

Catherine Best

From: Neil Pritchard - CRA <neil@collisionrepair.co.nz>
Sent: Friday, 28 February 2014 11:56 a.m.
To: Jeff Hamilton
Subject: IAG / Lumley
Attachments: CC Sub IAG Lumley 27 Feb 2014.pdf; CC Sub IAG AMI 13 Feb 2012 public.pdf; Attachment A.pdf; Attachment B.pdf; Attachment C.pdf; Attachment D.pdf

Hi Jeff

Please find attached our submission.

In the attachments we include our previous submission on the AMI purchase. The version I am including here is the public version as some of the content remains sensitive.

If for any reason you need a full copy please let me know.

I remain happy to discuss any questions you may have and thank you again for the extra week.

Kind Regards

Neil Pritchard
General Manager

Telephone : 021 663 459



www.collisionrepair.co.nz

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12 February 2012

CONFIDENTIAL

Gavin McNeill
Commerce Commission
PO Box 2351
WELLINGTON

Via email to: registrar@comcom.govt.nz

Subject: IAG/ AMI

Introduction:

The Collision Repair Association (CRA) wishes to provide to the Commission information on the motor vehicle collision repair industry in New Zealand, and advise you of the concerns members have as a result of the proposed acquisition of AMI by IAG.

Background:

CRA is an industry association whose membership consists mainly of panelbeaters and auto refinish painters and also includes other car collision repair tradesman and allied businesses.

Founded in 1913, formerly known as the NZ Motor Body Builders' Assoc, the Association changed its name to CRA in 1998 to better reflect progress in the trade. CRA aims to provide quality and safety assurance to customers by assuring its members' work meets its own high standards.

It does this first by screening prospective members to make sure panelbeaters have the correct skills and equipment to repair a vehicle to manufacturers' specification. These vehicle specifications have little or no tolerance and are essential for the cars performance and for safety features/systems to function properly again if involved in another collision.

The Association also has established a quality assurance disputes procedure. Customers who are unhappy with work done by a CRA member can apply to have their complaint adjudicated by a committee in order to resolve the dispute. Membership, and the prestige which goes with it, will be revoked from businesses who refuse to abide by a dispute recommendation or whose standards fall.

CRA is also involved with ongoing training. It organises training courses for both members and non-members through its training arm known as I-CAR. I-CAR New Zealand operates under a licence from I-CAR USA an interactive training organisation based in USA undertaking research into the correct repair methods required for today's modern vehicle. It is also working with the Motor Industry Training Organisation to standardise and streamline apprentice training, especially the 'off-site' or theory training.

The Association aims to continue building on the reputation of the original body, formed by coachbuilders and allied tradesmen to guarantee high-quality workmanship. There are five employees and eight regional branches covering the country.

Membership currently stands at around 580 (including 100 associated members). Customers can identify Association members and be assured of a high standard of workmanship, by the CRA logo which will be found displayed on members' premises.

Although exact numbers are unknown it is likely there are around 1100 participating businesses in the collision repair industry. The market is split roughly 80/20 between insurance work and private work. The larger insurance companies have appointed their own "preferred repairer" networks and these networks are heavily dominated by CRA members. We estimate that members of the CRA are responsible for around 80% of the insurance collision repair market. The IAG preferred repairer network numbers just over 300 of whom roughly 240 are CRA members.

Changing Requirements of Collision Repair:

Since the late 1990's, car manufacturers have been developing safer and more fuel efficient vehicles by minimising weight. Car construction technology has changed significantly - the majority of new cars contain many different types of steel and aluminium while composite materials are more common than ever. Safety features such as air bags, pre-tensioning seat belts, crumple zones etc in addition to other components (which differ between manufacturer & model) are increasing the complexity of repair work. These new technologies mean that repairers must constantly retrain and up-skill and reinvest in new machinery and equipment. When vehicles are accident damaged it is vitally important that they are repaired in accordance with the vehicle manufacturers' specification. Not to do so could seriously compromise safety systems designed to limit personal injury and save lives.

The requirement for model specific repair techniques has led to the CRA's emphasis on continual retraining. Our C-CAR points system introduced 8 years ago requires members to gain 8 points annually (equivalent to 8 hours training) in order to maintain their member status. Together with the need for specialised equipment, this places a significant cost burden on repairers. The average shop rate (the charge out rate for production technicians) necessary to recover all costs and provide a reasonable return for the owner of a modern collision repair facility is now over \$90 per hour.

Market Players:

The motor insurance market in New Zealand comprises three sectors:

- a. Direct business - as marketed to the public by State Insurance, AA Insurance, Tower and AMI.
- b. Bank business – insurance is marketed by banks to its customers and underwritten by insurance companies as follows; BNZ and ASB (State Insurance); ANZ and NAB (Vero); Westpac (Lumley Insurance).

- c. Broker business – insurance brokers sell policies to their clients which are underwritten by NZI, Vero, Lumley Insurance, Zurich and others.

The complexity of the market means that market share information is difficult to estimate. The following analysis is based on our experience on repair jobs undertaken.

Currently IAG is by far the biggest player in the motor insurance market with around [REDACTED] of insurance claim repair work. Their vehicle repair model involves a strong push to encourage clients to remain within their preferred repairer network and a heavy reliance on digital assessing (from photographs taken by repairers of the damaged vehicle and sent to IAG). Parts must be sourced using PartsTrader (an online bidding system) and margins on parts are strictly controlled.

We estimate AMI's market share at [REDACTED]. Their customers are only encouraged towards the AMI repairer network where the client has no particular preference of a repairer. They largely use the traditional assessing method where an assessor visits the repairer premises, views the damage and negotiates a price to repair the damage. [REDACTED]

AA Insurance's market share is around [REDACTED]. AA's preferred model is to encourage customers to take their vehicles to one of their depots, where the vehicle is left. AA then asks a number of preferred repairers to view the vehicle and provide a price for the work and from that AA selects the repairer. The vehicle is taken away for repairs and returned to the depot for collection by the customer. [REDACTED]

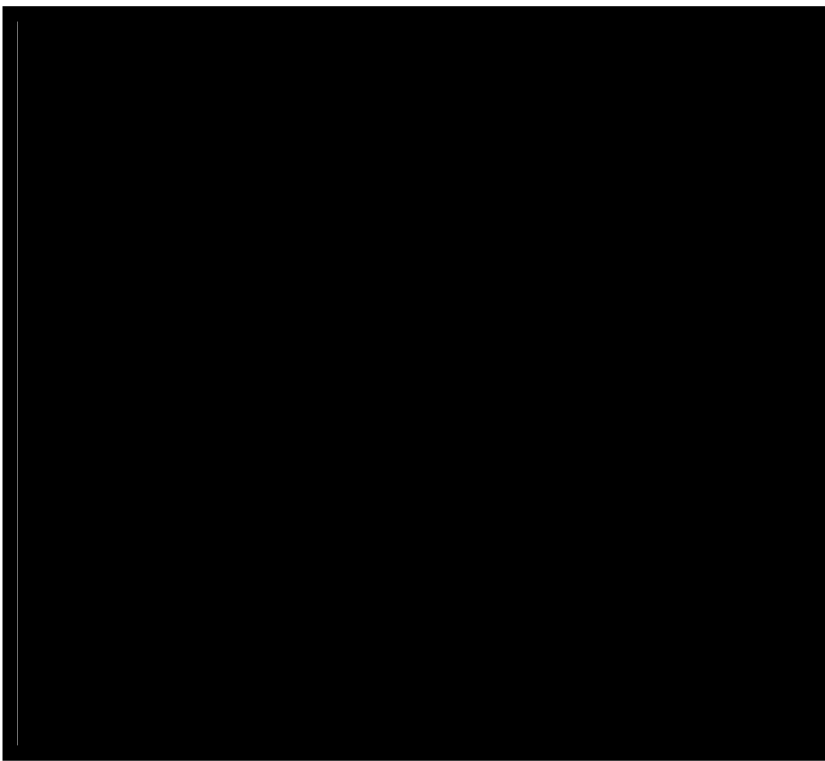
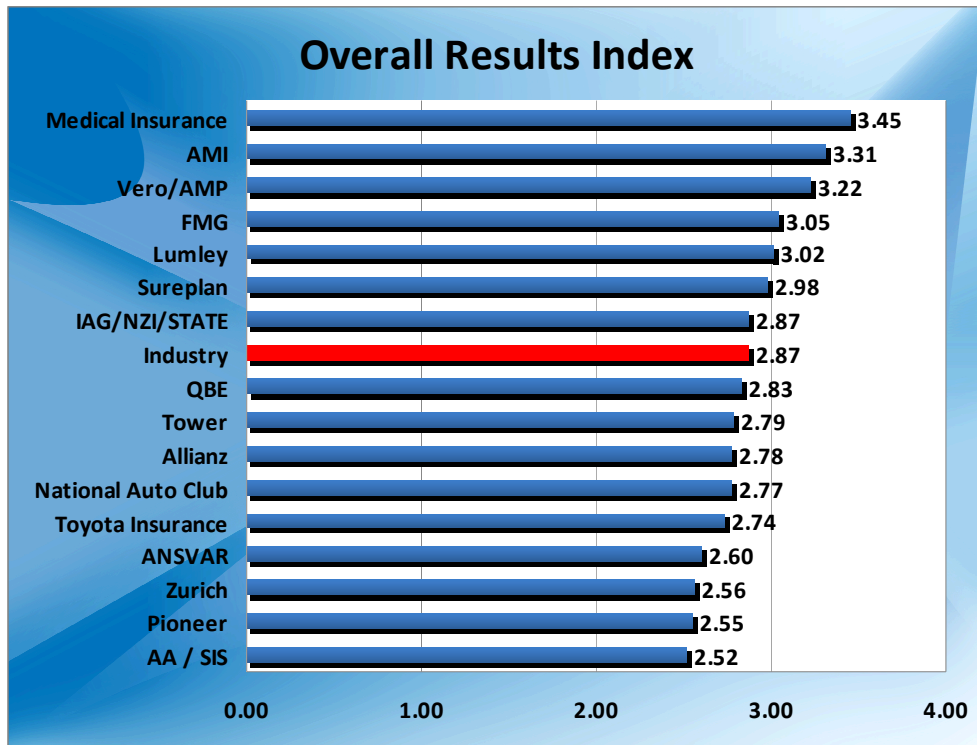
We estimate Vero market share to be [REDACTED]. Vero has a large repairer network from which clients are free to decide who repairs their vehicle. Assessments are mostly by digital photography, [REDACTED].

Lumley's market share is around [REDACTED]. Lumley also has a preferred repairer network but does not aggressively direct work away from those selected by clients who are not in their network. Their assessment model is a mixture of digital photography and in person. [REDACTED]

How repairers feel about the performance of insurance companies is surveyed annually by the CRA. Last year this resulted in AMI receiving an award as "Best General Insurer". (Medical insurance won the award as "Best Niche Market Insurer".) The data shows that this is not as a result of the winner being the most "generous" in terms of payments, but repairers favour the overall assessment model used which means a repair can be completed promptly at a fair price. On the questions of "Fairness of hourly rate" and "Fairness of assessment times" IAG rates bottom. These results are verified in the following graphs:

[¹Our estimates of motor vehicle insurance market share are confidential to CRA.

²Parts margins and sourcing information of other insurance companies is confidentially sensitive.]



[³The industry would be compromised if “more generous” insurance companies knew they were viewed this way.]

[REDACTED]

[REDACTED]

[³The industry would be compromised if “more generous” insurance companies knew they were viewed this way.]

Member Concerns:

As the survey indicates, IAG already behaves differently from others –

[REDACTED]

credit, it pays repairers very promptly.

Compare with smaller insurers which do not yield this power. They are more reasonable over pricing and the repair process less fraught with delays (see previous graph). It is the mix of IAG and other better paying insurance and the odd bit of private work that enable

[⁴Our view could compromise our relationship with IAG]

members to remain in business. Some smaller insurers do not rate well in the survey for various reasons however their size means that repairers are free to choose whether or not to do their work.

Some might say that by keeping repair rates down, IAG is doing a good thing as this keeps insurance premiums down. At a general level of principle, there is some validity in this argument if lower premiums are actually shown to result (and not that lower services are being provided, or the savings are lost by reason of other inefficiencies). However we think this practice is a false economy in our members' situation as what is happening is that others are subsidising at least part of the effect of IAG's power as the part of the costs that cannot be absorbed by members are being borne by others without such power. This distortion must not be efficient and may translate to anti-competitive effects over the longer term (smaller insurers' costs rise which makes them less competitive when underwriting business). In the short term, members are being squeezed which has effects on investments and puts at risk the quality level required to repair modern vehicles.

To summarise, our concerns are:

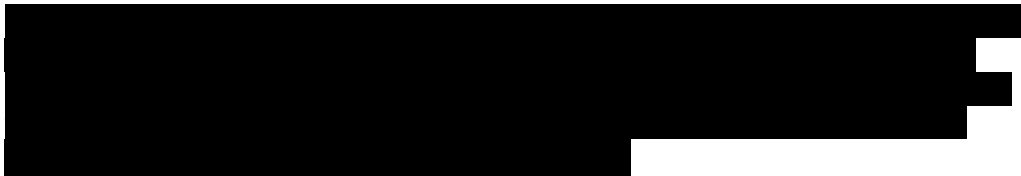
- a. Repairers not in the IAG network fear a loss in volumes if IAG direct AMI claims through the IAG network. We understand the new company will have 61% market share in the important direct lines market leaving little work for non-aligned businesses. This will cause longer repair times and capacity may be forced to exit the market by reason of IAG's control over volume (and not based on a lack of efficiency). The CRA has always advocated for the consumers' right to choose who repairs their vehicle. IAG strongly directs work to their network whereas AMI tends to allow the consumer to choose their own repairer.
- b. As our surveys show, IAG rates lowest in terms of hourly rates and assessing times whereas AMI are considered to be fairer. The AMI assessing model involves a personal visit from an assessor rather than a heavy reliance on digital photographs. The industry prefers the AMI model as it leads to an earlier start to the job and a negotiated price. More administration time and cost is applied on repairers on IAG jobs. Having a greater control over volume from AMI will accentuate the cross subsidy effects described above.
- c. IAG insists on the use of PartsTrader (a competitive online bidding system) for sourcing parts. AMI does not. Repairers prefer not to be forced to use PartsTrader as this often leads to delays in parts delivery. Equally, quality of parts is often not as expected (particularly true with recycled parts) which leads to more delays and arguments over who is responsible for rectification. The cost burden for parts delays and quality of parts issues lies with the repairer as the repair process is delayed and often courtesy vehicles have to be provided for longer periods of time.

Conclusion:

If this acquisition is allowed to take place, we strongly recommend consideration be given to how the practices described above can be monitored or controlled for the benefit of the industry and the public who pay premiums with the belief that their damaged vehicle will be repaired properly and in good time. Competition in the policy issuing market is not going to

provide any protection in the repair markets as they are shielded from each other. To the consumer, the occurrence of accident damage is often 4 to 5 years apart, so the connection between policy purchase and collision repair is often disconnected. We understand members are not permitted to join forces to counter the heavy weight of an IAG/AMI so the introduction of an independent moderator / arbitrator / watchdog to oversee the collision repair industry would be a good step. Without this we fear that the dominant position which IAG will have could lead to a situation where our industry will be economically unsustainable. Vehicle safety could be compromised and new entrants discouraged.

Confidential Information:



Please contact me if further information or clarification of our views is required.

Yours faithfully

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[⁵Our view could compromise our relationship with IAG]

27 February 2014

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IAG (NZ) HOLDINGS LTD / LUMLEY GENERAL INSURANCE (NZ) LTD

The Collision Repair Association (CRA) wishes to provide the following information about the likely effects the proposed acquisition of Lumley's motor vehicle insurance business by IAG will have on the market for collision repair services. On behalf of its members, CRA is opposed to the acquisition. The further loss of choice of insurance work customers - which provide the financial backbone of our members' businesses - will have adverse consequences as collision repairers will be dominated by IAG alone, or as part of a duopoly with the Suncorp Group. We think the solution is for Lumley's vehicle insurance business to be sold to another insurer, but preferably not Suncorp.

Background/ IAG-AMI Submission

CRA made a submission dated 12 February 2012 in relation to IAG's application to acquire AMI. CRA was opposed to that acquisition for the same underlying reasons as we oppose the current application. Attached is a copy for your convenience. The 2012 submission sets out CRA's functions and a description of our industry which need not be repeated here as little has changed. Our current membership stands at around 550 including approximately 100 associate members. There are approximately 1000 collision repair businesses operating in New Zealand. Accordingly there has been some contraction in the repair industry over the last 2 years.

Survey of Members

Since our phone discussion, CRA has surveyed its members about the proposed Lumley acquisition. We asked what percentage of work do IAG (all brands) and Lumley account for in terms of their total business and whether they wished to comment on the acquisition.

Attached marked **A** are the results of the survey. The combined percentage is above 57% on average. We understand that the MTA conducted a similar survey which produced an average of around 60%. IAG has itself estimated that it accounted for around 60% of insurance work which did not take in account Lumley. The viability of almost all of our members is already heavily dependent on IAG work: firstly they are exposed to that work not continuing and secondly in relation to the remuneration rates for the work they undertake. That exposure will be increased should IAG be allowed to purchase Lumley's vehicle insurance business.

Respondents to the survey were also asked to offer any comments on the proposed merger. Almost all who responded expressed concerns about the resulting size of IAG and its ability to dictate terms (including who gets the work and payment rates).

Post AMI Acquisition

Prior to being taken over by IAG, AMI was regarded by our members as one of the top performers of the insurance companies (see page 4 of our 2012 submission). We have undertaken the survey for 2013 (see graph marked **B**) and as expected, AMI has dropped below market average to be alongside

IAG, NZI and State. This is a result of reduced labour rates and coming within the same claims process system run by IAG.

Despite IAG's undertaking to the Commission that all AMI approved repairers will be offered a place within the IAG approved repairer network, we think only around 20 actually moved over and at least double that number did not. We are not privy to the reasons why those others did not take up the offer (assuming they were genuinely made) but on the face of it, there is a concern. However last year, IAG issued a Request for Proposal to the industry for the opportunity to become/remain within the IAG approved repairer network. This was quite a complex process and was probably difficult for the smaller panel beaters to participate in. We accept that such a process has merits as repairing modern vehicles is getting more specialised and some repairers are not up to it. We understand IAG received about 540 responses and after a scoring exercise, around 100 failed the initial screen and were declined. The selection process is continuing and many of our members are holding their collective breaths that they will get selected. The prospect of not being selected is made worse if Lumley work was also lost. IAG will be able to play God over the future of many family owned collision repair businesses.

Current IAG Rates are already unsustainable

IAG set the lowest labour rates which are currently between \$41 - \$51 per hour (Auckland repairers obtain t \$5.00 more than rest of country but still within this price range). This rate is well below what is needed to properly run a modern collision repair business (estimated to be \$90 ph). IAG has only marginally increased rates over the last 10 years as below:

2004	\$40* ph
2006	\$43 ph
2007	\$45 ph
2011	\$46 ph

* Auckland repairers received an extra \$5 from 2004 and non-aligned repairers receive \$5 less.

These rates are way below CPI changes over the period and also take no account of the higher costs associated with repairing modern vehicles. Yet over a similar period, insurance companies have achieved increased profitability from motor vehicle insurance business. Attached marked **C** is a graph showing these increases which are being subsidised in part by artificially low repair rates.

IAG is in a market position to force agreement of its rates because of the need for panel beaters to retain the volume of work that comes from being an approved IAG repairer. The situation will be made worse if Lumley's work is also added and its rates (currently around \$60 per hour) will likely be dropped to IAG rates. Panel beaters choice of customers will be very limited (private work makes up only a small percentage of work) and there is a heightened risk that a duopoly situation between IAG and Suncorp will keep rates suppressed and cause a market failure. Parallels are developing regarding the positions of suppliers vis-à-vis the two New Zealand supermarket chains.

IAG's rates are used as a benchmark for smaller insurers as well. For example, Tower's rates are similar to IAGs and they can get away with that simply by reason that IAG does. However Tower is a little more realistic of time schedules allowed for the job.

Attached marked **D** is a copy of an article from the industry magazine *Paneltalk* which provides more information about the problems over insurance company rates.

We note that in paragraph 101.1 of the Commission's decision in IAG/AMI, reference to collision repair service providers having the opportunity to remain in business by competing for other insurance and private repair work. Before the Commission relies on this factor again, we encourage the Commission to actually check this out by not only talking to a selection of repairers but also examine their accounts to verify or not the accuracy of this claim. We can assist in organising a random selection of members but they will probably request anonymity given the sensitivity of their future relationship with IAG.

The Commission may be aware of a very recent TVOne's Seven Sharp investigation (aired on 20/2/14 and 24/2/14) into the position faced by panel beaters as against the rates imposed by insurers. This investigation was sparked by the alleged treatment of suppliers by Countdown and was coincidental to the IAG application. We did not prompt it but I was approached to provide CRA's views. In the second report, a panel beater advised that as a consequence of low insurance rates, private customers were charged a lot more in order to survive and were effectively subsidising insurance work. We think this is a serious indictment on the current situation as it also means that some uninsured vehicles are not being repaired because of the higher cost, or taken to a low cost operators which do substandard work which may affect vehicle safety (see our 2012 submission which discusses what it takes to repair modern vehicles). This situation will only get worse if Lumley (which currently pays more than IAG) is absorbed by IAG.

Preferred Supplier Network

As noted above, IAG is currently reviewing its approved network of repairers and we do not know what the final number will be appointed and in what locations. We note from the IAG/AMI decision (paragraph 101) references to consumers retaining a choice of preferred repairer and that as IAG currently guarantees work undertaken by its approved repairers, it needs to support repairers. The reality is that customers have little option but to send their vehicles to an approved repairer because IAG say their guarantee does not apply to other repairers (who will be paid even less anyway) and this works as a strong incentive for customers to agree. Also the guarantee is provided by the repairer to IAG (it is in the contract) so IAG carry very low risk. With respect, the Commission's reasons on these two points are not matched by reality and will not help protect repairers from depressing prices below competitive levels. As noted above, the resulting duopoly situation will compound the risks facing this market.

The duopoly factor also neutralises the other argument that customers who have a bad repair experience can switch to another insurer. Not only would IAG blame the repairer, customers are tied into policies by graduated no-claim rebates incentives that other insurers may not match when taking out a new policy at least initially. Customers may also have other insurance with IAG under discounted plans. These two factors lower the risk of customers switching to another (there are not many left) because of a bad repair experience. These factors should also be discarded this time around.

In summary, we would be happy to facilitate inspection of a sample of repairers to substantiate market dominance of the various insurers and the low levels of profitability in the repairer industry. We believe that sustainability is a growing issue in the collision repair industry and that the power base lies entirely with too few players. We are available to discuss any questions you may have.

Yours faithfully



Neil Pritchard
General Manager

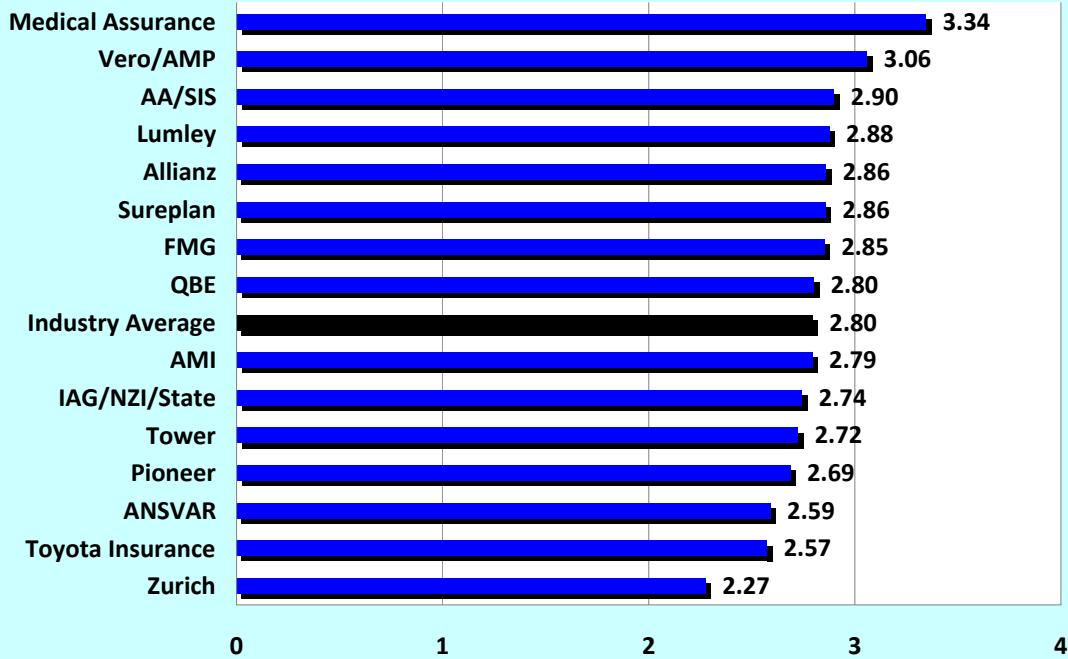
What percentage of your insurance work is provided by IAG NZ (State, NZI, AMI)?

Response	Chart	Percentage	Count
0-10%	2%	2%	4
11-20%	9%	9%	19
21-30%	14%	14%	29
31-40%	15%	15%	31
41-50%	12%	12%	26
51-60%	19%	19%	40
61-70%	14%	14%	30
71-80%	13%	13%	27
81-90%	3%	3%	7
91-100%	0%	0%	0
Total Responses			213

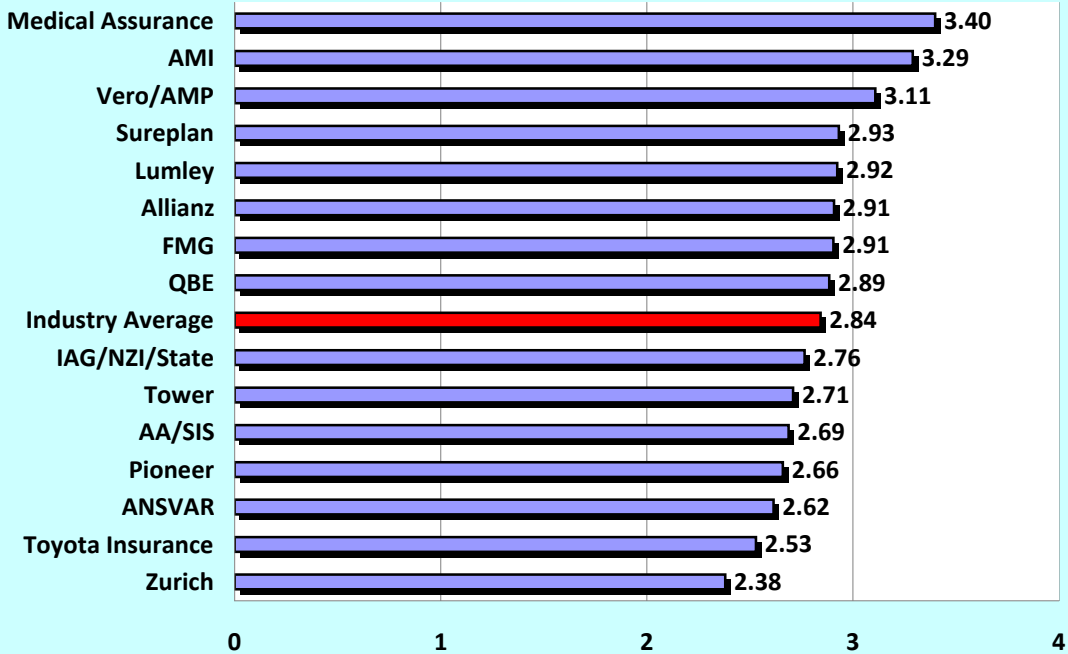
What percentage of your insurance work is provided by Lumley Insurance?

Response	Chart	Percentage	Count
0-5%	30%	30%	63
6-10%	34%	34%	70
11-15%	20%	20%	42
16-20%	8%	8%	16
21-25%	4%	4%	9
26-30%	1%	1%	2
31-35%	1%	1%	3
36-40%	1%	1%	2
41-45%	0%	0%	0
46-50%	0%	0%	0
over 50%	0%	0%	1
Total Responses			208

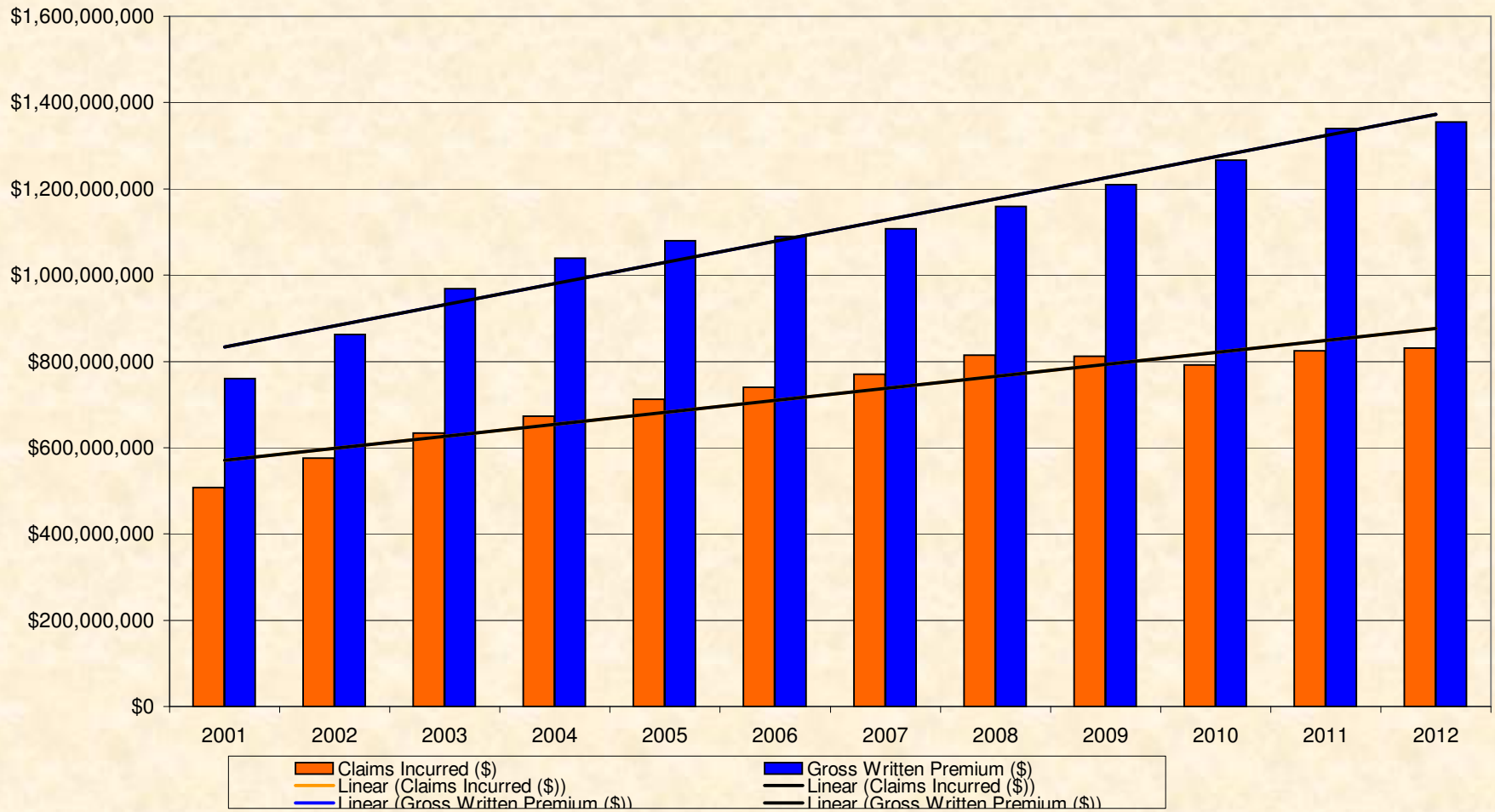
2013 - Overall Results Index



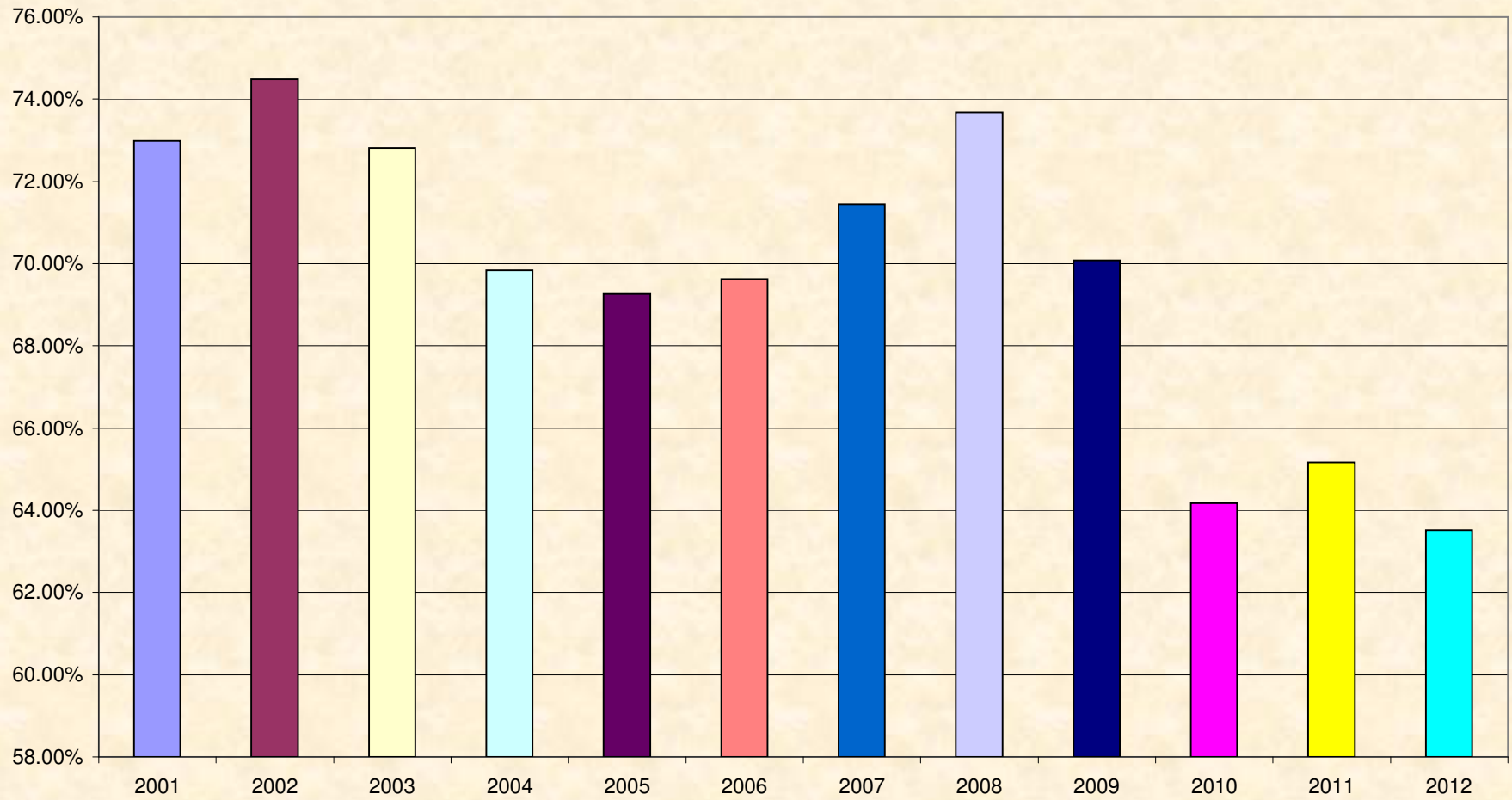
2012 - Overall Results Index



Gross Written Premiums and Claims Costs - Motor



Loss Ratios - Motor





Time Schedules and Rates in New Zealand

Time for a complete update

The IAG time schedule, by default the leader in influencing standard times in New Zealand's collision repair industry, is now over a decade old and in need of a serious revamp.

Think back to 2002. What was playing on the radio? What was the fashion? And, more importantly, what did the average car look like? Find a Toyota Corolla or Corona of that vintage and have a look at it, as these were the reference vehicles used by the creators of the IAG time schedule.

It was agreed at the time that anything above that model specification fell outside of the schedule and allowances would be made. Remember also, that the schedule was for NZI prior to them being purchased by IAG and the labour rate they applied was \$55 per hour.

A number of the standard times in this schedule were reduced significantly around 2004 with the advent of combination times. Even at that time these combination times were hard to achieve in actual hours and were grossly unfair from the start.

While the schedule was put together by a group of repairers and assessors in a rare demonstration of responsible cooperation, unfortunately it has lost its original intent over the years. Repairers struggle to get much, if any, recognition for the changes in vehicle manufacture and the complexity of their systems, and are constantly reminded of the schedule times.

In the last few years, a lot has been made of the use of the manufacturers' recommended repair procedures, and rightly so. However, the manufacturers' times have been ignored to date. Yet these times are put together as a guide to how long an operation will take, ensuring that it is carried out safely and in line with the manufacturers' recommendations. It has always been assumed that manufacturer's times are very tight as they are real times for trained technicians and charged out at dealer market labour rates.

Now, with the valuable assistance of Honda NZ, PanelTalk has carried out comparisons between the IAG Schedule and the manufacturers' recommended times and surprisingly, the actual time allowances are very close in most cases.

The problem, as has always been the case, lies in the labour rate. In New Zealand a motor vehicle dealership workshop will charge their labour out at anything between \$90 and \$130 per hour. Take the case of Honda East Auckland. It has a large, state of the art collision repair facility and a large state of the art mechanical facility side by side. In one they are paid as per the Honda schedule at \$115 per hour while right next door, in a much more capital intensive facility, they are paid \$51 per hour.

How does that work? Obviously it doesn't, and this is the issue that is driving the collision repair industry in this country to the wall.

It is all so illogical, it is hard to see how it came to this, so let's take a trip down the changes that have occurred over

If the insurance industry is serious about the word 'sustainability', then it is time they moved their rates significantly

the last decade.

In 2004 the rate paid per unit (hour) by IAG was \$43 (Auckland \$48). At this time an average qualified technician earned around \$22. Around 2007 this rate was lifted to \$45 (Auckland \$50) and then in 2011 it was lifted again to \$46 (Auckland \$51). Today an average qualified technician earns around \$25.

That means that in nine years the rate has increased by 7% compared to the CPI index increase of 26.9%.

It is little wonder that we struggle to get good people into the industry when their wages are continually falling behind the rate of inflation, which incidentally has been really low through this period. As a comparison, an average builder in a metropolitan area is paid around \$38 - \$40 per hour.

Around 2002, NZI employed independent consultants to find a sustainable solution to repair costs. These consultants came back with a true labour rate required by a collision repair facility back then of \$57 per hour. NZI settled on a rate of \$55 per hour, a full 14.5% more than the rate that IAG applied to Auckland repairers in 2004 (28% for those outside of Auckland). The trade off was a reduced parts margin, something that has occurred anyway due to several factors.

Now let's look at what has changed in the industry in the last decade.

- Equipment requirements have increased dramatically. Inverter spot welders, electronic measuring, paint prep bays, infra-red drying, dustless extraction systems, the list goes on.
- Training cost have increased dramatically to maintain the ability to carry out safe repairs.
- Customer service expectations have increased.
- Administration expenses have increased dramatically to cope with insurer demands and local and central government compliance.
- Courtesy cars are now a standard requirement and the level of standard of vehicle required has lifted.
- Opinion times have decreased markedly as times schedules have been expanded and panel repairs have diminished. This shifts more labour to the unrealistic labour rate.
- Parts margins, for so long the only profit available to New Zealand repairers have decreased in real terms significantly. For example, a new or second hand \$100 cost price part used to result in \$25 for the repairer. This now equates to \$10 for new and \$20 for second hand. This differential is further increased by the fact that now repairers have no relationship with many of their second hand suppliers and thus suffer from quality issues, which can add to their labour time for often no remuneration. Also one cannot, in

this context, get away from the fact that since the advent of PartsTrader, parts prices have reduced significantly.

Now let's compare all of that with the figures released by The Insurance Council of New Zealand for the 12-month period to September 2012. These are the latest figures available.

New Zealand insurance companies during that 12 months collected about 1.3 billion for commercial and private motor policies, up a massive \$43 million on the previous year. Interestingly, during that period the cost of claims for those policies only rose by \$6.5 million.

Everyone is watching and waiting for IAG, the undisputed market leader, to make a move. If the insurance industry is serious about the word that they preach a lot, sustainability, then it is time they moved their rates significantly. The long and the short of it is that if they don't, eventually there won't be a collision repair industry to repair the vehicles that they are insuring.



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