5 Views of third parties

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Introduction

5.1. We invited views from competitors, intermediaries, motor car manufacturers and fleet management/leasing companies, trade and consumer associations, trade unions, the DETR and other interested parties. This chapter summarizes the evidence we received. Oral hearings were held with the AA, Britannia, the Consumers' Association, Direct Line, Europ Assistance, London Association of Recovery Operators, Lex Service PLC, Mondial and The Prudential Assurance Company Limited.

Competitors

The Automobile Association

5.2. The AA told us that it had provided services to motorists for over 90 years. For many years the market comprised the AA and RACMS and the level of overall competition was low. Following Green Flag's entry the market had become much more competitive. In response the AA had started to focus more on improving value and service quality for its members. It had developed a new management system and restructured its working practices, for example, in call handling. As a result of the galvanizing effects of competition over the past five to ten years, AA members now received the best breakdown service ever delivered by the AA.

5.3. At the end of 1997 the AA had adopted a new strategy designed to reassert its pre-eminence in the face of growing competitive pressures. Recognizing that, in a 'not-for-profit' organization, there was not the same profit motivation as in a plc, the AA's new Director General was determined that its breakdown services should be run on strictly commercial lines, even though not for profit, while all its other businesses (for example, financial services) would be run on plc lines. In 1998 the AA exited from several activities in order to cut costs and simplify the business, reducing its employee numbers by 1,200.

5.4. The AA had achieved an average time to attend of about 46 minutes in 1997 and concluded that this was unsatisfactory given Green Flag's claim of 35 minutes time to attend. It had therefore set out to improve all aspects of service quality, not just time to attend but also time to answer calls and the ability to fix vehicles at the roadside. By a combination of measures—investment in technology, improved call handling, increasing the number of patrols, improving their flexibility through new rostering arrangements and making more use of contractors—the AA had brought down its average time to attend to 34 minutes in 1998.

5.5. The AA's financial policy was to maintain reserves sufficient to run the operation for at least 12 months. Its status as a mutual organization, and whether this constituted a constraint on its ability to compete, continued to be under active review but no decision for change would be taken unless it was in the best interests of AA members. Adequacy of funds for investment in order to remain competitive was one factor that would influence future consideration of this issue.

Market definition

5.6. The AA saw the market for insured breakdown services as comprising two main segments—personal membership and business cover. Personal membership, which had always formed the core of the AA's service, was purchased on a discretionary basis by the motorist. This included purchase through intermediaries. Business cover was vehicle-based and provided on a commercial basis to organizations, notably motor manufacturers and fleet operators.

5.7. The AA had chosen not to sell through intermediaries because margins were lower and because the AA preferred to have a direct relationship with individual members. Many members who acquired vehicle-based cover automatically as a result of buying a new car chose nevertheless to retain their AA membership. For those who did not, the AA would suspend their membership and reactivate it when the vehicle-based cover came to an end.

5.8. The AA's primary aims in seeking to win motor manufacturer contracts were to continue the relationship with its personal members and to build partnerships with vehicle manufacturers. If motorists continued to receive service from the AA under a motor manufacturer scheme, having bought a new car, they would be more likely to reactivate their personal AA membership afterwards. The AA aimed, nonetheless, to make a profit on its motor manufacturer business [*Details omitted. See note on page iv.*].

5.9. The supply of breakdown services for heavy vehicles was a specialist area. The AA provided a call-handling and deployment service, largely on a POU basis, and used contractors to provide the actual breakdown service.

Competitors

5.10. RACMS had suffered due to the strong positioning of the AA as the fourth emergency service and Green Flag's credible, value-for-money offering. It had attempted to differentiate itself with a new corporate identity focused on mobility but this was not perceived to be a success. Nevertheless RACMS had been more innovative in the last two years, for example it had introduced a no-call-outs discount and, earlier in 1998, had marketed the first traffic-warning device available to the public at a low price.

5.11. Green Flag was a skilled competitor and had used marketing techniques not previously used by the AA and RACMS. It had been a key innovator: it had been largely responsible for the development of intermediary sales channels and had been very successful in promoting a value-for-money proposition focusing on speed of arrival, establishing 35 minutes as the industry norm for average time to attend. As a result its impact on the market had been far above the level indicated by its market share, and it had provided more impetus for competition than RACMS had.

5.12. Direct Line appeared to have been recruiting about 10,000 members a month since its launch as a direct provider in May 1998. The amount it had spent on advertising and marketing would indicate that its average customer acquisition cost was high. The 70,000 members recruited to the end of September were probably the easiest to acquire. Direct Line's action in offering 50 per cent discounts to people who also bought motor insurance from it suggested that it might be having difficulty meeting its sales targets. The AA saw Direct Line as a considerable potential threat but insured breakdown services were not yet a commodity as motor insurance had become: reputation still mattered and Direct Line had some way to go before building the necessary credibility.

5.13. The AA saw the recent entry of Kwik-Fit as another significant development but, as with Direct Line, it remained to be seen whether Kwik-Fit would achieve size and influence in the market. Mondial was achieving success in the motor manufacturer channel but this was not directly relevant to consumers.

5.14. Asked why Boncaster, Britannia and Europ Assistance did not appear in the section on competitors in its business plan, the AA said that these suppliers were still very small in market terms or, as in the case of Britannia, were heavily reliant on an affinity scheme. The AA did not see them as having a significant influence in the market at present.

Entry

5.15. The market was mature and there was relatively little product innovation and little opportunity to differentiate the basic product. New entrants had relied on garage contractors and unless they had a different approach (for example, Direct Line's introduction of insurance concepts of risk-based pricing) their cost profile would be similar to their competitors'.

5.16. The barriers to entry were dropping through improved communications and a garage trade prepared to diversify to meet the needs of the developing breakdown organizations. Although it was relatively easy to enter the market, however, it took time and investment to establish brand credibility and to build market share. There was no certainty that any of the other breakdown organizations besides the AA, RACMS and Green Flag would create a clear identity and build a significant share over a reasonable period of time.

Prices

5.17. The AA said that its direct retail prices were generally similar to RACMS's but around 10 to 15 per cent higher than those of other competitors. As a not-for-profit organization it aimed to provide high-quality services valued by its members rather than to maximize profit. In addition to breakdown cover AA members received legal and technical advice, free routing, a quarterly magazine, motoring and traffic information and the AA handbook. The AA recognized that it needed to keep prices competitive. Over the last year it had reduced costs and moved towards tactical pricing, rather than increasing prices in line with annual inflation as had been its practice in the past. It hoped to achieve an overall price structure in 1999 that reflected no inflation-related increase.

5.18. The AA required its businesses, other than the personal membership business that operated on a not-for-profit basis, to make a profit in order to provide funds for the mutual activity.

Patrols and contractors

5.19. In the mid-1960s about half of the AA's service had been delivered by patrols and half by garage contractors. By the early 1970s its dedicated patrol force was handling the majority of jobs. In the last two years its use of garage contractors had risen from just under 10 per cent to 13 per cent of its breakdowns as a means of achieving a more consistent service.

5.20. The AA did not have exclusive contracts with garage contractors and did not know of a breakdown organization that did. As part of its aim to improve the quality of its contractors' services, the AA was currently conducting a pilot study in London and Essex. One feature of this scheme was that the participating garages were required to reserve particular breakdown vehicles for the AA's use at three days' notice. This provision would help the AA to plan and meet its requirements. It did not prevent the contractors from entering into similar arrangements with other breakdown organizations. (Up to 6 November 1998 the provision had not been activated.) So far the study had been well received by the garages taking part and had improved service. It would enable them to invest in their businesses in the knowledge that the AA would provide a volume of work. It was not, however, the AA's intention to sign up contractors to work exclusively for the AA because such action could cause other breakdown organizations to do the same, with damaging consequences for the whole market.

5.21. Competitors that relied solely on contractors sought to demonstrate that there was no difference in quality of service between in-house patrols and garage contractors. The AA disagreed. Its patrols possessed well-developed interpersonal skills as well as expertise in roadside diagnosis and repair, a very different set of skills from those of mechanics brought up in a workshop environment.

The AA therefore believed that the roadside assistance provided by its patrols was far superior to that provided by contractors, and this was reflected in relative roadside fix rates.

5.22. The AA knew from monitoring its members' views that they preferred a patrol-delivered service: that, indeed, was why they joined the AA. Moreover, it was more economical for the AA to provide the great bulk of the service through patrols: if the AA had to depend wholly on contractors, its costs—based on the current rates of its payments to contractors—would rise by £100 million a year.

The merger

5.23. The AA believed that the merger, if allowed to proceed, would make the market less competitive and adversely affect the interests of consumers. If there were at least three strong players, the market was more likely to remain competitive, stimulating innovation and providing value for money and high-quality services. This could be achieved only by ensuring that RACMS and Green Flag were operated under separate ownership.

5.24. The AA could not itself have justified paying a price of £450 million for RACMS. Even taking account of the potential for winning new customers it was difficult to see how the acquisition at that price could result in an economic return. As Cendant was a large US franchising and marketing corporation, the revenue generated from its other activities might be used to cross-subsidize its breakdown services and make its entry into the UK successful. The AA speculated that the merged company could compete aggressively in order to expand its customer base for cross-selling or, having paid a high price, might not wish to discount prices. As the number two player in the market it would be able to control prices and might loss-lead in order to force small competitors out of the market.

5.25. The AA concluded that if Green Flag and RACMS were under single ownership the market would be adversely affected for three main reasons. First, the purchasing power of the combined RACMS and Green Flag could enable the company to demand exclusivity from garage contractors. The AA estimated that after the merger Cendant would account for about 50 per cent of actual contractor usage. By tying up the larger garages it would restrict its competitors' use of good-quality contractors and could well control over 60 per cent of usable capacity. The cost of contractors was an important part of the cost of service and as such was a probable target for cost-efficiency measures. Cendant might demand lower prices from contractors that wished to keep its business, and the contractors might then increase prices for other breakdown organizations. The AA's second concern was that the company could dominate other suppliers of roadside assistance such as windscreen replacement companies and tyre specialists. Thirdly, the influence which could be brought to bear by the alliance of National Car Parks, PHH, Green Flag and RACMS would present significantly higher barriers to entry and growth.

5.26. We asked the AA about a statement in its business plan, drawn up shortly after Cendant's agreed bid for RACMS was announced, that the market was facing its most competitive period ever. Recognizing the role of such documents as an instrument to galvanize internal change, the AA said that several factors had led it to this view: Cendant's buying its way into the market through acquisitions; the unprecedented intensity of advertising, particularly by Green Flag; the revitalization of RACMS; the entry of Direct Line and Kwik-Fit; and the success of Mondial in the motor manufacturer channel. In the short term the market gave all the indications of becoming more competitive than at any time in the past. In the medium to long term, however, the bringing together of RACMS and Green Flag gave rise to serious concerns as to whether the competitive pressure now apparent would be sustained or brought to a premature halt because others could not replicate Green Flag's entry into the market.

Possible remedies

5.27. The AA thought one of the difficulties in suggesting remedies was the uncertainty over how Cendant might act and, therefore, which behavioural undertakings might be appropriate. Undertakings of this sort would also be difficult to police. A possible solution to any public interest detriment might be the divestment of Green Flag. Asked about potential buyers of that company as a stand-alone operation, the AA said that it knew of several companies that might be interested in the acquisition.

Boncaster Limited

5.28. Boncaster Limited (Boncaster) told us that it was an insurance broker dealing in motor and household insurance. It marketed insured breakdown services through three schemes: Auto Aid, Autonational Rescue and NARPO Rescue.

5.29. Boncaster was concerned that the merged company might use its dominant position within the resulting duopoly to pressurize the garage contractors into giving it preferential treatment at the expense of the smaller breakdown organizations. Contractors should not have to choose between giving priority to Cendant or risking the loss of substantial volumes of work. Other than in exceptional circumstances they should be free to operate on a first-come first-served basis.

5.30. Boncaster believed the smaller breakdown organizations had not been able to develop a larger market share because of the dominance of the major brands. Brand name and awareness enabled the major breakdown organizations to command a higher market price. This, combined with the lower rates they could negotiate with contractors, resulted in higher margins which could be reinvested in advertising to maintain brand image. Smaller companies were generally more competitive, though customer loyalty combined with the dominance of the major brands made expansion difficult.

Britannia Rescue Services Limited

5.31. Britannia Rescue Services Limited (Britannia) said that it had been set up as a subsidiary of the CSMA in 1983, specifically to provide breakdown services to CSMA members. Prior to that the service had been supplied by National Breakdown (now Green Flag). In 1984 Britannia had begun providing services to non-CSMA members. It currently had 324,000 members, 74 per cent of whom belonged to the CSMA.

5.32. Britannia had found it difficult and costly to create brand awareness beyond CSMA members. It had been unable to compete with the larger companies, that is the AA, RACMS and Green Flag, in terms of press and television advertising and sponsorship. Britannia’s breakdown service had been voted ‘Best Buy’ in *Which?* magazine’s last three market surveys but even this had not enabled Britannia to increase its market share significantly.

5.33. Britannia operated through approximately 450 garage contractors with about 560 depots nationally. It did not have exclusive arrangements with these contractors but maintained a close relationship with them. About half of the contractors it used worked for both Green Flag and RACMS as well. Britannia believed that there would be a continuation of the move in the industry towards exclusive arrangements with contractors. This might result in fewer contractors and less competition and would probably have an adverse effect on the service provided.

5.34. Apart from its parent the CSMA, Britannia did not sell through intermediaries. It had previously had contracts with motor car manufacturers but had withdrawn from that sales channel because of fierce competition. It said that market research conducted among CSMA members had shown that 52 per cent of those who obtained another breakdown organization’s cover on purchasing a new car also kept their Britannia membership.

The market

5.35. Britannia priced its services slightly below those of the market leaders. There appeared to be a preference for the large organizations, as indicated by market share analysis, even though their prices might not be the most competitive. Green Flag’s success had resulted from the amount it had spent on marketing (currently 25 per cent of the industry total) rather than its simpler pricing structure. Its growth had been beneficial to smaller competitors in that it had been seen to compete effectively with the AA and RACMS.

5.36. Although time to attend was probably the main measure of service quality, Britannia saw it as only one aspect. Equally important was the need to meet the motorist’s requirements, for example to provide transport to the airport or home if the car could not be repaired at the roadside. To help evaluate the quality of its service Britannia sent questionnaires to all members using its breakdown services and about 50 per cent of these were completed and returned. It assessed its garage contractors according to the response. These assessments were updated daily and used by Britannia (together with consideration of location) when allocating a contractor to a particular breakdown.

5.37. The main barriers to entry were lack of a customer base and the cost of marketing. Although Direct Line had entered the market it had had little impact so far. It appeared to be offering special discounts to its existing insurance customers, rather than attacking the competition head-on in national advertising.

The merger

5.38. Britannia thought the merger might reduce the ability of the smaller breakdown organizations to provide an acceptable service to their members if Cendant, with the Green Flag and RACMS businesses, were to rationalize its network of garage contractors. This could concentrate all call-outs on a small, select group of larger contractors and enable Cendant and the AA to dictate terms, including specifying which breakdown organizations contractors were allowed to work for. This would also reduce the choice of alternative viable contractors for the remaining breakdown organizations.

5.39. This problem would be compounded if Cendant were to offer the franchise of its breakdown services, including the current RACMS patrol force, to a small number of organizations, either existing contractors or other organizations wishing to enter the market. This would enable Cendant to reduce its overheads without damaging its ability to offer a service.

5.40. Britannia thought that Cendant’s main reason for the merger might be the acquisition of the customer base. Cendant’s stated aim was to cross-sell its other products and services to members of its breakdown organization; it might therefore offer breakdown services as a loss leader to increase the sale of its other profitable offerings. Its financial strength, large market share and consequent public awareness would enable it to sustain a price advantage in order to reduce competition in the market for insured breakdown services.

5.41. Overall, Britannia was concerned that after the merger the two major players, Cendant and the AA, would control approximately 90 per cent of the market and that their competitors would be unable to offer an alternative service to the public if either of the above scenarios were allowed to develop. The creation of a duopoly could eventually lead to price increases and less choice and innovation.

Direct Line Insurance plc

5.42. Direct Line had originally been established in 1985 initially to sell motor insurance to private motorists. It later expanded into other personal insurance and financial services products. From the beginning it had offered insured breakdown services only to its motor insurance customers on an unbundled basis. The offering was a standard package underwritten and provided by Europ Assistance. This was rebranded as Direct Line Rescue in August 1997 and actively sold to Direct Line customers, but Europ Assistance continued to take the risk.

5.43. In May 1998 Direct Line entered the insured breakdown services market in its own right, underwriting and administering the business itself and actively marketing to the general public as well as its own customers. Delivery of call-centre services and management of the contractor network were both contracted out to Europ Assistance, though Direct Line had more involvement and control than under the previous arrangement (for example, on contractors' rates, quality control and training). Direct Line told us that its objective was to provide more flexible and competitively priced products than had previously existed. Its product differed from those provided by other breakdown organizations in that it was risk-rated. The cover was for the vehicle, not the person, and there were no-call-out discounts.

5.44. Direct Line's sales of insured breakdown services began to accelerate after the rebranding in August 1997 and by 30 November 1998 there were 207,000 policies in force (up from 70,000 in 16 months). Direct Line told us that, despite significant advertising, only 15 per cent of these policies had been sold to non-insurance customers. The breakeven point for a profitable business was probably around 500,000 policies.

5.45. Direct Line believed it could be most competitive in the direct retail sales channel. It had no plans to seek contracts for motor manufacturer schemes (for which prices were so low as to be unsustainable) or intermediary schemes. The key to growth would be its ability to take customers traditionally loyal to the AA and RACMS. Most of Direct Line's recent growth had been at the expense of the AA and RACMS, though about 20 per cent had been completely new business. It believed the market to be 60 to 65 per cent saturated.

5.46. Direct Line's pricing was related to risk and costs. It told us that it would not sell at a loss (for example, its current half-price offer to comprehensive insurance customers was a short-term marketing exercise fully justified by the lower acquisition costs and lower risk rating of those customers). However, it did benchmark against the competition and had found that it could offer a commercially viable product at rates significantly less than those of the AA and RACMS.

The market

5.47. Direct Line said that the concentration of market share had resulted in limited competition and choice. Until the entry of Green Flag, the AA and RACMS had dominated the market, offering almost identical services at similar prices. Both organizations enjoyed tremendous consumer confidence and brand awareness and both stressed the use of patrol forces as being their key strength. Only Green Flag had challenged the position of the AA and RACMS: it had competed on both price and quality of service and had gained overall market share. It had also modernized and professionalized the garage contractor network. Despite this its overall brand awareness remained low and it had made little impact in the direct retail channel.

5.48. Direct Line submitted that there was no real price competition between the AA and RACMS. Its own market research between January and March 1998 had confirmed that confidence in brand was more important than price. However, Direct Line believed that its early success was a direct result of an offering based on price (especially the recent half-price offer): this showed that there could after all be a degree of price sensitivity in the market when backed by a recognized brand.

5.49. The key factors influencing market entry included set-up costs and the need for brand awareness. Direct Line had invested around £5 million in launching its branded service. Other factors were the ability to compete on price, the dominance of the AA and RACMS, and the ability to achieve cost advantages from garage contractors from greater volumes of work. Direct Line believed that without its brand strength in motor car insurance it would have faced an insurmountable barrier to entry. Given the dynamics of the market the only likely new entrants would be those with established brands and large databases of customers who were potential purchasers of the new service, for example other insurance companies, supermarkets or motor car manufacturers.

The merger

5.50. Direct Line submitted that if Cendant owned both RACMS and Green Flag it would restrict competition between them, even if the two brands were retained (Direct Line had already noted significant reductions in Green Flag's marketing expenditure). Cendant could also choose to keep prices high, having removed the third largest player.

5.51. Direct Line believed the merger would seriously affect the garage contractor network. Both RACMS and Green Flag already relied heavily on contractors. Under joint ownership they would be in a powerful position to drive down rates and to insist on exclusive arrangements or priority, at the expense of the smaller breakdown organizations. This could reduce the contractors' potential investment funds and prevent other breakdown organizations from providing a competitive service.

5.52. Alternatively the merged company could get economies of scale from increasing the liveried patrol force to service more of RACMS's work and to cover Green Flag's as well. Competition in the breakdown services market was crucially dependent on the viable and professional contractor network which Green Flag had done so much to create and sustain. Direct Line estimated that the merged company would account for about 75 per cent of the work carried out by that network for breakdown organizations. If Cendant withdrew significant amounts of business from it, its viability would be jeopardized.

5.53. Despite Direct Line's early success, its ability to continue to offer an alternative to consumers could be threatened if the merger went ahead. Cendant could use its size to compete aggressively—for example, by reducing prices of both RACMS and Green Flag by cross-subsidy from other parts of its business. This scenario was entirely feasible given the size and scope of Cendant's business operations and the fact that its motive for entry into the UK breakdown services market must be to achieve growth.

5.54. Direct Line believed the merger would concentrate insured breakdown services in the hands of too few, too powerful owners. There were significant risks that fair competition, innovation and consumer choice would be restricted. In particular, there were significant threats to the ability of smaller organizations to access the independent contractor network and to offer a choice of products and prices to consumers.

Possible remedies

5.55. Direct Line said that a possible remedy would be to require divestment of Green Flag, whose established niche position would make it attractive to potential purchasers.

Europ Assistance Limited

5.56. Europ Assistance told us that in Continental Europe its group was the leading supplier of insured breakdown services, selling primarily through the major motor car manufacturers and insurance and leasing companies, as well as to direct retail customers through agents (usually banks). However, in the UK, where the two dominant brands were regarded almost as national institutions, Europ Assistance had chosen not to compete under its own brand name and not to attempt to sell to direct retail customers. Instead it developed own-brand services for intermediaries, mostly insurance companies and banks, who sold them on to retail customers. It therefore occupied a small niche position, a long way behind the two dominant suppliers, the AA and RACMS, and Green Flag.

5.57. Europ Assistance operated its own 24-hour call centre and provided breakdown services through a network of 160 to 200 regional garage contractors. It did not have any exclusive contracts with these contractors and did not know of any organization that did. Europ Assistance told us its contracts stipulated that it should not be discriminated against and that contractors dealt with call-outs on a first-come first-served basis.

5.58. Europ Assistance told us that, despite offering a high standard of service as regards speed to answer the telephone and time to arrive at breakdowns, it found the key form of competition to be price. It had various price structures because its services were tailor-made to each intermediary's requirements and all its income was accounted for on a net turnover basis, recognizing that intermediaries would add premiums to cover their own marketing and internal costs and to provide for commission. Lack of brand recognition meant that the end price to the consumer had to be pitched quite substantially lower than the retail prices of the AA and RACMS (normally about 20 to 25 per cent lower).

5.59. In the 1970s Europ Assistance had attempted to build its brand in the UK, but concluded that the substantial investment required would not generate sufficient returns compared with other businesses it was involved in. The decision not to promote the Europ Assistance brand meant that its success depended on the strength of the intermediary's brand name. Its associations with strong brands like Direct Line, Commercial Union and Age Concern were very successful. However, an intermediary with a weaker brand would dual-brand the breakdown services with Europ Assistance and this did not always work. Europ Assistance had lost business to both the AA and RACMS, whose stronger brands were perceived to carry additional credibility with consumers.

Market entry

5.60. Europ Assistance acknowledged that setting up a call centre and a contractor network, and acquiring expertise in pricing and structuring the products, were not impediments to entry. However, very few companies had done this, except in small niches. Direct Line was a special case because it had a very large database and a strong brand already associated with motor cars. Entry without these two advantages would represent a huge risk because the AA and RACMS were so entrenched, and because there were limited margins to be made unless an entrant had the ability to cross-subsidize or cross-sell.

5.61. Furthermore, there were significant barriers to expansion. For example, the motor manufacturer sales channel was extremely competitive due to the willingness of the AA and RACMS to price unrealistically low in order to have the possibility of converting these customers to direct customers at the end of the warranty period. This could only be done by organizations that already had large numbers of customers paying the full price. No new entrant could contemplate pricing in this way without knowing in advance that it would be compensated by substantial follow-on business.

5.62. Europ Assistance considered that the increasing trend for cross-selling could also act as a barrier to entry or expansion. In order to attract sales of other products, cross-sellers might charge unrealistically low prices for breakdown services and this could drive other providers out of the market.

5.63. Apart from the AA and RACMS, only Green Flag had made any impact on the direct retail sales channel. Europ Assistance did not consider Green Flag to be a significant innovator. Its success was probably because it had chosen to specialize predominantly in breakdown services (unlike Europ Assistance and Mondial, for example, which had other lines of business) and had invested substantially in building and promoting its brand. In spite of this, Green Flag's brand remained less well known outside the north of England, which demonstrated how high a barrier brand represented. The strength of the two dominant brands was virtually unassailable except by investment of huge funds. (Europ Assistance estimated that the amount which would need to be spent each year would be as much as its own total UK annual turnover.)

5.64. Europ Assistance did not think another company would be attracted to copy Green Flag's approach. Any new entrants were likely to be existing players in related industries which, like Direct Line, already had brands associated with motoring and a ready means of accessing customers, preferably through their own databases. The most likely new entrant would be one of the volume motor car manufacturers, to provide breakdown services for vehicles of its own brand as a means of cultivating extended loyalty and retention of customers. Europ Assistance could not think of another insurance company that would enjoy the advantages that had contributed to Direct Line's early success.

5.65. The intermediary sales channel was easier to enter than direct sales. However, the opportunities were less attractive since margins were low and the environment generally more competitive because of the strength of the corporate buyers.

The merger

5.66. Europ Assistance was concerned about the increased opportunities for cross-selling after the merger. It noted that the AA was already engaged in this and that Cendant was a particularly effective cross-marketing organization. The total financial value of an individual customer relationship would be far greater and more profitable if spread over several products than if the relationship were only for insured breakdown services. The financial dynamics of such a relationship would allow the merged company to subsidize breakdown services to attract new customers and increase its database. The merged company would therefore gain a competitive advantage.

5.67. Whilst this might bring benefits to consumers in the short term, there could be more serious detriments in the longer term. Competitors like Direct Line would remain successful only as long as they were able to undercut the AA's and RACMS's prices. Competitors like Europ Assistance would consider withdrawing and pursuing more interesting markets. If Direct Line and others left the market, Cendant would be in a stronger position to drive up prices for breakdown services to a level where it could still increase its database and cross-sell, but maximize its sale price as well.

5.68. Europ Assistance said that it would be logical for Cendant to increase the merged company's use of contractors. It was a lower-cost operation than in-house patrols and easier to manage from a systems point of view. Other breakdown organizations with lower volumes of work might then find it difficult to get access to good contractors.

5.69. We put to Europ Assistance the opposite scenario, that Cendant might extend its use of patrols to cover more of RACMS's work and Green Flag's as well, and withdraw large amounts of work from the network. Europ Assistance thought that if this were to happen, it would damage the business base of the network and its ability to provide good-quality service to other breakdown organizations. The network would probably survive, but in a different form. Europ Assistance and other smaller competitors would have to use a larger network of smaller contractors and the costs of managing and controlling it would increase.

5.70. Europ Assistance considered that either scenario would bring threats that competitors would have to respond to. Either would also make it tougher for a new entrant to set up a network.

Remedies

5.71. Europ Assistance did not think that remedies could be found to deal effectively with concerns about the merged company entering into exclusive arrangements with contractors (contractual or otherwise). In practice they would be very difficult to police, as would any requirement on Cendant to place specified levels of business with contractors.

5.72. Asked if Cendant would be able to find a buyer for Green Flag in the event of being required to divest it, Europ Assistance said that it thought it would. Other organizations might see the acquisition of Green Flag as a means of entry.

Mondial Assistance (UK) Ltd

5.73. Mondial told us that it was a subsidiary of Mondial Assistance International, based in Paris. It had been formed in 1980 to provide insured breakdown services and other services to motor car manufacturers in the UK. It now had contracts with 14 manufacturers who provided breakdown services free with warranties on new vehicles (lasting between one and three years). Its share of this sales channel had grown steadily and was now about 15 per cent but expected to reach 22 per cent in 1999 when its latest contracts, with Rover and Chrysler Jeep, came on stream. Slightly over 80 per cent of Mondial's turnover was derived from motor manufacturer schemes. This figure included all the conversion business classified as falling into the discretionary segment: see paragraph 5.76. In 1998 and 1999 Mondial Assistance (UK) Ltd would be the largest company in the Mondial group in terms of market share. It did not actively market through the direct retail channel due to the intense competition from the AA and RACMS.

5.74. Because of the increasing sophistication of new cars, technicians with specialist skills, dedicated to an individual brand, were required to repair them at the roadside, as well as branded parts and dedicated diagnostic equipment. Mondial therefore concentrated on quality of service and marketed direct to manufacturers and leasing companies on a wholesale basis. It priced to risk and, despite charging higher prices, it was able to win business in competition with the AA and RACMS, which ran their motor manufacturer schemes as loss leaders in order to have the opportunity of charging high prices when converting indirect customers into direct customers at the end of the warranty period. Mondial said that it would not run a scheme at a loss.

5.75. Mondial worked on behalf of other motor car manufacturers and, to a much lesser degree, insurance companies and associations. It typically managed the manufacturer's relationship with its customers in respect of marketing, customer service and warranties and was able to achieve consistent quality, service levels and training. As a deliberate strategy, Mondial itself was never seen or heard by the retail customer, who received the impression of dealing direct with a manufacturer. Mondial had evolved this strategy in response to manufacturers' increasing focus on after-sales care, rather than pre-sales marketing, as a way of achieving higher degrees of customer loyalty and retention.

5.76. While its motor manufacturer scheme business fell within the non-discretionary part of the market, Mondial also had a very proactive programme to convert customers under these schemes into paying customers at the end of the warranty period. At that point these customers fell into the discretionary segment. The service was still supplied and invoiced in the name of the manufacturer, though the funds eventually flowed to Mondial (usually after a commission to the manufacturer). But the retail customer remained the customer of the manufacturer and if a manufacturer decided to change supplier, these discretionary customers would be lost by Mondial, along with the non-discretionary ones, to the new supplier. However, as the service provision was designed to be seamless, the customer would probably not be aware of any change.

5.77. Under its contracts with BMW, Volkswagen and Land Rover, Mondial provided breakdown services through 160 dedicated technicians, split between the three manufacturers. They operated in the appropriate livery and branded vehicles in busy urban and motorway areas, backed up by a network of garage contractors. The technicians were trained to high standards by the manufacturers, including in customer care. Quality of service was vital to motor manufacturer schemes and Mondial was working at building a partnership with its contractors to bring their skills up to the same levels as the dedicated technicians. This had involved rationalizing the network, reducing it from 800 to 400 contractors in the UK as a whole and from 40 to 4 in the area within the M25. The contractors in this smaller network were getting a higher volume of Mondial's call-outs, in return for higher rates.

The merger

5.78. Mondial said that in principle it had no objection to the merger. RACMS under Cendant's ownership would probably be a more serious competitor for the AA. The AA appeared to have improved over the months since the acquisition was announced and the merger could have an overall positive effect in driving the market forward. Cendant's ability to cross-subsidize and its stated intention of cross-selling were a potential concern but Mondial noted that the AA engaged in similar activities.

5.79. Mondial would be very concerned if the merger resulted in Cendant franchising the garage contractors. This could result in the smaller breakdown organizations being unable to provide adequate levels of service in the smaller and rural areas. However, the smaller organizations might between them generate sufficient volumes of work to be able to retain the services of some smaller contractors, who recognized the advantages of a stable and better relationship.

National Autopoint Motoring Ltd

5.80. National Autopoint Motoring Ltd, whose trading name was National Autopoint Motoring Organisation (NAMO), told us that it had been dormant since 1995 when told by HM Customs and Excise that it was trading incorrectly. NAMO believed it was unable to compete on level terms with the AA and RACMS because it was not exempt from authorization under the Insurance Companies Act 1982. New entry was difficult because the AA and RACMS were able to exert influence over independent garage contractors and other bodies. NAMO was against the merger because it would further consolidate the position of the two most dominant players, to the detriment of their smaller competitors.

Intermediaries

Banks

Lloyds Bank Plc

5.81. Lloyds Bank Plc (Lloyds) told us that it used both RACMS and Green Flag to provide breakdown services to Lloyds and TSB customers. It did not think the merger would be detrimental either to the group or to its customers in the provision of competitively priced services. The merger would leave three strong brands in the market (RACMS/Green Flag, AA and Mondial) from which it could choose a supplier, should it need to change.

Midland Bank plc

5.82. Midland Bank plc (Midland) told us that it used Green Flag to provide breakdown services to its customers through a product called Midland Option. It also offered its customers the opportunity to join Green Flag through its credit card loyalty programme.

5.83. Midland said its customer research indicated that the use of a branded breakdown organization (that is, AA, RACMS or Green Flag) was essential if Midland Option was to be seen as valuable and attractive to a wider customer base. Midland needed a service that was well known to consumers, who would put trust in its reputation. The merger would reduce its choice of branded breakdown organizations to two and perhaps affect the terms it secured.

Insurance companies

Churchill Insurance Company Ltd

5.84. Churchill Insurance Company Ltd was concerned that the merger would restrict choice for insured breakdown services.

Equity & Provident Ltd

5.85. Equity & Provident Ltd (Equity & Provident), which provided breakdown services for its customers through Green Flag, was opposed to the merger, believing that Cendant's resulting market share (estimated to be over 40 per cent) would enable it to control the insured breakdown services market. This might lead to unfair competition, including price fixing. Cendant might also lower its membership prices in order to win share from the AA and drive smaller breakdown organizations out of business. Equity & Provident was also concerned that Cendant might sell the RACMS patrol vehicles on a franchise basis. Existing patrolmen unable to raise the finance to purchase a vehicle might then be made redundant.

Inter Partner Assistance

5.86. Inter Partner Assistance, the UK branch of a Belgian insurance company, said that it wholesaled breakdown services to the company's corporate clients in the UK and overseas. It would not expect the merger to change its current strategy and would only be concerned if, as a result, the smaller breakdown organizations had access to fewer garage contractors.

Liverpool Victoria Insurance Company Limited

5.87. Liverpool Victoria Insurance Company Limited told us that it did not have strong views on the merger because of the opportunities for new entry, even though it would substantially increase Cendant's share of the breakdown services market.

Norwich Union Insurance Limited

5.88. Norwich Union Insurance Limited (Norwich Union) told us that it arranged breakdown cover for its customers with RACMS, either directly or through insurance intermediaries. It believed it was the largest provider of breakdown cover in the insurance industry. This was an area of growth. The provision of bespoke products and pricing within the insurance industry widened the choice available to the consumer. The merger would combine the resources of Green Flag with RACMS; this would be positive for Norwich Union and its customers. It expected to benefit from economies of scale as a result.

5.89. Alternatives to RACMS as sources of breakdown services were limited: a strong brand was important because it afforded Norwich Union a credible service. It monitored the services offered by other breakdown organizations, particularly the AA and Green Flag, and had regular contact with Mondial and Europ Assistance. It would consider using breakdown organizations other than the three largest if they demonstrated sufficient brand strength. However, it would also consider building its own network of contractors using existing garages if no other competitor offered a credible brand.

The Prudential Assurance Company Limited

5.90. The Prudential Assurance Company Limited (Prudential) said that since 1994 it had had an agreement with Green Flag to provide insured breakdown services to all Prudential's motor insurance customers. The motor insurance market was very competitive and Prudential bundled breakdown services with motor policies to make the latter attractive to new customers and to help retain existing ones. Prudential purchased the breakdown services in bulk. This, together with the good risk profile of its motor insurance customers, meant that it could negotiate a competitive price. When Prudential had originally invited tenders for the business neither the AA nor RACMS had been interested, but subsequently both organizations had approached Prudential to quote for the account.

5.91. Prudential said that price was the most important factor in considering the tenders. Also important was flexibility on the part of the breakdown organization (for example, willingness to adapt its procedures to meet the intermediary's changing requirements). Prudential told us that the insurance industry was changing. As insurers increasingly looked to outsource functions and to extend the range of services they offered, they wished to limit the number of relationships with external organizations. It would therefore be in the interests of breakdown organizations to offer a range of assistance products, for example claims management, travel emergency cover, etc. Whether the service was through dedicated patrol forces or garage contractors was not significant. Prudential's surveys of its customers suggested that they were satisfied with current levels of service. Smaller breakdown organizations might have been able to provide the service to Prudential but might not have been as flexible as Green Flag had proved to be.

5.92. Branding was generally less important for the non-discretionary segment of the market than for the discretionary one. At present Prudential jointly branded its service with Green Flag, believing that the organization's name added value. If it had a relationship with a breakdown organization with a less well-known brand, Prudential's brand name alone would be sufficient to carry the breakdown services for its customers.

5.93. Prudential did not consider that the market was saturated. The recent entry of Direct Line showed that there was potential to exploit an existing customer database from a related sector. Other insurers could follow. Prudential did not think there had been significant innovations, except for Green Flag's £10 rebate for non-attendance within one hour and RACMS's introduction of no-call-out discounts. Like motor insurance, provision of breakdown services was becoming commoditized and consumers were prepared to buy on price.

5.94. Prudential said that the merger would obviously have a detrimental effect on the overall insured breakdown services market but in the non-discretionary segment the impact would be minimal. In terms of the number of employees per insured vehicle, RACMS had traditionally had a higher cost structure and overheads than Green Flag. It was therefore possible that after the merger Cendant might adopt RACMS's structure and that this would lead to increased prices. If Green Flag became less competitive, there were a sufficient number of breakdown organizations to provide an alternative service.

Motor car manufacturers and fleet management/leasing companies

Ford Motor Company Limited

5.95. Ford Motor Company Limited told us that RACMS supplied it with insured breakdown services and supported its extended warranties. It said that the AA and RACMS were the principal competitors in the market though there were others. A high-profile brand added credibility and thus value to Ford products.

Lease Plan UK Limited

5.96. Lease Plan UK Limited (Lease Plan) told us that it was the seventh largest car leasing company in the UK and the biggest in Europe, controlling 56,000 and 440,000 cars respectively. It said that it secured RACMS's insured breakdown services for its customers in part by paying a monthly fee and in part by paying for each breakdown.

5.97. Lease Plan was extremely concerned that the UK market would be reduced from three suppliers to two, leaving the AA as the only credible alternative for companies of Lease Plan's size. It believed RACMS and Green Flag would not adopt different policies and would ensure that they did not compete against each other. Lease Plan was also concerned about the confidentiality of the information it shared with RACMS: Cendant owned PHH, which was an important competitor of Lease Plan.

5.98. Lease Plan believed the merger would be against the public interest and should not be allowed to proceed: it could affect the price and quality of the service supplied.

Lex Service PLC

5.99. Lex Service PLC (Lex) said that it provided a range of services to private and business customers including contract hire, fleet management and accident management for company vehicles; and importing, marketing and distributing Hyundai cars through independent franchised dealers. Lex bought RACMS insured breakdown services through its vehicle leasing and Hyundai car businesses.

The former offered RACMS breakdown cover to fleet customers who included this service as part of the contract hire package (about 72 per cent of the total fleet); and the latter offered RACMS cover to buyers of new and used cars with its warranty and after-sales package. Both schemes had an element of POU. When negotiating contracts Lex's prime consideration was service quality, in particular time to attend and ability to repair the car at the roadside. The latter was likely to become more important as improved technology made cars more difficult to repair.

Lex's market research

5.100. To understand motorists' requirements Lex carried out market research into their attitudes and behaviour. It surveyed from 1,000 to 1,500 motorists annually, asking a wide range of questions about motoring issues. Since 1988 the results of the surveys had been published in the *Lex Report on Motoring*.

5.101. Lex's research showed that AA members typically took slightly fewer services than RACMS or Green Flag members so that the average price paid was lower, although the list price was higher. This suggested that the AA might be pricing itself too highly. Green Flag members paid the lowest amount and were most price-sensitive—44 per cent said that they would change to another service if the price increased by £10 a year (compared with 27 to 28 per cent of AA and RACMS members). About 60 per cent of AA and RACMS members would accept the higher price compared with half of the Green Flag members. If members changed, about 40 per cent would switch to the AA, 30 per cent to RACMS, 25 per cent to Green Flag and about a third would change to the organization with the lowest price.

Market entry

5.102. Lex said that to build up a critical mass of members a new entrant needed a nationwide contractor network and consumer confidence. Both elements were difficult to establish without a customer base.

5.103. The AA and RACMS had built their market positions over 100 years using their own patrols and developing call centres which, in recent years, had exploited modern information and communications technologies to become very efficient. New business had come from direct advertising and from motor manufacturer schemes. The small breakdown organizations without these advantages had struggled to establish market positions, using garage contractors to minimize their investment while providing the required national coverage. Green Flag had been the most successful, although it had taken over ten years to reach its present position. It had achieved this by targeting intermediary schemes, offering low prices because of its lower overheads, and exploiting the cash flow support and marketing opportunity from its parent, NPC.

5.104. Direct Line had the advantage of the customer base of its insurance business. Its success was so far unknown but other competitors owned by insurance companies (Mondial and Europ Assistance) had failed to make a significant impact.

5.105. If Green Flag entered into exclusive contracts with garage contractors it would prevent a new entrant from building up a network or force it to use contractors of lower quality and reputation. There had been concerns in the past over less reputable breakdown recovery operators attending drivers on motorways. If this could not be properly regulated, then established players should not be removed from the market.

The merger

5.106. Lex [*Details omitted. See note on page iv.*] thought that the price of £450 million which Cendant had agreed to pay for RACMS was high but believed that Cendant saw the acquisition as a means of obtaining a potential 6 or 7 million customers. This would justify the high price.

5.107. Lex's main concerns were Cendant's control of RACMS and the elimination of Green Flag as a competitor leading to a potential duopoly situation, whereby the two major organizations, one commercial and one mutual, would tacitly agree not to compete on price.

5.108. Lex was concerned that Cendant might divert resources from RACMS to support its other activities (for example, those in the USA) leading to a poor service to its customers generally and to Lex's customers specifically. Given the nature of the services RACMS provided it was important to maintain its reputation for probity and customer safety.

5.109. Lex's immediate competition concerns arose through its relationship with RACMS. Even though Green Flag had only a small presence in the fleet sales channel, Lex believed that both RACMS and the AA were constrained by its presence in the direct retail channel. As Green Flag was very competitive on price and had a substantial network, it could easily expand in the fleet sales channel. RACMS and the AA were currently competitive on price, but if the Green Flag and RACMS operations were merged the competition was unlikely to be as intense. Although Lex's customers who received RACMS breakdown cover did not directly see the costs of these services, it was inevitable that any increase was passed on to the consumer.

5.110. As far as the direct retail channel was concerned, if the merger were to take place, there would effectively be only two players. This could result in decreased competition on price and services and would be detrimental to the price-sensitive Green Flag customers. Green Flag's breakdown services were substantially cheaper than the other organizations'. The recent high-profile advertising campaigns of the AA and RACMS appeared to indicate that they were reacting to the threat posed by Green Flag.

5.111. Lex thought it unlikely that there would be sufficient new entry to compensate for the removal of Green Flag from the market. Like Green Flag, a new entrant would take a time to establish itself in the market and success was by no means assured when competing against established organizations like the AA and RACMS. A possible remedy to the adverse effects it had identified would be the divestment of Green Flag. Its purchase by a third party would introduce a third competitive force.

Mercedes-Benz (United Kingdom) Limited

5.112. Mercedes-Benz (United Kingdom) Limited (Mercedes) expected that the merged company would be able to deliver improved service at better prices. The potential for synergy would enable it to be more competitive. Mercedes said that there was an adequate level of choice in the market for insured breakdown services.

Renault UK Limited

5.113. Renault UK Limited said that there was an adequate level of competition from the three main suppliers of insured breakdown services. However, as in most industries, a reduction in suppliers could have a detrimental effect on competition.

Toyota (GB) Ltd

5.114. Toyota (GB) Ltd told us that it had had an association with RACMS since 1989. All purchasers of its new vehicles received Club Toyota membership, which included breakdown cover provided by RACMS, free for the first year and at a competitive rate thereafter. It expected that the services it received from RACMS would be enhanced by the merger and did not think it would lead to any consumer dissatisfaction.

A contract hire company

5.115. A large contract hire company said that RACMS provided insured breakdown services to the vast majority of its customers. It paid RACMS on a POU basis.

5.116. The company said that the merger would lead to a reduction in competitive pricing and service quality and leave Cendant in a position of market dominance with a share in excess of 25 per cent. It would reduce the number of credible suppliers from three to two. The obvious remedy would be to block the takeover or require Cendant to dispose of Green Flag to an independent party.

5.117. As a competitor of PHH, the company was also concerned about the potential for Cendant to discriminate between customers. In addition it was concerned about the future confidentiality of its contracts, including customer details, if RACMS were in the Cendant group.

5.118. In the market for contracted services it was important to provide reassurance to drivers as part of the contract hire product offering. Attendance by a liveried patrol provided this reassurance. Green Flag, although not as strongly liveried as the AA and RACMS, was nonetheless a stronger brand than the other suppliers in the market. The company would not wish to see the only three credible suppliers reduced to two.

Trade associations

Association of Vehicle Recovery Operators Limited

5.119. The Association of Vehicle Recovery Operators Limited (AVRO) told us that it represented about 600 operators in the UK and the Republic of Ireland. AVRO members had a general concern that the merged company would control approximately 80 per cent of the work available to the independent contractors from breakdown organizations. They were particularly concerned that Cendant might franchise RACMS's patrols and that this would have a further detrimental effect on independent contractors.

5.120. We put to AVRO some specific hypothetical effects of the merger and asked it to comment. In replying, AVRO pointed out that the variations in the possible outcomes of the merger were almost incalculable and most AVRO members had some concerns over one or more of the possibilities.

5.121. AVRO thought it would be possible for the merged company, because of the volume of work it would command, to impose pressure on contractors to give it priority (ie over other breakdown organizations, the police and non-insured members of the public). This was more likely to happen in bad weather. AVRO was not aware of any exclusive contracts in existence between its members and breakdown organizations. In theory such arrangements were feasible but it was difficult to predict how individual contractors would react in practice.

5.122. AVRO members differed on whether Cendant would cut the rates it paid to contractors. Some thought it would cut rates, because it was answerable to shareholders. Others thought Cendant and other suppliers would recognize the need for contractors to reinvest and keep abreast of technology and therefore not cut rates. In some instances a reduction in rates could put garage contractors out of business, thereby jeopardizing the network.

5.123. AVRO thought that if the merged company expanded its use of contractors, there was no risk of other breakdown organizations being squeezed out. Contractors would continue to respond to increases in demand. If Cendant expanded the RACMS liveried patrol force and withdrew significant amounts of business from the contractors, this could jeopardize the ability of some operators to continue in business. This in turn could result in reduced services to Cendant's competitors, to the police and to non-insured motorists. In certain areas there could be longer response times, perhaps leading to traffic congestion and danger to motorists.

Institute of Car Fleet Management

5.124. The Institute of Car Fleet Management said that reduced competition in the market for insured breakdown services would not be to a level that would adversely affect its members.

London Association of Recovery Operators

5.125. The London Association of Recovery Operators (LARO) said that it represented about 30 garage contractors operating within the area bounded by the M25. Asked to comment on some specific hypothetical effects of the merger, LARO stressed that it could speak only for contractors in the London area. There were about 50 contractors, of all sizes, working for breakdown organizations within the M25. Some contractors depended on one organization for as much as 60 to 70 per cent of their work.

5.126. We put to LARO members the concern of some third parties that, after the merger, Cendant would be in a strong position, as a buyer of contractors' services, to insist on exclusive arrangements or apply pressure on the best contractors to procure de facto exclusivity or priority. LARO members generally shared this concern and told us that some of the larger breakdown organizations appeared to be moving in this direction already, though none had actually negotiated exclusive contracts. There was a growing trend to concentrate work on a small number of contractors in order to achieve economies of scale: within the M25, the AA had reduced from 32 to 11 contractors and Mondial from 25 to 4; Europ Assistance had also reduced, whilst RACMS had reduced its national network from 1,500 to 300. Indeed, RACMS, answering a specific question in an interview in *Recovery World*, had said that it would consider regional franchising because of the difficulty of differentiating itself sufficiently when contractors worked for several breakdown organizations.

5.127. LARO members thought that, whilst these developments might benefit larger contractors in terms of work volumes, they could threaten their independence, especially if liveried vehicles and staff were required. A contractor who operated liveried vehicles for one organization would be unlikely to get work from another. And LARO members considered that it would be inefficient for a contractor to have a mixed fleet, with some liveried vehicles dedicated to, say, RACMS and the remainder available for independent work. Contractors needed maximum flexibility to deploy all their resources efficiently to respond to the very dramatic increases in work at peak periods (when call-outs could rise to as much as twice or three times the normal number). Given that there would be limitations on the range of jobs for which liveried vehicles could be used, there was a risk of underutilization.

5.128. Most LARO members thought that exclusive franchising of contractors would result in lower rates being paid to those contractors, despite RACMS's statement (in the article in *Recovery World* referred to in paragraph 5.126) that the merged company would use its market strength to push for more efficient contractors rather than lower rates. If rates were pushed down, there could be adverse effects on smaller contractors, who might go out of business; on smaller breakdown organizations, which would have fewer contractors available to service their call-outs; and on non-insured motorists for whom rates would increase. One LARO member thought that rates would go up rather than down because breakdown organizations would have to pay more to guarantee exclusivity.

5.129. LARO told us of some moves in the industry to help contractors provide bespoke services without sacrificing their independence, for example development of electronic stationery so that paperwork could be tailored to each breakdown organization, and a proposal for digital signs on vehicles (similar to those used on buses and trains) which could readily be changed for each call-out to display the name and logo of the relevant breakdown organization.

5.130. LARO said that, because of traffic congestion, the most profitable call-outs in London were repairable breakdowns rather than recovery jobs. Its members estimated that they repaired about 85 per cent of breakdowns passed to them by Green Flag. The AA passed on both repairs and recoveries whereas RACMS tended to pass on only work that the patrols could not repair. LARO members were therefore seriously concerned that if Cendant franchised the RACMS patrols, Green Flag's fixable jobs would also stay with the patrols and no longer be passed to contractors.

5.131. As to hypothetical remedies, LARO members were generally in favour of a requirement on Cendant to keep separate the physical delivery of breakdown services by Green Flag and RACMS, though they had no problem with economies of scale in the back-office which should lead to more efficiency and better service. LARO believed Green Flag had been a very effective competitor, leading the way in providing service through a contractor network and stimulating the AA and RACMS to improve. Other new entrants had followed, but only Green Flag had achieved a substantial share and was strong in the discretionary sector, which showed that significant numbers of customers did not want a patrol-based service. The removal of Green Flag would therefore be a loss to the public. Asked if one of the smaller competitors or a new entrant could take Green Flag's place, LARO said that entry barriers were low but it took time to build market share, by which time the contractors might not be there to provide the services. The result would be a reduction in choice for the general motoring public.

Retail Motor Industry Federation

5.132. The Retail Motor Industry Federation (RMIF) said that it represented about 11,000 motor industry retailers in England, Wales and Northern Ireland, of which about 3,000 provided breakdown services. It said that RACMS had an excellent record in attracting company business, though its share of the direct retail market was less than half that of the AA. Competition in provision of breakdown services was severe and the merger would strengthen it. The merger was unlikely to create a duopoly because consumers would still be able to exercise choice.

5.133. The Government White Paper, *A new deal for transport: better for everyone*, indicated that technology would play an increasing role in developing an integrated transport system, which would require enormous investment. Consumers' interests would be best served by large professional corporations that had the necessary finance.

5.134. We asked the RMIF to comment on the following specific hypothetical outcomes of the merger. In replying, the RMIF emphasized that whilst it had specialist knowledge of and experience in the recovery industry, it did not have an association within its structure solely concentrating on recovery. It therefore had contacted members informally and had used its own knowledge base.

5.135. The RMIF said it was unlikely that Cendant could use its strong position to obtain the exclusive services of a few good contractors to the detriment of its competitors. At present, very few contractors would commit to one breakdown organization. And current initiatives within the industry (to agree a minimum standard and to introduce generic rather than bespoke systems for communicating with breakdown organizations) made it less likely to happen in future.

5.136. The RMIF thought it unlikely that the merger would lead to a pricing position where other breakdown organizations would be charged more than RACMS/Green Flag. The AA was a powerful purchaser but had not been able to negotiate substantially lower rates.

5.137. The recent entry of Direct Line demonstrated the ability of the contractor market to respond to increased demand. If Cendant extended its use of independent contractors, it was unlikely to disrupt the market or squeeze out other suppliers.

5.138. The RMIF thought that if Cendant expanded the RACMS liveried patrol force, it would be unlikely to withdraw significant amounts of business from the contractor network. Breakdown organizations would always need to maintain partnerships with garage contractors to deal with peaks in demand and call-outs in rural areas. The balance in this relationship was more likely to be influenced by communications, telematics and IT than by the proposed merger.

Road Rescue Recovery Association

5.139. The Road Rescue Recovery Association (RRRA) said that it represented the interests of about 560 recovery operators throughout the UK. The members' main concern was that Cendant would franchise the RACMS patrol force and/or a few large independent contractors. For example, RACMS's use of contractors could be restricted to only 70 or 80 throughout the UK. This could result in smaller contractors losing significant amounts of work and possibly going out of business. The RRRA thought the merger should only be allowed to proceed if enforceable conditions were applied preventing franchising.

5.140. In responding to questions on specific hypothetical outcomes of the merger, the RRRA said that at present contractors would give priority to call-outs from the breakdown organizations which paid the best rates. The RRRA thought it likely that the merged company would use its enhanced purchasing power to cut rates to contractors or lag behind inflation increases and that this could lead to contractors charging higher rates to non-insured motorists and a poorer service to Green Flag/RACMS members in order to continue in business.

Others

Brian Currie Milton Keynes Limited

5.141. Brian Currie Milton Keynes Limited, a Leyland-DAF dealer, was concerned about the provision of breakdown services for heavy vehicles. It told us that it did not believe the merger would be in the public interest. Competition between the two major providers of breakdown services had resulted in the advancement of technology and kept prices down. The likelihood of new entry would be slim because of the investment required. The merged database of the two companies would make it easy for them to identify customers for a variety of other services and would shut out rival suppliers.

The Caravan Club Limited

5.142. The Caravan Club told us that it used Green Flag to provide insured breakdown services to its members. It said that the merger might result in it losing the benefits it enjoyed as a major account holder with a smaller breakdown organization.

5.143. The Caravan Club believed there were alternatives to the AA, RACMS and Green Flag. The constraints on setting up insured breakdown services were not great given the existing network of garage contractors that could be used.

5.144. The Caravan Club believed the merger would encourage greater competition from smaller operators which would offer a variety of services, and from major insurers setting up their own schemes.

Cardiff Truck Centre Limited

5.145. Cardiff Truck Centre Limited, which was concerned with the provision of breakdown services for heavy vehicles, said that the majority of fleet leasing companies subcontracted breakdown work through Green Flag. The AA was responsible mainly for light commercial vehicles. The company thought the merger was detrimental to the public interest and should not be allowed to proceed. It would reduce the already limited amount of competition and would enable Cendant to control far more than the market for insured breakdown services.

Celfra Trust

5.146. Celfra Trust, a registered charity, told us that some charities might lose out if the merger did not proceed. It had been promised a large donation from members of the Club on the basis that RACMS was successfully sold.

Consumers' Association

5.147. The Consumers' Association (CA) said that it reported regularly on the breakdown services market. Its latest report had been published in the November 1996 issue of *Which?*; this had been based on 934 responses to a questionnaire sent to 15,000 *Which?* readers belonging to breakdown organizations. The participants had completed the questionnaire if their car had broken down within a particular ten-month period. CA said that the response had enabled it to assess the performance of the AA, RACMS, Green Flag and Britannia. The AA had corresponded with CA over the published results of its survey and the methodology used and, as with most of the organizations CA dealt with regularly, there was ongoing discussion between the two parties. Information for CA's next report on the market was still being collected and would not be available until after completion of the MMC's report.

5.148. In addition to its surveys, CA's policy department monitored and noted trends in particular industries including the car industry. Motorists occasionally wrote to CA complaining about breakdown services but were generally more likely to write to the organizations concerned.

5.149. CA emphasized that each of its surveys involved different participants and therefore data from different surveys were not really comparable. Its 1996 survey had indicated that time to attend had been the aspect of service with the highest level of dissatisfaction. Britannia had, on average, arrived 20 minutes sooner than RACMS and the AA and this was the main reason why it had been voted the 'Best Buy'. In other areas (for example, the number of cars repaired at the roadside) the AA and RACMS had a higher score than Britannia. Besides time to attend, the other aspects of service which respondents considered important were a liveried patrol force (to provide a greater feeling of personal security), the breakdown organization's ability to repair the vehicle at the roadside, the service standards at the call centre and, to a lesser extent, price.

The market

5.150. In CA's view there had been little change since its 1996 report. The market appeared to have become static again after the entry of smaller niche organizations that had targeted specific groups of consumers. One notable difference was the increased amount of advertising and marketing by breakdown organizations, particularly the AA, RACMS and Green Flag, which indicated that they were trying to maintain their market shares.

5.151. CA had not seen any significant product innovation in recent years. The AA had developed and built its brand more effectively than RACMS. The only dynamism in the market had come from Green Flag which, by its marketing and pricing, had tried to establish a position in a market dominated by the AA and RACMS. Other new entrants had stayed within their established niches and had not challenged the two main players.

Prices

5.152. Consumers were not generally price-sensitive. The AA and RACMS offered a complex range of products that confused consumers and made price comparisons difficult. This encouraged motorists to stay with their current breakdown organization. This feature could indicate that the market was not functioning properly and that breakdown organizations were trying to avoid head-on competition. Breakdown service customers generally belonged to the A, B and C1 socio-economic groups. Only Green Flag with its clear basic pricing policy had aimed at the lower groups.

Garage contractors

5.153. CA's market report had not mentioned the performance of garage contractors, but it believed the lack of complaints from respondents suggested that there had been few significant problems. CA had seen no evidence that the AA and RACMS were given priority by garage contractors, although it thought that this might happen if they increased their use of contractors.

Barriers to entry

5.154. CA thought that although theoretically market entry was easy, establishing and maintaining a position was difficult, partly because of the strength of the existing brands and partly because the inertia in the market enabled the current suppliers, particularly the AA and RACMS, to maintain their market shares. This view was supported by the fact that Green Flag's marketing expenditure was vastly disproportionate to its market share. One of the few ways to enter the market was by arrangements with third parties. The AA and RACMS were competing vigorously for fleet and motor manufacturer schemes and appeared to be pricing below cost and foreclosing these routes to new entrants.

5.155. Increased use of telematics might have different effects on market entry. Consumers might choose to stay with established organizations, believing they would be more proficient in the technology involved. Motor car manufacturers, particularly those that supplied breakdown services with their warranties, might try to limit the ability of unauthorized mechanics to diagnose problems with the manufacturers' vehicles and this could undermine the breakdown organizations. There might also be an opportunity for telecommunications companies to enter the market.

The merger

5.156. CA said that after the merger Cendant might continue to operate both RACMS and Green Flag as separate organizations, maintaining their current pricing policies and promoting the RAC brand as its premium brand. It might then cross-sell its other products through RACMS. CA was also concerned that Cendant and the AA might enter into exclusive arrangements with garage contractors and thus restrict access by smaller organizations.

5.157. CA thought the most appropriate remedy for the detriments it had identified would be the divestment of Green Flag. Its continuation as a stand-alone organization should create more effective competition at retail level.

Department of the Environment, Transport and the Regions

5.158. The DETR said that the merger would restore the dominance of the two established brand names, although new entry remained possible. The effect on the quality of service to the public, police and highway authorities, and on RACMS's provision of traffic and travel information services, was uncertain.

5.159. The DETR recognized the public interest in having a competitive market for insured breakdown services, notwithstanding that the market had for most of this century been dominated by the AA and the RAC brands. For some years there had also been smaller operators, but apart from National Breakdown (now Green Flag) none had offered serious competition. Although there were opportunities for other entrants, the proposed merger would effectively restore the dominance of the two established players.

5.160. The DETR also saw a public interest in the road safety and traffic management benefits of maintaining the efficient removal from roads of broken-down vehicles, not least on the trunk road network (including motorways) in England for which the department's Secretary of State was the highway authority. RACMS and Green Flag both provided this service, either through the RACMS patrol force or through arrangements with garage contractors. In the absence of breakdown insurance (or of a sufficiently speedy response) the police needed to arrange for the removal of these vehicles.

The effect of the merger on the quality of service to the public, the police and the highway authorities was uncertain but there was the risk of more monopolistic practices developing.

5.161. The DETR also had an interest in maintaining a competitive market for the provision of traffic and travel information services, another area in which RACMS was a leading player and one which was likely to expand as technology developed.

Interval International Limited

5.162. Interval International Limited (Interval) told us that it was Cendant's principal competitor in the timeshare exchange business. Interval had formerly been owned by CUC. As a pre-condition for clearance of CUC's merger with HFS to form Cendant, the US Federal Trade Commission had required the divestment of one of the timeshare exchange businesses upon closing of CUC's merger with HFS. The US Federal Trade Commission allowed the divestment of Interval to an investment group formed by Willis Stein and Partners LP (the majority shareholder) and a consortium of international hospitality and travel companies.

5.163. Interval was opposed to the merger. Cendant would gain control of about 40 per cent of the UK market for insured breakdown services, which would consolidate its already dominant share of the timeshare exchange business. This would seriously affect Interval's ability to compete with Cendant in that business and in related services. The merger would leave only two large firms in the UK breakdown services market, dominating it with their strong brands.

5.164. Interval said that customers chose the larger breakdown organizations, seeing them as offering the high standards required for essential emergency services. Interval was concerned that the merger would restrict its choice of service provider should its members decide they wanted membership of either the AA or RACMS. RACMS might refuse to supply the services it requested and the terms offered could be unduly unfavourable. In addition, RACMS might pass commercially confidential information to RCI, Cendant's principal timeshare subsidiary.

5.165. The creation of a duopoly would be detrimental. It was unlikely that smaller competitors would be able to compete successfully; new entry would be more difficult; customers would have a reduced choice of service provider; and the price of breakdown services was likely to rise.

5.166. Interval said that the merger should not proceed. But if it did, Cendant should undertake to run the RCI timeshare exchange business separately from the RACMS/Green Flag business, with no exchange of information between them.

Transport and General Workers' Union

5.167. The TGWU told us that it had had a long working relationship with RACMS and an exclusive single union agreement covering employees in its business operations. The former RAC staff association (SAFRACE) had merged with the TGWU in 1978 and had been placed under the responsibility of its Regional Secretary for Wales.

5.168. The TGWU had worked with RACMS management to achieve seven reorganizations to consolidate its business, reducing the number of call-centre locations from 17 to 5. It favoured the provision of a liveried service but had agreed reluctantly to RACMS contracting out 20 per cent of its business.

5.169. The TGWU said that the merger would be of substantial benefit to RACMS's members, customers and employees. The additional volume of work expected would protect 200 patrol jobs and 300 support jobs. The merged company would be smaller than the AA but better equipped to provide a stronger, more efficient and competitive service of higher quality, which would sharpen up the competition from the AA. Green Flag would also benefit from obtaining access to a patrol service.

Vehicle Recovery Link Ltd

5.170. Vehicle Recovery Link Ltd (VRL) told us that it was an independent monthly magazine for the recovery industry. VRL said that the merger would reduce choice and competition, particularly in prices.

5.171. Cendant would be in a powerful position to apply financial and operational pressure on independent garage contractors. This could reduce some contractors' ability to respond to call-outs from non-insured motorists and force them to compromise on safety. There could be reduced efficiency in the command and control of roadside assistance and recovery operations if Cendant combined the RACMS and Green Flag control centres in the Republic of Ireland.

5.172. Cendant already had much customer information on its database and any further increase would be against the public interest.

RAC Motoring Services staff

5.173. We received two anonymous letters purporting to be from RACMS staff, one of which said that it was on behalf of several concerned RACMS patrols. Both witnesses believed that Cendant would franchise out RACMS's patrols. One said that if it did Cendant would find it more economical to use contractors. This would lead to reduced competition because the AA would then be the only breakdown organization with a patrol force. The level of service to the consumer would be affected because patrols repaired 80 per cent of breakdowns at the roadside whereas many contractors towed cars to local garages because they worked there or had arrangements with them. If Cendant withdrew patrols many RACMS members, preferring a patrol service, would be likely to join the AA. The witness also believed that the financial position of Cendant could jeopardize the second and third largest players in the market. This would be detrimental to competition and ultimately lead to lower levels of service.

5.174. The second witness also said that the merger would have an adverse effect on competition and be detrimental to RACMS staff. The only beneficiaries would be those with a financial interest in the merger. Cendant was acquiring RACMS for its brand name and intended to franchise out its highly trained patrol force. This would result in unemployment and leave the AA as the only breakdown organization with a dedicated patrol force. This witness also stressed that RACMS patrols repaired more than 80 per cent of breakdowns at the roadside. Garage contractors were more likely to tow vehicles away rather than repair them. This was disadvantageous to consumers in terms of time and cost.

Members of the public

5.175. Nine members of the public gave us their views. Six of these, including two members of the Club, were opposed to the merger. Most of these were concerned that it would result in less choice: this would be against the public interest. Two correspondents believed there were enough breakdown organizations in the market and that the merger should be allowed to proceed.

5.176. We received letters from some relatives of deceased Club members expressing concern over the distribution of the sale proceeds. This matter was not regarded as falling within our terms of reference.