non-fault insurers will on average retain £95 per repair relative to the costs of their repair, the actual net revenue for the non-fault repairer is estimated to be **£7** per repair, as it will also incur the costs of managing a claim (which the CC has calculated to be £88 per repair).[7]

2.3 In relation to write-offs, the CC's analysis indicates that non-fault insurers, in fact, lose money on average: the costs of write-offs, when subrogated by non-fault insurers, are on average £53 per claim higher than the actual write-off costs due to the difference between the reported and actual salvage value, while the costs of managing the claim are still approximately £88,[8] implying that on average non-fault insurers receive net revenue of **-£35** per subrogated write-off claim.

2.4 On this basis, it is very clear that while, at worst, the extent of "overcosting" on insurer-to-insurer subrogated repairs is estimated by the CC at **£7**, overcosting by CMCs will be substantially higher. Even if CMCs have higher costs of operations, the additional costs of **£230** relative to insurer-to-insurer subrogated repairs cannot be justified.[9]

3. Insurer-to-insurer subrogation model for repairs/write-offs incentivises efficiencies

3.1 Furthermore, even the £7 overcosting identified by the CC is liable to overstate the actual overcharge arising from insurer-managed claims, to the extent that any ostensible overcosting helps to drive efficiencies in repairer networks and salvage management. Absent such efficiency incentives, the costs of repairs managed by non-fault insurers, or indeed all claims, may well be higher. This is consistent with the recent findings of the Italian Antitrust Authority in an inquiry into the Italian motor insurance industry, in which it emphasised the need to incentivise efficiencies within any claims handling model.

3.2 In particular, esure considers that the overcosting the CC identifies in insurer-to-insurer subrogated claims is most likely to be a product of the vertical structures relied on by insurers to engender efficiencies in their repair networks and salvage managers. Repair costs are a crucial cost input for insurers: [redacted]

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[7] See Provisional Findings, Table 6.4, and Appendix 6.6, §23.

[8] Provisional Findings, Table 6.3 and Annex 6.6. §23.

[9] As noted below, given the competitive dynamics in PMI insurance, it is to be expected that any net revenues for non-fault insurers would be competed away, with the effect that very little, if any, of the £7 per claim overcosting would lead to consumer detriment. Taking the same approach to the treatment of referral fees paid by CMCs to non-fault insurers (estimated by the CC at £53 per claim) would leave an overcosting of CMC-managed claims, relative to insurer-to-insurer subrogated claims, of £177 per claim.

[redacted]

It is therefore axiomatic that insurers will adopt pricing arrangements with repairers and salvage managers which reflect these incentives to maintain efficiencies. Such supply management schemes are not unusual and are widely recognised to have the potential to increase efficiencies: for example, volume-based payment schemes can incentivise repairers to offer lower pricing, once they are guaranteed sufficient volume of commerce to justify offering such lower prices.[11]

3.3 Furthermore, such payment schemes must be seen in the context of investments made by insurers in developing an overall lower-cost repair network. For instance, as is recognised by the CC, all of the top ten insurers invest in monitoring the performance of their approved repairers.[12] [redacted] Clearly, these investments in insurer networks will incur significant costs for insurers: [redacted]

3.4 If insurers are able to retain, at least in part, the cost savings from any investment in their supply chain when managing a claim for its non-fault customers, it necessarily strengthens their incentives to undertake such desirable investments: any benefits retained in relation to non-fault claims increase the incentive to undertake such investment, while a requirement to fully pass on such benefits may even create perverse incentives for insurers not to control costs when managing non-fault claims (as these would be fully to the benefit of its competitors).

3.5 esure acknowledges that if non-fault insurers could not retain any of those discounts, they would still have the incentive to invest in lowering the cost of repair when they are at-fault. However, removing any potential for insurers to retain the efficiencies they generate when they manage a non-fault claim could lead to lower incentives to invest in an overall efficient network, and lower incentives to use their (efficient) repairer network for non-fault repairs and write-offs. Both of these alternatives might ultimately lead to **higher** repair costs. Taking this into account, the £7 "overcharge" cannot properly be seen as representing overcosting associated with insurer-to-insurer subrogation.

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[10] [redacted]

[11] The fact that these payments are used to ensure efficiency (rather than to inflate non-fault repair costs) is evident in the fact that [redacted], irrespective of the fault status of its customer. See esure's response to the CC's Questions to Insurers, §60.2.

[12] Provisional Findings, §7.27.

4. Pass-through of overcosting to consumers

4.1 The CC itself recognises that the overcharge of any non-fault insurer-to-insurer subrogated repairs cannot, in itself, be seen as an indication of consumer harm, since non-fault insurers would be incentivised to share the benefits of any net revenue increases with consumers, in the form of lower price premia.

4.2 The CC states that the costs involved in managing a repair "*vary pro rata with the number of repairs managed*".[13] These costs are, therefore, variable and the CC goes on to recognise that "*variable costs… are most likely to be passed through into premiums*".[14] esure agrees with the CC's finding.

4.3 In particular, esure notes that the motor insurance market is one which is characterised by strong price competition, inelastic supply by insurers who are able to increase their sales at a very limited cost, and inelastic market demand (as purchase of PMI is mandatory), all of which are factors that can be expected to lead to high, and close to pro rata, pass-through rates.

4.4 The CC is concerned that the pass-through of non-fault insurers' (net) revenues may be lower than the pass-through of at-fault insurers' (net) costs arising from separation.[15] However, the CC's findings on this point rely on several assumptions, which do not apply to the PMI market, or to the costs and revenues arising out of the separation of cost and liability.

4.5 Most fundamentally, the CC states that the cost effect of separation for at-fault insurers is likely to be more symmetric than the revenue effect to non-fault insurers, because each insurer has a different model of cost subrogation, while insurers receive repair bills from many insurers.[16] However, this analysis does not take into account the following important factors:

(i) the CC itself finds that there are substantial differences between subrogated and captured claims costs faced by different at-fault insurers, with a variation

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[13] Provisional Findings, Appendix 6.2, §63

[14] *Ibid*

[15] Provisional Findings, §6.59.

[16] Provisional Findings, §6.56 (d).

between the two of between £20 and £205. This is directly at odds with the suggestion that the net costs faced by insurers may be symmetric;[17]

(ii) as noted above, a key factor in the net costs and benefits of insurer-to-insurer subrogated claims are the costs of managing a claim (incurred by the non-fault insurer, and saved by the at-fault insurer). esure notes that, as found by the CC, these are substantially different between insurers and will therefore contribute further to asymmetries in the net costs faced by different at-fault insurers;[18] and

(iii) insurers will differ in their ability to capture non-fault claims. This will clearly lead to asymmetries in the insurer's overall cost impact, as insurers who capture more non-fault claims will receive a smaller number of insurer-to-insurer subrogated claims, which will therefore have a smaller impact on its costs.

4.6 In addition, the CC's view that asymmetric effects lead to lower pass-through than symmetric ones is driven by the assumption that insurers who have a stronger market position (in relation to the customer) are able to obtain more cost savings (or revenue benefits).[19] Without this assumption, it cannot be concluded – even if at-fault insurers' net cost effects were more symmetric than the non-fault insurers' net benefits – that the pass-through would be greater for the former than the latter. The CC presents no evidence to support this fundamental assumption in its model.

5. Frictional costs

5.1 The only additional cost of insurer-to-insurer subrogation identified by the CC, over and above the net "overcosting", relates to the frictional costs faced by at-fault insurers in settling or disputing subrogated insurer-to-insurer claims. esure accepts that these frictional costs are indeed a cost of separation. However, the CC's assumption that they are at least as high as the costs saved by at-fault insurers of not managing a claim is not supported by any evidence.

5.2 In estimating the net costs to at-fault insurers arising from insurer-to-insurer subrogation, the Provisional Findings repeatedly fail to account for the cost savings to the at-fault insurer from not having to manage the repair. While these savings are noted by the CC at §6.21, the failure to include them in the CC's calculations is only justified if the CC assumes that the frictional costs incurred by the at-fault insurer in disputing

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[17] Provisional Findings, Annex 6.2, §30. While we understand that the CC has indicated that these differentials might in part be due to accounting differences, esure considers that the magnitude of the differentials nevertheless strongly counters the suggestion that symmetry of net cost increases can be expected.

[18] Provisional Findings, Annex 6.2 §65.

[19] Provisional Findings, Appendix 6.4, Technical Annex §21.

subrogated claims will, at the very least, offset the costs saved by the at-fault insurer of not managing the claim. esure would not expect the costs of managing a captured non-fault repair claim to be substantially different from the costs of managing a non-fault repair claim that is subrogated to the at-fault insurer.[20] Therefore, esure estimates that at-fault insurers would save, on average, the same £88 per repair that the CC attributes as extra costs to non-fault insurers.

5.3 Indeed, there is no evidence presented in the Provisional Findings that would support the suggestion that the frictional costs (of settling or querying the subrogated repair claims) are very high in relation to this sub-set of claims. Rather, as the CC notes, these costs are predominantly related to car hire, and to credit hire companies ("**CHCs**") and CMCs:

(i) "transactional/frictional costs incurred by at-fault insurers **in dealing with CHCs and CMCs** exceeded the average cost of managing repairs that at-fault insurers would have incurred in the absence of separation" [emphasis added].[21]

(ii) "the bulk of fault insurers' transactional/frictional costs, which we assume equal to at least the management costs saved due to separation, **is attributable to replacement cars rather than repairs and write-offs**" [emphasis added].[22]

5.4 Without being able to provide evidence of the frictional costs that would arise through insurer-to-insurer subrogated repairs/write-offs, the Provisional Findings offer no justification for the CC's assumption that they exceed the cost savings to non-fault insurers of not managing the claim.

5.5 esure notes that the reasoning outlined above applies in exactly the same way to write-offs, as the CC has again failed to account for the cost savings incurred by the at-fault insurer, and has therefore failed to accept that the only extra costs to insurers are the frictional costs of querying a subrogated write-off. In esure's own experience these frictional costs are substantially lower than the costs of dealing with write-off claims, as write-offs are typically settled on the basis of reasonable estimates of write-off value.

6. Conclusion

6.1 Based on the above, the Provisional Findings plainly do not provide any reasonable evidentiary foundation capable of supporting an AEC finding in relation to the cost of

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[20] [redacted]

[21] Provisional Findings §6.81(d).

[22] Provisional Findings, §6.83, footnote 50

insurer-to-insurer subrogated repairs and write-offs. The net revenues to insurers when managing non-fault claims are, by the CC's own estimates, not substantially in excess of the costs of managing claims which the at-fault insurer would need to undertake were it to capture the non-fault driver. Furthermore, they are likely to be reflective of insurers' efficiency initiatives in respect of their repairer networks, and can, in any event, be expected to be passed on to customers in the form of lower insurance premia. Similarly, there is no evidence presented in the Provisional Findings that would indicate that the frictional costs of settling or querying insurer-to-insurer subrogated repair/write-off claims are significant.

6.2 In these circumstances, the impact on consumers from separation of cost control and cost liability in relation to insurer-to-insurer subrogated repairs/ write-offs can only be expected to be very limited. While there is, therefore, no evidence to support an AEC of the breadth identified in the Provisional Findings, the CC's evidence does support an AEC that is confined to overcosting in connection with credit repair and CMC handled write-offs.

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PART III – THEORY OF HARM 2 (MSXI REPORT)

1. Introduction and summary

1.1 Due to the lack of underlying information available in the MSXI Report, esure was unable to respond fully to the MSXI Report in its working paper response ("**Initial Response**").[23] esure therefore requested that the CC provide access to additional information to enable it to properly assess, and respond to, the MSXI Report.[24]

1.2 Following esure's request, the CC made certain information relating to the MSXI Report available in a data room (the "**Data Room**").[25] Having reviewed and analysed the further underlying information, the criticisms of the MSXI Report in esure's Initial Response – namely around sample selection and MSXI's methodology – all remain. Indeed, access to further underlying data has both reinforced esure's initial concerns about the integrity and reliability of the MSXI Report and also caused esure to identify further ways in which the MSXI Report is materially deficient.

1.3 esure's concerns are outlined in this further, more comprehensive, response to the MSXI Report. In summary:

(i) esure has significant concerns that the **sample size** relied on is both too small to yield statistically significant results, and that the inspection sample is biased towards sub-standard repair. These concerns, already outlined by esure in its Initial Response and further supported by additional analysis of the underlying survey data provided in the Data Room, fundamentally invalidate the reliability of the MSXI Report's findings.

(ii) In relation to the **approach to vehicle inspections** adopted by MSXI, esure's review of the repairs it managed raises serious concerns that:

(a) MSXI has not taken sufficient account of the fact that any damage to the car observed during the inspection might not have resulted from the quality of the repair but, either by damage to the car before the accident, or in the intervening period between the repair and the inspection (on average fourteen months in the complete sample);

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[23] esure's response to the MSXI Vehicle Inspection Report, submitted 26 November 2013.

[24] In those circumstances, esure's Initial Response was provided to the CC as a preliminary response without prejudice to any further comments esure would be able to provide with access to further underlying information (see email from Christopher Graf to Sean Cornall, sent at 17:03hrs on 11 November 2013 and letter from Slaughter and May to Erika Lewis and Sean Cornall dated 26 November 2013).

[25] As set out in the CC's Disclosure Notice dated 9 December 2013.

(b) the MSXI Report repeatedly fails to recognise an element of discretion in evaluating repairer choices concerning the exact method of repair selected. On many occasions investigators criticise the repair route that was undertaken simply because it differed from the MSXI inspector's own subjective opinion regarding selection of repair method – even in the circumstances where Audatex reports (contemporaneous to the repair) supported the methodology taken by the repairer;

(c) MSXI's findings are, in many cases, simply not supported by the evidence available in the Data Room – either due to a lack of evidence for the apparent faults identified or, more concerning still, because they are contradicted by the evidence that was available; and

(d) finally, taking these factors into account, esure could, on a review of the repairs for which it was the responsible insurer, only identify faults in one out of the [redacted] repairs that had been found by MSXI not to return the car to its PAC.

1.4 While esure's analysis in the Data Room focused on those repairs it managed, the nature of these flaws can be expected to be replicated across the whole inspection sample.[26]

1.5 Given the extent and gravity of the shortcomings identified by esure, the MSXI Report provides no legitimate basis to support a finding of an AEC arising from Theory of Harm 2.

1.6 This is even more the case in light of the significant body of evidence which suggests that the quality of repairs is high (including the CC's own customer survey, the monitoring of repairs by insurers and repairers, the standards adhered to by repairers in which insurers rely, and customer feedback on repair). In particular the CC's own survey of drivers involved in a non-fault accident (the "**Non-Fault Survey**") found that only 11% of all drivers suggested their repaired vehicle was in less than PAC.[27] The Provisional Findings also refer to the survey made by GIMRA[28] which showed that 78% of respondents said they were extremely satisfied with the repair service received and only 6% were dissatisfied overall.[29]

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[26] [redacted]

[27] Non-Fault Survey, conducted by IFF Research, §2.11.

[28] General insurance Market Research Association, survey dated December 2012.

[29] Provisional Findings, §7.19.

1.7 It follows that the CC's provisional finding of an AEC arising form Theory of Harm 2 cannot be sustained.

2. Sample selection

2.1 As noted in esure's Initial Response, the MSXI sample is materially flawed as it clearly has over-selected: (i) customers who thought that their car was not repaired to its PAC; and (ii) cars that had been subjected to a rectification. esure remains of the view that these biases are of fundamental importance and discredit the results of MSXI's inspections and thus the conclusions the CC seeks to draw from them.

2.2 Reviewing the data provided in the Data Room revealed that the sample selection issues already identified by esure are also present in other key variables: for example, the information from the participants' responses to the Non-Fault Survey available in the Data Room suggests that the sample also over-selected repairs that did not use OEM parts,[30] and repairs that did not use new parts where not using OEM parts.[31]

2.3 esure believes that all these factors are an indication that the MSXI sample was biased towards repairs that could be perceived as being lesser quality. The CC appears to recognise this in its Provisional Findings when it states that "it would **not** be appropriate to take the MSXI inspection to be a representative sample of non-fault repairs as a whole".[32]

2.4 However, later in the Provisional Findings the CC suggests that it is able to allow for this bias:[33]

> *Even allowing for this, for example if we assume that the actual prevalence of cars not repaired to pre-accident condition is about half of the MSXI proportion in line with or below our survey respondents' self-assessment, the implication is there could be a considerable number of non-fault claimants who are not receiving the quality of service to which they are entitled.*

2.5 This approach to correcting the results is misplaced as it neither takes into account the various measures of bias that the MSXI sample has been found to exhibit,[34] nor the

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[30] In the MSXI sample, in 24% of the repairs where parts were used these were not OEM parts, while the actual share in the Non-Fault Survey is 15%.

[31] the MSXI sample, in 63% of the repairs where parts were used these were not new non-OEM parts, while the actual share in the Non-Fault Survey is 58%.

[32] Provisional Findings, §7.32.

[33] Provisional Findings, §7.40.

impact on statistical significance of any findings when a sample is attempted to be rebalanced along these lines. This is particularly problematic given the very small size of the MSXI sample in the first place.

2.6 That being the case, the CC's continued reliance on the MSXI Report is at odds with its own guidance,[35] which suggests that consumer survey evidence must have a clearly defined and properly represented population of interest[36] with careful consideration to avoid bias.[37] Although not binding, the CC states that it "will endeavour, where possible, to follow the good practice principles";[38] yet, it is clear from the above that the MSXI Report's limited sample size and bias fall short of the standards prescribed in the CC's own guidance.

3. The MSXI inspections

3.1 At the time of preparing its Initial Response, esure did not have access to sufficient information to properly assess the precision of car inspections carried out by MSXI. However, esure noted its concern that the methodology employed by MSXI might have resulted in a bias towards finding that cars were not in their PAC, through no fault of the repair itself.

3.2 In order to assess whether its concerns were justified, esure has reviewed the reports produced by the MSXI experts for the [redacted] esure-managed repairs in the sample.[39] From this review it is clear that, at most, one of the [redacted] esure-managed repairs identified by MSXI as not having been repaired to the PAC does not meet that standard (Annex A provides a detailed review of evidence in the Data Room available for each of the [redacted] esure-managed repairs in the MSXI study).

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[34] For example, in the MSXI sample, the proportion of vehicles which had been subsequently rectified after the initial repair is at 48% excessively high: if the CC were to assume (conservatively) that the correct proportion was 5%, this would suggest that the sample was more than nine times more likely to select faulty repairs. If the CC had used the same methodology to account for this bias, this would suggest that the actual proportion of faulty repairs was less than 5%.

[35] *Good practice in the design and presentation of consumer survey evidence in merger inquiries*, March 2011, ("**Consumer Survey Evidence Guidance**") http://www.oft.gov.uk/shared_oft/consultations/merger-inquiries/Good-practice-guide.pdf
Note that although the title specifies merger inquiries, the introduction explains that this focus does not '*preclude the principles set out being relevant in other types of investigation*' (§1.10).

[36] Consumer Survey Evidence Guidance, §2.5.

[37] Consumer Survey Evidence Guidance, §3.10.

[38] Consumer Survey Evidence Guidance, §1.15.

[39] Given esure's understanding of its own estimation and repair management systems, esure is better able to review these repairs compared with repairs managed by other insurers, which may use different parameters in their own estimation systems and may have a different repair management system.

3.3 However, esure's review of these inspections revealed several fundamental deficiencies in MSXI's methodology. In particular, esure noted that all of the MSXI records it reviewed indicated that a proper assessment of any faults was not undertaken to ensure that they were related to a lower quality of repair. esure expects that these issues are very likely to be present across the whole sample of repairs, especially as these relate to the methodology applied and because the type of faults highlighted are the same across the whole sample of MSXI inspections.

The relevant benchmark

3.4 esure agrees with the CC that any repair of a non-fault car should return the car to its PAC - the driver's legal entitlement. When inspecting a repair, esure agrees that a repair is sub-par if it does not return the car to its PAC.

3.5 However, when inspecting a car, especially when the inspection is taken some time after the repair, an inspector is not able to correctly assess:

(i) the car's condition just prior to the accident;[40] or

(ii) its condition immediately after it was repaired (the "**Post-Repair Condition**").[41]

A proper assessment of a repair will include an effective methodology to estimate these two conditions. Once properly identified, a repair robustly can be classified as being sub-par if the Post-Repair Condition is not the same as, or better than, the PAC.

3.6 esure expressed concern in its Initial Response that MSXI did not give enough consideration to this inherent difficulty in its assessment.[42] esure would expect that any inspection exercise should start by setting out the assumptions and the methodology it used to ensure that it was able to attribute any faults, with a reasonable level of certainty, in the car to the repair process. Having now had access to further information underlying MSXI's approach to the assessment, it is clear that MSXI fails to do this. In fact, the MSXI Report presents no information at all on its methodology.

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[40] esure notes that it is in fact impossible to perfectly assess the PAC at any stage after the accident. However, there are well established industry methodologies that allow for the identification of pre-accident damage, for instance by estimating the impact area of an accident.

[41] For instance, by comparing the deterioration of the vehicle in repaired and non-repaired areas of the vehicle.

[42] See Initial Response, §§3.1-3.5.

Approach to PAC

3.7 In order to estimate whether a car, through repair, was restored to its PAC after a repair that has occurred some time ago, the relevant benchmark should be set such that:

(i) it does not capture any faults that were present in the car **before** the accident (i.e. tort law does not require the repair of any faults that were present in the non-fault driver's car before the accident); and

(ii) it does not capture any fault in the car arising **after** the repair (i.e. a car can be expected to suffer light damage due to wear and tear, or more material damage from subsequent use, e.g. driving over a deep pothole, and the insurer is not under any obligation to ensure that the non-fault driver's car will remain in PAC forever).

3.8 As is clear from the above, to properly assess a car, the relevant benchmark at the time of the inspection is the car's condition at that point in time had the accident not happened. It is against this counterfactual that the MSXI analysis should have been conducted and it is against this counterfactual that esure has reviewed the evidence from the inspections (as set out below).

Assessing the PAC and Post-Accident Condition after the event

3.9 A repair inspection plainly must establish to a sufficient standard that the faults identified arise out of, or are due to, the repair. If this likelihood is not assessed, then any inspection is bound to find many false positives simply due to the fact that cars are not generally in a perfect (i.e. new) condition. The average age of the cars in the sample was 5.3 years at the time of repair, while on average there was a 14 month period between the repair and the MSXI inspection. It is thus probable that all cars inspected will have been subject to minor damage from wear and tear in the intervening period which would not be attributable to the accident or the repair.

3.10 A review of MSXI's inspections confirms that MSXI failed to take sufficient account of the possibility that that the damage observed was either part of the PAC, or may have been sustained since the repair. The latter is clear from the fact that MSXI continually refers to whether cars were in a PAC at the point of inspection, even when that inspection has taken place, in many cases, over a year after the repair.

3.11 Put otherwise, MSXI did not apply any methodology at all to account for the most obvious pitfalls when assessing a repair. This major shortcoming fundamentally erodes the evidential value of the MSXI inspections and MSXI Report.

MSXI's failure to account for the PAC

3.12 As stated above, the difference between the time of the repair and the inspection (on average, over one year for the cars in the MSXI sample) necessarily implies that it is harder to correctly determine a car's PAC[43] – and its true post-accident condition – as part of the inspection process. It was therefore vital that MSXI carefully took into account:

(i) any contemporaneous information, such as the Audatex estimation reports which are carried out right after an accident; and

(ii) the likelihood that any faults found with the car were present before the repair was undertaken and were not attributable to the accident covered by the repair. This is particularly relevant given that the cars in the MSXI sample included many older cars, with the average age of the car in the sample at the time of the repair being 5.3 years.[44]

3.13 MSXI purport to be experts in the assessment of the PAC,[45] which makes it all the more striking that its inspectors did not take sufficient account of the possibility that any faults/defects identified were present in the car's PAC. This is clear from just the esure-managed sample of repairs. By way of example:

(i) when inspecting car [redacted] in the sample, the MSXI Report states that it found damage on the parking sensor on the right hand side of the car, and attributes this damage to the repair. However, the Audatex repair estimate indicates that this car had suffered damage on its left hand side due to the accident and all repairs were carried out on that side of the car. Furthermore, the evidence in the Data Room indicates that the right hand parking sensor had at some point been removed and refitted. Given that the repairs being inspected were carried out to other side of the car, and there was no indication that this parking sensor was refitted or replaced, this was more likely to have happened prior to or after the repair; and

(ii) when analysing car [redacted] the MSXI inspector finds that the repair is unsatisfactory, because the colour of a panel which was repaired allegedly does

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[43] In fact, to be able to correctly assess the PAC, a vehicle would have to be inspected with a very high frequency to ensure that any minor damages would have been caught.

[44] The determination of a vehicle's age at inspection is based on the difference between the year the inspections were done (2013) and the car's registration year. Please see footnote 46 for details on estimation of the time elapsed between inspection and repair.

[45] MSXI Report, slide 4.

not match other areas adjacent to the panel. While esure could not identify the alleged fault from the documentation provided in the Data Room, it is notable that the MSXI Report fails to mention, or take into account, the fact that areas adjacent to this panel have previously been repaired poorly, despite this being clearly mentioned in the Audatex estimation report. Since the Audatex comments were made immediately following the accident, it is esure's view that the apparent colour mismatch in the panel is more likely to be due to the previous faulty repairs, rather than to the repair assessed by MSXI.

Failure to account for wear and tear since point of Post-Accident Condition

3.14 In addition, esure found that in almost all MSXI inspections it analysed, the reasons given by MSXI's inspectors for finding repaired cars not to be in PAC are factors such as minor paint damage, especially in areas around the wheel arches, which can often be accounted for by normal wear and tear in the time between the repair and the inspection by MSXI.

3.15 For example:

(i) when inspecting car [redacted] the MSXI inspector lists the fact that the car had been touched up as a fault of the repair, but does not link this directly to the repair being analysed. This could have been due to any other instance such as minor damage caused by stone chips picked up through normal use since the repair;

(ii) when assessing car [redacted] the MSXI inspector concludes that the repair was not satisfactory because the boot was hard to close due to a misaligned tailgate. However, esure's experts understand that the tailgate for this car is positioned on fixed points and therefore will only fit in one place. Since this car had driven 11,600 miles since the repair, it is more probable that over time the tailgate had become hard to close as a result of an object causing closure obstruction;

(iii) the MSXI inspection report for car [redacted] speculates that rusting damage is due to a grinder catching the frame during repair, which the repairer failed to paint. esure notes that this damage is very common wear and tear damage (from the repeated opening of a door) and is surprised that the MSXI inspector did not even consider this possibility rather than attribute it to the repair; and

(iv) in assessing car [redacted] the MSXI inspector finds various faults in back of the car, including damage to the number plate and loose left tailgate grip handle and inner trim clip, but fails to notice that, as is clear from the Audatex report, none of these parts were damaged in the accident and were thus not repaired. It is therefore apparent that these faults were due to damage occurring after the repair. In fact, the MSXI inspectors completely disregard the fact that the car had driven more than 10,000 miles since the accident and purport to attribute

other likely wear and tear issues, such as the paint flaking and problems with the wheel arch and wheel trims, to the repair being faulty.

3.16 As detailed in Annex A, esure found many other similar instances where MSXI failed to take into consideration whether an identified 'fault' was attributable to the quality of the repair or to subsequent use of that car or, as noted in §3.12 *et seq* above, to its PAC.

3.17 This failure on the part of MSXI is all the more significant when the cars inspected by MSXI, which were inspected on average 13.6 months after the initial repair,[46] had been driven on average 11,010 miles in the period since repair.[47] To put these figures in context, the AA estimates that a car's value would depreciate on average at least 20% per year when driving 10,000 miles.[48] While this depreciation is also driven by general demand and supply conditions, it is also reflection of the fact that older cars are expected to have small minor "faults" from wear and tear, such as slight deteriorations in painting, rusting in parts of the car, stone chips or small dents caused through general use.

3.18 In other words, it appears that MSXI's inspections have compared a car's current state against an unidentified PAC (which may or may not correlate to the specific car's PAC), rather than comparing the car's Post-Repair Condition with its PAC. In any fair assessment of repairs, MSXI's inspectors ought to have taken into account any expected damage likely to arise due to use of that car since the repair.[49]

Alleged failures due to repair route

3.19 As the CC is aware, the correct repair route for accident damage will be taken only after considering all the relevant factors. In particular, when a repairer decides whether to replace or repair a damaged part, it will consider a number of factors, including the extent of damage to the part, the viability of a repair, the car's age and the PAC of that

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[46] Based on esure's estimates. Note that the date of inspection and repair were redacted from the Data Room. However, esure has estimated the time elapsed between the repair and inspection by dividing the miles driven by the estimated average yearly mileage of each vehicle. Please see footnote 26 below on the estimation of the miles driven between repair and inspection. The average yearly mileage of a vehicle has been calculated by dividing the car's total mileage by the car's age.

[47] Based on the difference between mileage in the inspection report, and mileage reported in the Audatex pre-repair estimate. Note that these data was not available for all vehicles and some vehicles were not included due to probable typos in the reporting of mileage at inspection (where the vehicle mileage was lower than the, evidenced, mileage at the time of the repair and one observation where there was a typo in the vehicle inspection report).

[48] http://www.theaa.com/motoring_advice/car-buyers-guide/cbg_depreciation.html (visited on 21 January 2014).

[49] Obviously a careful assessment would have to take into account each car's special circumstances such as the miles that have been driven, the conditions of the roads that it normally drives in, the condition of any areas not affected by the accident, etc.

part. For example, for a repair to obtain a PAS 125 BSI Kitemark licence [redacted], the repair route chosen must adhere to the repair methods for the identified faults prescribed by the car manufacturer or Thatcham's escribe. Amongst other things, these stipulate whether each component should be repaired or replaced.

3.20 Ultimately, esure, the repairers and the estimation service providers (who are all experts in the repair field) take a decision after considering all the variables involved, and this decision always is taken with the customer's best interests in mind. While different experts may disagree on the route to take on each repair, and, in fact, different repairers may feel that they are able or unable to repair the same damaged part, care is always taken to ensure the repair route does not lead to an inferior quality repair.

3.21 esure would expect MSXI to be aware of these processes and in particular to understand that there is, *a priori*, no reason to expect that a repair is of a lesser quality just because one route was chosen over another. esure is therefore surprised that, in assessing a number of repairs, the MSXI Report classifies repairs as faulty simply because MSXI disagrees with the chosen route, without supplying any reason for why this would lead to a lesser quality of overall repair or why it would not be able to restore the car to its PAC.

3.22 For example:

(i) when assessing car [redacted] the MSXI inspector stated one of the faults was that a panel was repaired and should have been replaced, without providing any supporting evidence for this claim or any evidence of detriment as a result of the decision to repair; and

(ii) when assessing the repair car [redacted] the MSXI inspector suggested that the car's rear bumper should have been replaced and not repaired, without providing any supporting evidence for this claim.

3.23 Notably, it would appear from some of the inspection reports that the MSXI inspectors took the view that any damaged part should always be replaced. In esure's view, this fails to take into account that the repair route chosen in each case is done with the objective of correctly indemnifying the injured customer. Whether a repair or replacement of a component is appropriate depends on many factors which MSXI did not take into account.

Lack of evidentiary basis

3.24 A more general review of the evidence provided in the Data Room also leads esure to consider that many of the MSXI inspection reports lack the evidentiary support for the faults in a car's repair that MSXI purport to identify. In particular, some inspections present no photos at all, while others present photos of very limited quality or where the alleged fault is not visible. While this does not in itself indicate any bias in the results, it does limit esure's ability to verify or challenge the conclusions reached.

3.25 More concerning still are those cases where the evidence available appears to contradict directly MSXI's findings. This is particularly true when comparing the MSXI findings to the Audatex estimation reports, which provide the best available contemporaneous evidence of the damage resulting from the accident and of the car's PAC. The Audatex reports are therefore much more reliable in assessing both the accident damage and the PAC given that they are carried out immediately after an accident.

3.26 While Annex A provides a more detailed analysis, just some examples where the MSXI Report's evidentiary basis is questionable include:

(i) the report identified as [redacted] has inspected a car that is a different make and model than the car for which repair data was provided; and

(ii) when inspecting car [redacted] the MSXI inspector suggests that repairs have not been carried out on the near-side (left-hand) B pillar as per the repair estimate. However, the original Audatex repair estimates provided to MSXI clearly show a picture of this part in the process of being repaired.

4. CC's conclusions on insurer selected repairers

4.1 In its Provisional Findings, the CC concluded that repairs are more likely to be low quality when an insurer, rather than the driver, chooses the repairer,[50] based on the customer's response to question C6 of the Non-Fault Survey.[51] The CC considers this as evidence for its concern under Theory of Harm 2 that insurers are more likely to choose a lesser quality repairer for their customers.

4.2 While esure is unable to comment on the repairs handled by other insurers (due to differences in each insurer's internal processes) it is evident from the sample of claims esure handled that customers are likely to recall incorrectly that esure chose the repairer, when in fact it was chosen by the customer.[52]

4.3 In the Data Room, esure found that [redacted] repairs which were marked as not being repaired to PAC, and where the customer survey indicated that esure had selected the repairer,[53] these repairers had in fact been selected by the driver: this is

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[50] Provisional Findings, §7.36.

[51] Question C6 of the Non-Fault Survey asks "Who made the final decision as to who would carry out the repairs / that no repairs would be carried out?" (see IFF Survey report, page 217).

[52] esure notes that while it was not able to determine the identity of the relevant repairers, due to the CC's excisions to the evidence in the Data Room, it was able to assess whether it had chosen the repairer itself from details on the technical documentation provided for each repair (see footnote 54).

[53] In all of these cases, esure had been the at-fault insurer.

evident from the fact that the repairs had been completed outside of esure's repairer network.[54] In other words, based on esure's sample, at least [redacted] of the repairs recorded as non-PAC and where the repairer was purportedly selected by the insurer are likely to have been incorrectly recorded due to the customer's erroneous recollection.

5. Conclusions

5.1 esure was surprised by the MSXI Report's findings, which are at odds with its own car repair audits and also with a number of other industry-wide reviews. esure's Initial Response was able to identify, even on the basis of the limited information available to esure, that the MSXI Report's sample was biased and its methodology flawed.

5.2 Following access to the further information provided in the Data Room, it is clear that the MSXI Report's flaws extend beyond those initially identified by esure:

(i) the MSXI sample is biased towards repairs that could be perceived as being lesser quality and its small sample size means that this significant bias is not able to be rebalanced;

(ii) the methodology employed by MSXI in carrying out its inspections and analysis is deficient in several fundamental ways: MSXI's methodology fails to identify both the PAC of a particular car, as well as the Post-Repair Condition (i.e. it fails to take into account the often lengthy intervening period between repair and inspection). This leads MSXI to assess a car's condition against the wrong counterfactual, causing its analysis to be fatally flawed;

(iii) MSXI appear erroneously to regard repairs as faulty simply because they disagree with the repair route chosen by a team of experts for a given repair, without providing any reason for the view adopted by MSXI; and

(iv) the evidentiary basis underpinning MSXI's analysis appears to contain errors and, importantly, fails to take into account, and is often at odds with, evidence contained in Audatex records, which provide a contemporary (and thus more accurate) record of PAC and the quality of repair undertaken.

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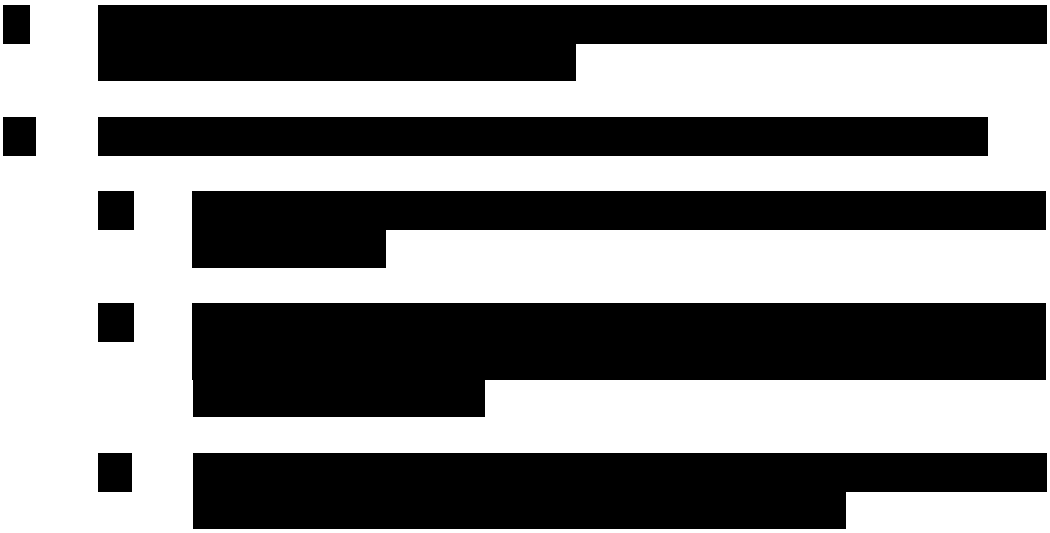
[54] esure was able to identify whether a repair was carried out in its repairer network by analysing the underlying repair estimate data provided in the data room. In particular, when a customer selects its own repairer, then esure will receive a cost estimate from that repairer, and will have to issue an authorization of the repairs, through a Repair Authority, before any repairs are undertaken. This documentation will then be part of the bundle of documents that is kept for the repair, and is therefore part of the documentation sent to the CC for each repair. As previously submitted by esure, when it selects a repairer for a driver, esure always selects a repairer in its repairer network.

5.3 In the case of the esure-managed repairs in the MSXI sample, these material shortcomings led MSXI to make a number of erroneous findings:



5.4 Coupled with the serious deficiencies in relation to MSXI's sample, it is clear that the actual share of repairs that were not of PAC quality is much lower than suggested in the MSXI Report. Assuming MSXI has overstated the extent of "non-PAC" repairs in the sample as a whole to the same extent it has for esure-managed repairs, this suggests that only [redacted] of the repairs were not of PAC quality, rather than the [redacted] indicated by MSXI.

5.5 Moreover, a rate of [redacted] would still not take into account the sample selection problems that the MSXI Report suffers from. The CC has itself suggested that accounting for these might halve the incidence of faulty repairs as compared to MSXI's measures; however, as set out above, in esure's view even such an adjustment is likely to substantially overstate the true incidence of faulty repairs.

5.6 All of these flaws indicate that the MSXI Report is so fundamentally flawed that it cannot possibly provide a sound evidentiary basis for any finding by the CC in its market investigation. It is esure's view that the MSXI Report is so flawed – and incapable of rectification – that the CC must set aside the MSXI Report and instead have regard to the other evidence it has obtained during its market investigation that is relevant to Theory of Harm 2.

Annex A

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