

New car warranties

Report of the market study

December 2003

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1 EXECUTIVE SUMMARY

- 1.1 This report sets out the findings and recommendations of a study by the Office of Fair Trading (OFT) into the warranties provided with new cars.
- 1.2 Over 2.5 million new cars are sold in the UK every year. New car prices have fallen by over 14 per cent in the last five years. Aftersales costs are a significant expense, representing around forty per cent of the whole life cost of the car. The total spend on car servicing and repair within the UK is around £10 billion a year, of which about £1.4 billion is spent on servicing cars up to three years old.
- 1.3 All new cars come with some sort of warranty covering failure of components due to manufacturing defects. The specific conditions attached to these warranties vary. It is usual for the car owner to pay the servicing costs. For the most part, this servicing is carried out at a garage that is part of the manufacturer's franchised network.
- 1.4 The car servicing sector is divided between garages that are part of a manufacturer's network ('franchised dealer') and those that are not ('independent garages'). We estimate that franchised dealers currently undertake 90 per cent of servicing of cars up to three years old. The available evidence also indicates that franchised dealers are significantly more expensive than independent garages, and overall that there is no clear difference in quality between the services offered by each.
- 1.5 This is an opportune time for assessing the aftersales sector. Relevant elements of the new EC Cars Block Exemption Regulation (BER) came fully into force in October 2003. Under the new regulation, manufacturers and their franchised dealers have been obliged to open themselves up to greater competition from garages outside their network.
- 1.6 To facilitate effective competition it is also necessary to ensure that consumer choice about servicing of new cars is not unnecessarily constrained or distorted. Our assessment of new car warranties has been carried out with this in mind.

The warranty arrangements

- 1.7 The basic warranty that comes with all new cars, known as the 'manufacturer's warranty', usually lasts for one to three years. In addition to this, most manufacturers who offer a one or two year manufacturer's warranty, also offer the option of extending total cover to three years, at no additional charge. This arrangement is known as the 'dealer based extended warranty'.
- 1.8 The majority of dealer based extended warranties, and some manufacturer warranties, require the car to be serviced at a franchised dealer of that manufacturer throughout the period of the warranty for the warranty to remain valid. Most manufacturers' warranties do not impose such a restriction.

Findings

- 1.9 We found that the conditions that make warranty cover dependent on the car being serviced at the manufacturer's franchised dealer limit consumers' abilities to choose where to have their cars serviced, and may lead them to pay higher prices for servicing. This is because:
- In principle, those consumers faced with warranties, offered with servicing restrictions but at no extra cost, nevertheless have the option of using a garage outside the manufacturer's franchised network. In practice, the vast majority of such consumers, who wish to ensure that their warranty remains valid and to secure peace of mind against their car failing, are effectively restricted.
 - There is widespread confusion amongst consumers about the terms attached to their warranties, with most believing that they must have their car serviced at a franchised dealer for the warranty to remain valid, when this is not necessarily the case.
- 1.10 It is difficult to get a precise figure of possible savings for consumers were the market to work better. If the prices that franchised dealers charge for servicing were to approach the level of the independent garages, then savings could be up to £500 million.

Next steps

1.11 To address these problems:

- We call on the trade to drop conditions attached to warranties that require a car to be serviced at a garage in its manufacturer's network.
- In May 2004, we will take a decision whether to launch a formal investigation under EC competition law, with a view to possible enforcement action against manufacturers still imposing these conditions.
- We will launch a consumer information campaign aimed at clarifying the terms attached to new car warranties.
- We will issue guidance to the trade aimed at sales staff providing accurate and clear information on warranty terms. We also invite trade associations active in this sector to address these concerns by incorporating appropriate provisions in their consumer codes of practice.

2 INTRODUCTION

Background

- 2.1 On 30 June 2003 the OFT announced a study into warranties for new cars in the UK. This was carried out under section 5 of the Enterprise Act 2002.
- 2.2 This study focuses on how competition in car servicing is affected by restrictions on where cars may be serviced during the term of new car warranties¹. Relevant elements of the new EC Cars BER^{2 3} came fully into force in October 2003. Also from May 2004 the OFT will take on joint responsibility for administering in the UK much of European Community competition law, including the new BER. The study is therefore a timely opportunity for us to look at issues affecting aftersales competition.
- 2.3 The study followed complaints to the OFT from purchasers of new cars (both private individuals and businesses) and independent garages. Consumers complained about having to use franchised dealers⁴ for routine maintenance and servicing, that could be obtained cheaper at independent garages. Independent garages complained about being denied work. The Independent Garage Division of the Retail Motor Industry Federation (RMIF)⁵ also made a substantive complaint. In this study we considered the impact of warranties on both private individuals and fleet buyers.

¹ For convenience 'servicing restrictions' is used in this report to denote terms and conditions in the warranty that restrict servicing to franchised dealers in order for the warranty, or certain aspects of the warranty, to remain valid.

² Commission regulation (EC) no 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector.

³ The BER provides an umbrella exemption from the prohibition in Article 81(1) of the EC Treaty on agreements between undertakings which affect trade between EC Member States and which have as their object or effect the prevention, restriction or distortion of competition

⁴ We use the term 'franchised dealer' in this report to include all garages authorised by manufacturers to service and repair their brand.

⁵ The RMIF's Independent Garage Division (IGD) covers a wide range of used car sellers, service and repair, and specialist automotive service providers.

2.4 Car warranties have been considered by competition authorities in the recent past. The 2000 Competition Commission (CC) report on New Cars⁶ also considered issue of restrictions contained in warranties, although they made no conclusions on this particular matter. Also in 2000 the OFT published the results of a study on the car servicing and repairs sector.⁷ That report concluded, among other things, that manufacturers should make better information available to consumers about servicing requirements. The OFT's general view was that where the consumer paid for the service, they should be free to choose where their car was serviced. Despite this there subsequently appears to have been an increased prevalence of warranties dependent on servicing being carried out by a franchised dealer in the manufacturer's network.

2.5 The aim of the new BER is to increase competition for new car sales and servicing.⁸ This includes better consumer services and more competitive prices. The European Commission in its Explanatory Brochure on the new BER⁹ has stated that:

'a general obligation to have a car maintained or repaired only within the authorised network during such a period¹⁰ would deprive consumers of their right to choose to have their vehicle maintained or repaired by an independent repairer and it would especially in the case of "extended warranties", prevent such repairers from competing effectively with the authorised network.'

Methodology

⁶ New Cars, A report on the supply of new motor cars with the UK, Competition Commission 2000, CM 4660.

⁷ Car Servicing and Repairs, 2000, OFT307.

⁸ See speech by Mr Mario Monti, Speech/03/59 'the new legal framework for car distribution'. Ninth Annual European Automotive Conference: Car retailing at a crossroads. Hilton Hotel Brussels, February 6 2003.

⁹ Explanatory brochure on Commission Regulation (EC) Commission Regulation No 1400/2002.

¹⁰ The manufacturer's warranty period.

- 2.6 During our study views were sought from trade associations representing car manufacturers, franchised dealers and independent garages. We sent questionnaires to individual manufacturers, dealer councils (dealers representing a single brand), warranty providers, insurers, independent garages and others in the industry. We also wrote to drivers' associations, fleet managers and consumer groups. A list of those who contributed is in Annexe A. Our website also invited contributions. We are grateful to everyone who responded.
- 2.7 In addition, we commissioned a survey of purchasers of new cars. We also conducted a small mystery shopping exercise asking independent garages¹¹ and franchised dealers for the price of servicing specific car models. A summary of the findings of this research is at Annexe B.
- 2.8 We looked at the situation in other countries and a summary of our findings is at Annexe C. We also contacted the European Commission about our study, given the scope and potential impact of the new BER.

Scope of study

- 2.9 Our study relates specifically to new cars bought by consumers, businesses and other commercial consumers. The study does not extend to motorcycles, vans, or lorries. It also does not include warranties sold with used cars after the new car warranty has expired.

Unfair contract terms

- 2.10 The study took account of the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs). These regulations provide that those terms in consumer contracts that deal with the price or subject matter of a contract ('core terms') are exempt from the test of fairness, provided they are in plain and intelligible language. Terms in car warranties that specify the requirements for servicing, for example, the intervals, where the work should be done, or standards of work, are considered to be core terms because they are setting out what is and is not covered under the warranty. As such they are not considered unfair, for the purposes of the UTCCRs, provided they are clear. Our study therefore focused on the implications for competition of the conditions in the warranties in the relevant markets, rather than whether the UTCCRs had been breached.

¹¹ In this case (and in other price and quality comparisons), independent garages are garages that are not part of any manufacturer's network.

Structure of report

2.11 The report is structured as follows: Chapter 3 outlines the market and the current situation, Chapter 4 outlines the issues of concern, and Chapter 5 presents our conclusions and recommendations.

3 THE MARKET

New car distribution and servicing

- 3.1 Car manufacturers in the UK sell most of their cars through a network of franchised dealers that typically also operate as garages providing servicing and repairs. The nature of the relationship between the manufacturer and dealer is heavily influenced by the BER. Relevant elements of the new EC Cars BER came fully into force in October 2003. Prior to this, franchised dealerships also supplied car servicing and repairs in addition to new car sales. The new version of the BER requires them to separate the distribution and servicing functions and creates a new status of 'authorised repairer' – a garage that is authorised by a manufacturer to undertake servicing and repairs for that brand. A manufacturer may not deny authorised repairer status to any garage that meets the manufacturer's qualitative criteria.
- 3.2 The introduction of authorised repairers may provide customers with greater choice and lower prices for servicing that is still compatible with warranties if the costs to garages of becoming authorised repairers are low.
- 3.3 For the purposes of this report we have looked generally at the supply of servicing and repairs for all major brands of new cars supplied in the UK. We did not seek to conclude whether the supply of such services forms a single market or is made up of a number of narrower markets covering each brand.

New car warranties

- 3.4 Warranties are an important part of a new car package in that they offer the consumer peace of mind in the form of free repairs for manufacturing faults. They also act as a quality signal from manufacturers to buyers. The exact nature of the warranty varies between brands, but it invariably covers the premature failure of major components. Warranties are in addition to other consumer rights, and a warranty does not affect the consumer's legal rights to reject a new car that is faulty and get their money back.
- 3.5 All new cars sold in the UK include a basic warranty, called the 'manufacturer's warranty'. These usually last for one, two or three years. Manufacturers with a one or two year basic warranty also offer at no extra charge what is called a 'dealer based' extended warranty that generally extends the total period of

cover to three years.¹² Around 60 per cent of new cars sold in the UK are offered with dealer based extended warranties.

3.6 Manufacturer warranties do not, in general, require a consumer to have the car serviced at a franchised dealer during the warranty period. Exceptions to this were DaimlerChrysler UK Ltd and Volkswagen Group UK Ltd who, at the time we commenced this work, insisted on servicing being undertaken by a franchised dealer if the warranty was to be maintained. At the time of this report we believe¹³ that both manufacturers were revising their warranties with the intention of removing these servicing restrictions.

3.7 Taken together, the suppliers that included a restriction¹⁴ to franchised dealer servicing for either the manufacturer's warranty or the dealer based extended warranty to remain valid, were (with market shares in brackets¹⁵):

- Ford Motor Company Ltd (15.6 per cent)
- Citroën UK Ltd (5.1 per cent)
- BMW (GB) Ltd (3.3 per cent)
- Peugeot Motor Company PLC (8.1 per cent)
- DaimlerChrysler UK Ltd (3.9 per cent)
- Volkswagen Group UK Ltd (12.1 per cent).

In total these represented around 49 per cent of new cars sold in 2002. In the last year Renault and MG Rover, representing around 11.5 per cent of new car sales, dropped this servicing restriction in their warranties.

¹² Although they are termed dealer based extended warranties, our study has established that it is the manufacturer that sets the terms and conditions and provides the bulk of the funding.

¹³ DaimlerChrysler confirmed that they would be revising their warranty in the New Year to remove restrictions on the servicing outlet. This will apply retrospectively to cars currently under warranty. Volkswagen appear to have amended their warranty with effect from 1 November 2003 (source: www.vw.co.uk). This has not been confirmed by Volkswagen. Nor have the arrangements for their other brands and whether the amendment is retrospective.

¹⁴ When this study commenced.

¹⁵ Registration of new cars in the United Kingdom by manufacturer, SMMT, 7 January 2003.

- 3.8 Manufacturers that do not explicitly make the manufacturer's warranty or dealer based extended warranty dependent on franchised dealer servicing, still recommend that consumers use these providers. In most cases where a garage outside the manufacturer's network is used, if the consumer cannot demonstrate that servicing was not the cause of premature component failure, the warranty claim will not be accepted by the manufacturer.
- 3.9 The service intervals required for the warranty to remain in force are set by the manufacturer. The exact nature of the service varies between brands and time periods. For example, the first service (typically one year) is usually relatively straightforward and could include items such as routine checks or changing of fluids and filters.

Size of market for car servicing

- 3.10 In 2002 new car sales comprised some 2.6 million vehicles ¹⁶ an increase of 4.3 per cent on 2001, a total value of £33 billion. Prices of new cars have declined in recent years. The Alliance and Leicester Car Price Index¹⁷ reported in September 2003 that new car prices had decreased by over 14 per cent in the previous five years. Possible reasons given for this include government action following the CC report into new cars, consumer pressure, changing market dynamics, buoyant UK sales and manufacturers seeking to protect market shares. Exchange rate movements have also been a factor.
- 3.11 Total expenditure on servicing and repair of all cars has been estimated to be some £10 billion,¹⁸ with the value of servicing for cars up to three years old estimated to be in the region of £1.4 billion.¹⁹

¹⁶ The Society of Motor Manufacturers and Traders reported that in 2002 there were 2,563,631 new car registrations. www.smmt.co.uk/dataservices.

¹⁷ Alliance and Leicester Car Price Index produced in association with What Car? www.alliance-leicester.co.uk/smartermotoring 24 September 2003.

¹⁸ Mintel International Group Ltd. Car Servicing/MOT – UK – February 2002 - the UK car servicing and repair market was worth an estimated £9.8 billion in 2001. This figure comprises all servicing and repair work paid for by the car owner and thus excludes warranty repairs, the repairing of fleet cars and accident related repairs that will normally be paid for by an insurance company.

¹⁹ There were 7.3 million cars less than 3 years old. Estimates of the cost for car servicing from the DTI mystery shopping exercise, and assuming one service per vehicle per year.

- 3.12 We estimate that franchised dealers account for about 90 per cent of servicing for cars up to three years old. In our consumer survey, of those owners whose vehicles had been serviced at least once, 91 per cent said they had used a dealer that was part of the manufacturer's network. This is consistent with estimates taken from Castrol Business Services: Trend Tracker.²⁰
- 3.13 This study is concerned with competition in the aftersales market. Aftersales costs, including servicing, are a significant element of the lifetime cost of a car, representing around 40 per cent of the whole life cost.²¹

Servicing costs and quality

- 3.14 In the course of this short study we have not carried out an exhaustive examination of the pricing and quality differences between different types of garages. We have, however, been able to draw on a range of existing analyses from other sources, which we have supplemented with a small mystery shopping exercise of our own.
- 3.15 Taken together, this evidence supports the claim that servicing at a franchised dealer tends to be significantly more expensive than servicing at independent garages²² and that there is generally no significant difference in quality between them:
- A major DTI mystery shopping exercise in 2002²³ revealed that the median cost of franchised dealer servicing is £199 compared to £116 for independent garages. It also found no significant difference in overall ratings between types of garage – 53 per cent of independent garages and 50 per cent of franchised dealers were rated either poor or very poor.

²⁰ The Castrol Business Services Car Service and Consumer Satisfaction Trend Tracker XIX Jan 2003 p i.

²¹ OJ 13/3/02 paragraph 8 quotes the purchase price and after sales servicing each account for 40 per cent of the cost of ownership. The remaining 20 per cent includes financing and insurance. European Commission Directorate General – Competition: Andersen study on the impact of possible future legislative scenarios for motor vehicle distribution on all parties concerned, 3 December 2001.

²² See footnote 11.

²³ Car Servicing and Repairs, Mystery shopping research, DTI, URV02/1293.

- Which? magazine reported in 1999 ²⁴ little difference in quality between independents and franchised garages, but did find that franchised dealers were generally more expensive.
- Our 2000 report on the car servicing and repair market examined the results of a number of mystery shopping exercises carried out by local authorities. This showed a similarly low level of satisfactory service both across independent and franchised outlets.
- The CC in Appendices to its 2000 report on New Cars,²⁵ considered opposing views about the cost and value of franchised dealer and independent garage servicing. This was not the main focus of the CC's work and no clear conclusions were drawn.

Relevance of new car warranties in consumer behaviour

- 3.16 An important question is to what extent the warranty arrangements affect consumer behaviour. When consumers in our survey were asked to list the most important factors guiding their decision on where to have their car serviced, the three most popular responses were the location of the garage – mentioned by 44 per cent of owners, the quality of service (30 per cent) and the price (20 per cent). The need to comply with warranty conditions was fourth most common, mentioned by 13 per cent of owners.
- 3.17 It is clear that for any car owner the available choice of garages, and hence the available choice of locations, prices and quality, is not materially affected by the age of the car. In the absence of other factors, location, price and quality do not readily explain why nearly 80 per cent of cars up to four years old are serviced by franchised dealers but that this figure falls to 38 per cent for cars between four and six years and to only 18 per cent for cars between seven and nine years of age.²⁶

²⁴ September 1999 Which? "Secret Service", Consumers' Association.

²⁵ New Cars, A report on the supply of new motor cars with the UK, Competition Commission 2000, CM 4660. Appendix 6.6

²⁶ The Castrol Business Services Car Service and Consumer Satisfaction Trend Tracker XIX Jan 2003.

3.18 Among the possible factors to explain this behaviour, the influence of warranty terms and conditions appears to be significant. In our consumer survey, a high proportion²⁷ of owners agreed that:

- servicing at a franchised dealer maintains the car's second hand value (67 per cent),
- servicing at a franchised dealer meets the manufacturer's requirements (84 per cent),
- using a non-franchised dealer will make a warranty invalid (69 per cent).

While warranty terms and conditions are not the only factor influencing decisions they thus appear to be highly influential.

3.19 There is an important corollary to the belief held by 69 per cent of new car owners, irrespective of brand, that using non-franchised dealers for servicing will make a warranty invalid. As only around half of new cars potentially have some form of servicing restriction, this suggests that any influence to use franchised dealers extends beyond those owners subject to servicing restrictions.

3.20 Another relevant issue is the extent to which consumers take into account the terms and conditions of the warranty and the price of franchised dealer servicing when choosing what new car to buy. Our consumer survey found that warranty packages were a significant factor in a consumer's choice of new car, equalling the importance of the manufacturer brand and beaten only by the specification. On the other hand, as noted above, the survey also indicates that consumers do not have an accurate understanding of all the terms and conditions contained in their warranty.

²⁷ Results quoted from our consumer survey are normalised for those respondents who did 'not know' or show a preference. In the results quoted in 3.15 this accounted for 3, 4 & 9 per cent of the sample respectively.

4 ISSUES OF CONCERN

4.1 In this chapter we examine the following four issues:

- the potential efficiencies associated with the servicing restrictions
- how well consumers understand the terms and conditions of their warranty
- whether the warranty arrangements have a detrimental effect on consumers who choose to rely on the warranty
- whether there exists a wider detriment to consumers other than the owners of cars under these warranty arrangements by affecting the viability of other garages or other warranty providers.

Efficiency arguments for car warranties

- 4.2 There are likely efficiencies associated with the manufacturer providing warranties with new cars. Warranties can be a signal of quality, for which consumers are often willing to pay a premium. In particular, at the point of purchase, consumers do not have full knowledge of the ongoing costs of repair and the likelihood of a catastrophic breakdown later in the car's life.
- 4.3 Risk averse consumers place greater value on such peace of mind than other purchasers. The warranty gives manufacturers the incentive to improve the quality of their vehicles to reduce the likelihood of warranty claims. The trend towards three-year warranties began with manufacturers originating in the Far East who have traditionally competed on a reputation for reliability.
- 4.4 This 'signalling' efficiency alone does not necessarily mean that the warranty's validity should be conditional on the consumer servicing the car at a franchised dealer. In terms of technical efficiency and financial viability of offering warranties, however, the manufacturer needs to ensure that the probability of the warranty being needed is minimised by competent servicing. Since there is a risk that poor servicing may cause or exacerbate defects that become the subject of warranty claims, manufacturers have an incentive to control the quality of servicing in some manner.
- 4.5 It is not clear, however, why the servicing restriction should apply for the period of the dealer extension in instances where it does not apply during the manufacturer's warranty. Warranties on older cars (often termed 'mechanical breakdown insurance') sold by independent warranty providers do not appear to have such onerous conditions on where the car must be serviced. Furthermore,

it is often the case that, for the extended warranty to remain valid, the consumer is required to use a franchised dealer for all prior servicing and not just the extended period. So, in these cases, the choice of whether to opt into the dealer extension needs to be made when the first service is needed.

Consumer understanding of warranty terms and conditions

- 4.6 The impact of warranty servicing restrictions is affected by consumers' frequent misunderstandings of the details and meaning of the conditions, and by the uncertainty about the risk of a major component failure. These misunderstandings and uncertainties combine to affect consumer behaviour.
- 4.7 First, our study found many consumers hold strong misconceptions about warranty terms and conditions, even for those warranties where there was no formal restriction. Around two-thirds of car owners questioned in our survey agreed with the statement that using a non-franchised dealer for servicing would make their warranty invalid. Information about how the validity of the warranty is linked to servicing is usually conveyed to consumers in sales literature, instruction documents supplied with the car, and in information from franchised dealers' sales and servicing staff. Half of our survey sample obtained their information about the warranty from the sales person, suggesting that, on many occasions, sales staff are not effectively correcting the misconceptions that we identified.
- 4.8 Second, even if consumers had a complete understanding of warranty conditions, they may still be faced with uncertainties about the likelihood of a major repair bill and what this would cost them if they were not covered by a warranty. This uncertainty, combined with the potential impact on the validity of their warranty from using an independent garage or a dealer franchised for another brand, means that for many consumers switching to an independent garage may be considered too great a risk.

Impact on consumers of choosing to rely on a warranty

- 4.9 Paragraph 3.15 outlined evidence that prices at franchised dealers were higher than the prices for comparable servicing work by independent garages and were not obviously different in quality.

- 4.10 Some consumers are risk averse, and even if well informed, would be willing to pay high prices for a servicing and warranty package, to guarantee peace of mind. For most consumers a new car represents a considerable financial outlay and they are naturally concerned about it going wrong. So it is entirely rational for these consumers knowingly to pay higher prices for servicing of the same quality to avoid the low likelihood, but very costly, worst case scenario.
- 4.11 But detriment still occurs in the following ways:
- Those consumers who wish to ensure that their warranty remains valid and to secure peace of mind against their car failing, are not free to use a garage outside the manufacturer's franchised network.
 - Some consumers, if they were better informed about the likelihood of claiming under a warranty, would elect to service their car at a non-franchised dealer and pay a lower price.
- 4.12 The result is that, despite efficiencies described in paragraphs 4.2 to 4.5, the servicing restriction potentially confers additional market power on franchised dealers that results in consumers paying higher prices.
- 4.13 The problem lies in identifying or isolating the extent of the effect that is attributable solely to these servicing restrictions. Warranty arrangements need to be considered against a general background of the poor consumer information in choosing a garage and a widely held belief that franchised dealers provide a superior service. Even without warranties, franchised dealers have a first mover advantage in encouraging the car buyer to use their garages for servicing.
- 4.14 Franchised dealer servicing declines rapidly after three years in favour of independent garages (see paragraph 3.17). Furthermore, our consumer survey supports the view that the servicing restriction does affect choice and understanding.
- 4.15 As previously stated it is also clear that, with few exceptions, manufacturers' warranties do not include a formal requirement to use franchised dealers for servicing, although they invariably come with a strong recommendation to use these servicing outlets. Viewed in these terms, the imposition of a formal restriction simply by virtue of a dealer extension of the original warranty, appears to lack any justification. Indeed, it invites the conclusion that the only reason for imposing the restriction on the period of both the earlier

manufacturer's warranty and subsequent dealer extension is to bolster dealers' already high share of new car servicing.

Detriment to other consumers by affecting the viability of other garages or warranty providers

- 4.16 The previous section outlined how warranty conditions could help franchised dealers exercise market power over some consumers and cause detriment through higher prices.
- 4.17 A related question is whether franchised dealers can exercise their market power to the extent that consumers whose behaviour is not affected by servicing restrictions also end up suffering detriment through higher prices. This might occur, for example, if franchised dealers can distort the competitive process to the extent that non-franchised garages might suffer a loss in economies of scale, resulting in higher unit costs or even complete foreclosure of the market to these garages.
- 4.18 There is no evidence, however, that non-franchised garages suffer from an increased risk of not being able to reach an efficient scale of operation or to realise similar efficiencies:
- There is a sizeable independent sector of around 16,000 garages, servicing 10-15 per cent of new cars and the vast majority of older cars. The independents' share of the total car servicing and repairs market is around 47 per cent.²⁸
 - The available evidence does not support the claim that standards are lower at independent garages (see paragraph 3.15).
- 4.19 Following the changes to the BER from 1 October 2003, non-franchised garages have full access to manufacturers' technical information, tools and parts. They may also apply to become authorised repairers for particular brands. Thus such garages can compete on more equal terms with the existing franchised dealers. It is too early to say what impact these developments might have on the

²⁸ Mintel International Group Ltd. Car Servicing/MOT – UK – February 2002, page 21

servicing options available to consumers who wish to ensure their warranty claims are likely to be met.

Conclusions

- 4.20 Competition for the servicing and repair of relatively new cars already works to the advantage of franchised dealers. Even franchised dealers of competing brands face large problems in tempting consumers to switch during the early years of a car's life.
- 4.21 The market is characterised by a great deal of misinformation, misunderstanding, uncertainty and risk aversion that confers greater market power on franchised dealers who would enjoy natural first mover advantages even without these features.
- 4.22 It is equally clear that servicing restrictions add to these information problems and that they cannot be justified by efficiency reasons alone. This creates an additional detriment to consumers (particularly risk averse consumers) who use franchised dealers, in the form of higher prices. We have not found any evidence that manufacturers and their networks can extend their market power to affect other consumers by foreclosing the market to independent garages and franchised dealers of another brand.
- 4.23 The net result is more customers using the manufacturer's network for servicing vehicles under warranty, possibly paying a higher price than in a competitive market place. The detriment, in terms of potential savings should the competitive process result in franchised dealers charging the same as independent garages, could amount to up to £500 million per year.²⁹ This is an upper estimate.

²⁹ Estimate based on £1.4 billion (value of new car servicing) multiplied by 40 per cent lower prices taken from DTI mystery shopping data, weighted for those who use franchised dealer servicing.

5 CONCLUSIONS AND NEXT STEPS

5.1 The conclusions of our analysis are that:

- the conditions that are placed on new car warranties which restrict servicing to franchised dealers appear unnecessarily onerous and effectively restrict choice;
- there is widespread consumer misunderstanding about the terms and conditions attached to their warranty.

5.2 Both of these result in consumer detriment in the form of some consumers paying more for servicing than they otherwise would.

5.3 Our recommendations are aimed at addressing both these problems.

Improved consumer information

OFT consumer campaign

5.4 It is important that all consumers have access to the facts about the choices available to them. We will address this issue by running an information campaign targeting people buying and servicing new cars.

5.5 This campaign, planned for the spring of 2004, will address existing consumer confusion within the car warranties sector by providing clear information for consumers. We will aim to involve the trade and work in partnership with them to inform consumers of their options. The campaign will be coupled with guidelines to dealers in selling warranties on new cars.

Consumer codes of practice

5.6 A consumer information campaign will not be sufficient to remove all the concerns identified with warranties dependent on franchised dealer servicing. It will not necessarily deal with the behaviour of sales staff for example, on whom consumers often rely. As well as our proposed guidance to the trade, there is also scope for improving the codes of practice in this sector.

5.7 Self-regulation through consumer codes of practice has the potential to provide an effective but lighter touch alternative to statutory regulation. Currently most codes of practice in the motor industry do not deal well with the issues we have identified related to poor consumer information. We therefore invite trade

associations active in this sector to address concerns about prices and warranties, by incorporating provisions in their consumer codes of practice and in particular by encouraging sales staff to provide clear and accurate information to consumers on the terms of their warranties.

The restrictive condition

- 5.8 The provision of clear information to consumers is not, however, sufficient for addressing the consumer detriment described above. In addition to such action, we consequently would also like to see the industry dropping from their warranties those terms that require consumers to have their cars serviced at garages that are part of the manufacturer's network.

Article 81 investigation

- 5.9 With effect from 1 May 2004 the OFT will gain responsibility for the enforcement of Articles 81 of the EC Treaty within the United Kingdom under the terms of Regulation 1/2003/EC (the Modernisation Regulation).
- 5.10 The provision of warranties is one part of the franchise agreement between car manufacturers and their dealers. The new BER exempts such agreements from the Article 81(1) prohibition on anti-competitive agreements provided, amongst other things, they do not contain specific restrictions.³⁰ Servicing restrictions are not included in the list of such restrictions.
- 5.11 Nonetheless, Article 29 of the Modernisation Regulation will permit the OFT to withdraw the benefit of the BER if the UK or any part of it has the characteristics of a distinct geographic market and the agreements in question have an effect in the UK incompatible with Article 81(3). It seems possible that in respect of the servicing of cars, the UK, or part of it, does have the characteristics of a distinct geographic market.
- 5.12 Article 81(3) provides that the prohibition in Article 81(1) on agreements that have the object or effect of preventing, restricting, or distorting competition may be declared inapplicable where the following four conditions are met:
- a. The agreement contributes to improving production or distribution or to promoting technical or economic progress

³⁰ Agreements which benefit from the BER will also be exempt from the Chapter I prohibition on anti-competitive agreements found in section 2 of the Competition Act 1998 (see section 10 of that Act).

- b. It allows consumers a fair share of the resulting benefits
 - c. It does not impose on the parties concerned restrictions that are not indispensable to the attainment of these objective
 - d. It does not eliminate competition in respect of a substantial part of the products in question.
- 5.13 The European Commission's explanatory brochure on the new BER states that servicing restrictions deprive consumers of their right to choose to have their vehicles maintained by an independent repairer and, especially in the case of extended warranties, prevent such repairers from competing effectively with the authorised network.
- 5.14 We will therefore consider further, next May, the case for a formal investigation under Article 81, which would include consideration of whether there are grounds for withdrawing the benefit of the BER, if servicing restrictions remain in place.

Market investigation reference to the Competition Commission

- 5.15 We have considered the case for further work to be carried out by the Competition Commission (CC). This would be as a result of a market reference under section 131 of the Enterprise Act 2002. Prior to making the formal reference the process permits us to require information and to give the affected parties the opportunity to propose undertakings in lieu of the reference. The CC has information gathering powers and can impose remedies by Order, among other powers. To make a reference to the CC the reference test must be satisfied, and a number of criteria met. We believe that the legal threshold for a market investigation reference has been met in this case. Nonetheless, the franchise agreements between manufacturers and their dealers are 'agreements' within the meaning of Article 81(1) of the EC Treaty. This means that, as from 1 May 2004, as a result of Article 3 of the Modernisation Regulation, the CC would be unable to impose remedies addressing any adverse effects on competition resulting from servicing restrictions in such agreements without parallel proceedings being opened under Article 81. It appears likely that any remedies imposed in enforcing Article 81 would be effective in dealing with the restrictive conditions. Therefore, since consideration will be given in the near

future to the opening of a formal investigation by us under Article 81, we are not pursuing a CC reference for the time being.

Summary of recommendations

5.16 In summary:

- we call on the trade to drop conditions attached to warranties that require a car to be serviced at a garage in its manufacturer's network
- in May 2004, we will take a decision whether to launch a formal investigation under EC competition law, with a view to possible enforcement action against manufacturers still imposing these conditions
- we will launch a consumer information campaign aimed at clarifying the terms attached to new car warranties
- we will issue guidance to the trade aimed at sales staff providing accurate and clear information on warranty terms. We also invite trade associations active in this sector to address these concerns by incorporating appropriate provisions in their consumer codes of practice.

A LIST OF RESPONDENTS

Consumer organisations

Consumers' Association

National Association of Citizens Advice Bureaux

National Consumer Council

Motoring associations/trade associations and representative groups

AA Motoring Trust

Association of British Insurers

Association of Car Fleet Operators

Automobile Association (AA)

Civil Service Motoring Association Ltd

Disabled Drivers' Association

National Franchised Dealers Association

RAC Foundation

Retail Motor Industry Federation

Scottish Motor Traders Association

Society of Motor Manufacturers & Traders Ltd

Manufacturers

BMW (GB) Ltd

Citroën UK Ltd

DaimlerChrysler UK Ltd

Fiat Auto (UK) Ltd

Ford Motor Company Ltd

G M Daewoo UK Ltd
Honda Motor Europe Ltd
Hyundai Car (UK) Ltd
MG Rover Group Ltd
Nissan Motor (GB) Ltd
Peugeot Motor Company Plc
Renault UK Ltd
Suzuki GB Plc
Toyota (GB) Plc
Vauxhall Motors Ltd
Volvo Car UK Ltd

Dealer councils

Alfa Romeo Dealer Council
BMW Dealer Council
Citroën Dealer Council
Fiat Dealer Council
Ford Dealer Council
Honda Dealer Council
Jaguar Dealer Council
Land Rover Dealer Council
Renault Dealer Association
Saab Dealer Council
Vauxhall Franchise Board

Warranty providers and insurers

Motorcare Warranties Ltd
Warranty Administration Services Limited
Warranty Direct Ltd
Warranty Holdings Ltd
London General Insurance Company Ltd
Motor Insurance Company Limited

Commercial/fleet operators/rental

Arriva Vehicle Rental
Interleasing (UK) Ltd
Key Vehicle Solutions
Lloyds TSB Autolease
Powermarque Ltd
PriceWaterhouse Coopers

Independent garages

132 independent garages

Overseas and international organisations

Australia Competition & Consumer Commission
The Federal Competition Authority (Austria)
Competition Service, Ministry of Economic Affairs (Belgium)
European Commission DG Competition
The Office of the Consumer Ombudsman (Denmark)

Office of the Director of Consumer Affairs (Republic of Ireland)
Finnish Consumer Ombudsman
Finnish Competition Authority
Federation of German Consumer Organisations
Hellenic Republic Competition Commission Secretariat (Greece)
Norwegian Competition Authority (Konkurransetilsynet)
Norwegian Consumer Ombudsman (Forbrukerombudet)
National Institute of Consumer Affairs (Spain)
Swedish Consumer Agency & Consumer Ombudsman
Swedish Competition Authority (Konkurrensverket)
Council for European Union Affairs, Federal Trade Commission (USA)

Other respondents

Inchcape plc

27 contributions from other respondents including members of the public

We also wish to acknowledge helpful discussions with:

Glass's Market Intelligence Service

Ellis Transport Services

NC Consulting (small independent business)

B SURVEY AND MYSTERY SHOPPING

Consumer survey: new cars, warranties and servicing

- B.1 As part of the study into car warranties we commissioned MORI (Market Opinion and Research International) to undertake a carefully targeted piece of research with a view to examining the behaviour of new car purchasers, at the time of purchase and subsequently.
- B.2 The objectives of the study were to:
- understand how consumers think about warranties and extended warranties when buying new or nearly new cars;
 - understand consumers' knowledge of warranty terms and conditions
 - assess consumers' behaviour during the period of any such warranty.
- B.3 MORI interviewed 751 adults aged 17 years or over, who had bought or been supplied with a new car for personal use within the past three years. The sample was drawn from a commercial database. Quotas were set on make of car, age, gender, and social class. Data was weighted by age group.
- B.4 The interviews were conducted by telephone between 18-28 September 2003. Some key findings are set out below:

Consumer understanding and beliefs about warranty terms and conditions

- B.5 The survey found that consumers hold strong beliefs about servicing at franchised dealers. Excluding don't knows, high proportions either tended to agree or agreed strongly with the following assertions:
- 'Servicing at a franchised dealer is necessary to maintain the car's second hand value' – 67 per cent
 - 'Franchised dealer servicing meets manufacturers' requirements' – 84 per cent
 - 'Using non-franchised dealers for servicing will make a warranty invalid' - 69 per cent

Consumer behaviour

B.6 Ninety-one per cent of respondents who had their cars serviced had used franchised dealers for their servicing.

Consumer decisions about where to have their cars serviced

B.7 When asked directly about the factors which were most important in deciding where to have their cars serviced our sample nominated the following:

- convenient location (44 per cent)
- serviced to a high standard (30 per cent)
- the price of the service (20 per cent)

B.8 Complying with the terms of the manufacturer's warranty was mentioned by 13 per cent.

B.9 Answers to other questions suggest the influence of warranty terms, however, may be stronger. When asked where can or could you have your car serviced, under the terms of the warranty, 19 per cent indicated only the dealer where that car was bought from and 71 per cent said any franchised dealer for that make of car.

B.10 The survey is reproduced in a separate annex available as a separate document *Car warranty survey: A survey of new car buyers* OFT 683a. This survey can be found on the OFT website www.oft.gov.uk

Mystery shopping – cost of servicing

B.11 During September 2003 we made around 150 telephone calls to garages (franchised dealers or independent garages) throughout the country seeking a price for standard service on range of five popular models. This exercise was to check the findings of existing research that franchised dealer servicing is more expensive than independent garage servicing. The results complemented the conclusions of existing surveys that there is a significant price difference. The results of this exercise are presented in Table B1.

Table B.1: Summary of results

Make	Model	Average cost: Independent garage	Average Cost: Franchised dealer	Difference – price	Difference - per cent
BMW	3series	£149	£232	£82	55
Vauxhall	Astra	£125	£150	£25	20
Ford	Focus	£112	£131	£19	17
Volkswagen	Polo	£123	£165	£42	34
Toyota	Yaris	£110	£149	£40	36
Overall				£42	33

Note

A small number of observations were omitted from the analysis for technical reasons.

C INTERNATIONAL EXPERIENCE

General comparisons

C.1 We also reviewed experience overseas. We wanted to know whether restrictions on servicing existed in other countries and if so the reaction of the relevant authorities. We received 14 responses in total from competition authorities and consumer organisations (more than one response from several countries).

Australia

C.2 In 1997 Australian Competition and Consumer Commission (ACCC) undertook an industry wide review of warranties. The ACCC noted that the terms of the warranties requiring periodic maintenance from authorised/approved repairers may contravene provisions of the Trade Practices Act 1974 (TPA). The ACCC took the view that extended warranties should not be voided unless a service was faulty or the parts defective and no representation should be made in the extended warranty to this effect. An extended warranty may be in breach of sections 47(6) and 47(7) of the TPA if it specifies a particular trader, who is not the warranty provider, to service the vehicle.

Austria

C.3 The Federal Competition Authority reported that the new car warranty is for two years, but manufacturers offer extensions for a further two, three or four years. All new car and extended new car warranties require consumers to have their cars serviced by approved repairers within the manufacturer's network.

Belgium

C.4 New car warranties of different lengths are common in Belgium. Many restrict consumers to servicing their cars at an approved repairer.

Denmark

C.5 The Office of the Consumer Ombudsman takes the view that terms in warranties restricting consumers to using original spare parts and authorised garages could constitute an infringement of the Marketing Practices Act. Following a settlement endorsed by the Danish Car Importers Association repairs can only be rejected if the manufacturer can prove that a fault/defect arises from use of deficient spare part or that a car had not been maintained in accordance with instructions.

Finland

- C.6 Following court action by the Finnish Consumer Ombudsman, the trade took voluntary action to eliminate the possibility of warranties being voided through independent servicing alone (whereas car dealers now have to prove a servicing fault by an independent repairer to void a new car warranty). The Consumer Ombudsman is planning to request a European Commission opinion on the effects on competition of these ties.

Germany

- C.7 The Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband eV) expressed the opinion that a free extension of new car warranties seems a positive aspect of competition for consumers.

Greece

- C.8 Car dealers in Greece offer extended warranties free of charge to new car buyers varying from two to seven years. It is common practice for these warranties to restrict consumers to servicing their cars at approved dealers. The Hellenic Competition Commission issued Opinion No 8/III/2003 concluding that EC Regulation 1400/2002 (articles 1 and 4) and the EC explanatory brochure was introduced to promote effective competition between independent and authorised repairers and that servicing restrictions oppose the scope of the new Regulation. The servicing restrictions deprive consumers of their right to have their cars maintained by an independent repairer and prevent independent repairers from competing effectively with the authorised networks. As a result the Hellenic Competition Commission has found such clauses or practices to be null and void.

Norway

- C.9 The Norwegian Competition Authority (Konkurransetilsynet) takes the view that restrictions in new car warranties is a matter that affects cross border trade and therefore this matter falls within the competence of the European Commission or EFTA Surveillance Authority. Car importers have however stated that restricting consumers to servicing their cars at approved repairers would end this year.

Sweden

- C.10 In Sweden almost all new car warranties are for two years. The Swedish Consumer Agency reached an agreement with BIL Sweden, the largest national organisation for importers and manufacturers, that there is no obligation for a buyer to service their new car at certain repairers. If a dealer can show that the probable cause of defect was unauthorised servicing the warranty will not apply.

D GLOSSARY

Authorised repairers: A repair shop within a manufacturer's network. Under the new BER any repair shop (including independent garage or franchised dealer of another network) that meets the quality standards set by a manufacturer can become authorised repairers within that manufacturer's network, without being obliged to sell new cars.

Cars Block Exemption Regulation (BER): Commission regulation (EC) number 1400/2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector. The European Commission's new rules exempting agreements for vehicle sales and servicing.

Dealer-based extended warranty: Extensions offered to the manufacturer's warranty at no extra charge. Terms and conditions may be different to the manufacturer's warranty, where these restrict servicing to the manufacturer's franchised dealer for the extension to remain valid this is often applied to the whole warranty period (manufacturer's and dealer-based extension). Typically they apply only within the UK.

Franchised dealer: A business in the manufacturer's network that through a franchise agreement is allowed to sell that particular brand of car. Historically franchised dealers could both sell new cars and provide aftersales repair and servicing. The new BER separates these functions and sets up a separate category of authorised repairer (see above). We use the term franchised dealer in this report to cover all those garages in a manufacturer's network that are authorised to service cars. This term is a more familiar one than authorised repairer, nearly all franchised dealers still service cars and at the time of this report only a few independent garages had achieved authorised repairer status.

Independent garage: For the purposes of this report, any garage that is not a franchised dealer for the make of car to be serviced.

Manufacturer's basic warranty: The warranty provided by the manufacturer with a new car. Typically they cover component failure for one to three years. Terms and conditions vary between manufacturers.

New car: For the purposes of this report, a car up to three years old where the warranty (whether manufacturer or dealer-based extension) offered at no extra charge at the point of sale is still valid. Cars that may have had more than one owner are included.

Acronyms

BER – see Cars Block Exemption Regulation above

RMIF – Retail Motor Industry Federation

SMTA – Scottish Motor Traders' Association

SMMT – Society of Motor Manufacturers and Traders

CC – Competition Commission

OFT – Office of Fair Trading