

To	Celia Patrick
Cc	Richard O'Reilly; Mark Rounthwaite; Brian Sara Leigh Mitchell; Robyn Elston
From	Stuart Worden
Date	18 May 2016
Subject	Water Damaged Vehicles – Deviation Process

Purpose

The Transport Agency has identified issues with the deviation process provided for in the Vehicle Inspection Requirements Manual for Repair (Repair VIRM) for water damaged vehicles. Recent media and Ministerial activity has also drawn attention to the issues, in particular with respect to new and nearly-new vehicles that have been flood damaged in Australia.

This memo seeks your agreement to a change in approach to vehicles identified as water damaged.

Introduction

Vehicles that have been written-off by insurers in New Zealand or overseas due to water damage can be repaired, certified and registered for use on New Zealand roads. The mechanism that allows for this is the Repair Certification process, whereby Repair Certifiers appointed under section 2.3 of the Vehicle Standards Compliance Rule 2002 inspect and certify that repairs to the water damaged vehicle have been carried out according to Land Transport Rule: Vehicle Repair 1998 and Land Transport Rule: Vehicle Standards Compliance 2002.

Where a vehicle has been water damaged, the Rules require vehicles and any systems and components to be repaired or restored to within a safe tolerance of their original state when manufactured. The Repair VIRM, which vehicle Repair Certifiers are required to adhere to as a condition of appointment, provides guidance on how to interpret and apply the Rules. In terms of water damaged vehicles, the Repair VIRM states that the vehicle is to be treated as having been completely submerged unless an approval to deviate from the requirement is obtained from the Transport Agency. The VIRM also sets out requirements around whether components can be replaced with second-hand items or (in the case of some less-safety critical items), stripped and inspected by the manufacturer or an approved representative.

Where a vehicle is treated as completely submerged, all electronic and pyrotechnic safety components, such as sensors, SRS control modules, airbags, pre-tensioner seatbelts and wiring must be replaced. In a modern vehicle with complex safety systems, this can be costly and in many instances renders the vehicle uneconomic to repair.

The deviation process allows a repair certifier to determine the level to which a vehicle has been flooded, and to not require components above this level to be replaced. As such, there is financial benefit in obtaining a

deviation, with the benefit being greater where the water level is found to be lower (thus minimising the number of affected components).

In 2016 to date, approximately 2300 used vehicles have been imported from Australia. Of those, just under 800 have been recorded as statutory write-offs (including both crash damaged and water damaged vehicles). In addition to statutory write-offs, there are an indeterminate number of repairable or economic write-offs (these are not routinely reported to the Agency). It is not possible to determine the proportion of statutory write-offs that are as a result of water damage as this level of detail is not reported. There have been three recent Motor Vehicle Disputes Tribunal cases relating to imported flood damaged vehicles, generally arising from the vehicle purchaser not being aware of the vehicles history. Around 140 deviations have been processed so far in 2016, with fewer than 10 being declined.

Deviation applications are processed by the Transport Agency's Vehicles Team. The team receives the applications via Repair Certifiers, who assess and make a determination of the extent of the water damage. The Vehicles Team do not inspect the vehicle and do not have complete information on the vehicle's history. The team's current assessment of applications is reliant on the quality of information supplied by the Repair Certifiers.

Analysis in response to consumer complaints has highlighted concerns with the deviation process. In a number of cases, Repair Certifiers have determined there is no sign of water damage in a vehicle, In determining a vehicle that has been written off for water damage has not in fact been water damaged, the Repair Certifier is implying the insurance company has written it off unnecessarily (and at considerable cost). This is not credible, and discussions with a major Australian insurance company (IAG) have confirmed a vehicle would not normally be written off for water damage that did not involve inundation of the passenger compartment. The Agency is now aware of around half a dozen cases in the past 6 months where a Repair Certifier has determined a vehicle has not been water damaged, but further investigation found the vehicle had been inundated with water. It is likely that there have been other cases that remain unreported and not visible to the Agency.

In other cases, water damaged vehicles are groomed, including replacement of some damaged components, prior to import into New Zealand or presentation to a Repair Certifier. In these situations, it is very difficult (if not impossible) for a Repair Certifier to reliably determine the actual extent of water damage.

Even where a water level can be accurately established, there are potential issues with electronic and pyrotechnic components that have not been submerged but may have been damaged by severe condensation resulting from the water ingress. This is potentially quite a significant problem in cases where a flooded vehicle has been stored in warm conditions. Water damage to electronic components will often not manifest until several months after the initial contact. As such, damage may not be detectable at the time of the inspection.

Why is this a problem?

There are several risks associated with improperly repaired water damaged vehicles:

1. **Safety Risk.** There is increased risk of water damaged components failing or not functioning properly, including in the event of a crash. For example, an airbag may fail to deploy or deploy too slow, or a restraint system may malfunction. The effect is increased risk of serious injury or death.
2. **Consumer Protection Risk.** There is increased risk of consumers purchasing vehicles that are not fit for purpose and/or lose value faster than the norm or expected. The effect is economic loss for consumers. This risk is exacerbated by there being no requirement for vehicle sellers to inform purchasers a vehicle has been previously damaged.

3. **Reputational/Media Risk.** The misuse of the deviation process – and the lack of transparency associated with damaged vehicles – has already caused, and may result in more, negative media and criticism of Transport Agency processes.

Legislative Framework

The water damage deviation process is essentially a vehicle-by-vehicle “exemption” from the general requirements set out in the Rules and in the VIRM.

As the deviation process is set out in the Repair VIRM, which is a policy document not covered explicitly by legislation but given status as part of the Repair Certifier appointment process, the Agency is able to remove or amend it, provided that the outcome is consistent with the Compliance and Repair Rules.

In addition to general repair certification requirements, water damage is addressed specifically in the Compliance Rule. Sections 6.4(1) and 6.5(5) allow an Entry Certifier or Repair Certifier to certify a vehicle only if the vehicle “has not suffered water damage as specified by the [Agency] under 11.1”

Section 11.1 is as follows:

11.1 Water-damaged vehicles

The [Agency] may, by notice in the Gazette, specify the extent of water damage that the [Agency] considers would make it impracticable to reasonably determine, by inspection, that a vehicle having suffered that damage is safe to be operated.

The Transport Agency does not believe any such gazette notice has been issued. This mechanism aims to prevent vehicles with a given extent of water damage to ever be certified.

Options

1. **Status Quo.** This is not a recommended option. The risks identified above would not be addressed.
2. **Delegate the Deviation Process to Repair Certifiers.** This option would involve allowing individual Repair Certifiers to decide whether to deviate from the default requirements. This option is not recommended because it is unlikely to mitigate the risks identified above. It may also increase the pressure on Repair Certifiers to certify vehicles without replacing water affected components, which anecdotal information from Repair Certifiers indicates is already an issue.
3. **Remove the Deviation Process.** This option would involve removing the deviation process entirely and requiring **all** water damaged vehicles be treated as fully submerged as per the current VIRM requirements. This option would be effective in avoiding most of the risks and issues identified above, and can be achieved with no legislative change. There is likely to be significant opposition to this from importers and sellers who specialise in damaged vehicles from Australia, as it would increase the costs of certifying flood damaged vehicles and would potentially make such a business uneconomic. It is estimated that at least half of the vehicles currently being repair certified would become uneconomic to repair, and the profit margin on the remainder would be reduced significantly, probably leading to changes in buying patterns.

Additionally, although the deviation process would no longer exist, because the VIRM is a policy rather than legal instrument, the Agency would still need to be open to considering individual vehicle circumstances should a request to be treated differently be submitted.

4. **Modify the Deviation Process.** This option would involve revising the deviation process to require credible independent evidence, for example from the insurance company, showing the exact water level and history. Importers state that they are generally unable to obtain this for various reasons, such as privacy concerns. This option would be effective in reducing the risks and issues identified above (it does not address the condensation issue), and can be achieved with no legislative change. This would potentially leave the door open for legitimate cases to obtain a deviation, but it may not offer many advantages over option 3.
5. **Issue a Gazette notice specifying the extent of water damage where vehicles cannot be practically inspected and be certified as being safe.** This option would involve the Agency setting the threshold at which a water damaged vehicle can be repair certified and a level of water damage where vehicles cannot be certified. This could be set at a level that effectively excludes all vehicles that had been written off for flood damage. This option would also avoid the risks and issues identified above. As with option 3, it would be likely to be opposed by importers of flood damaged vehicles.

One advantage of this option is that it is the most legally robust and administratively straight forward, as it is specifically provided for in the Rule and provides a strong basis for instructions provided to Certifiers. There would need to be a robust process around determining exactly what extent of water damage the Agency determines it is not possible to practically inspect a vehicle and certify it as being safe. A disadvantage would be that the option to repair a vehicle by replacing all potentially affected components would no longer be available.

The two recommended options are **option 3** and **option 5**. **Option 3** would require minimal work to implement and would provide a similar level of practical effectiveness to **option 5**, but because it is enabled via the VIRM, consideration will still need to be given to applications for exemption should they be submitted. It also retains the option to repair a vehicle by replacing all potentially affected components. **Option 5** would be an effective and legally strong mechanism for achieving a similar but slightly different outcome in that it bans certain or all water damaged vehicles from being repair certified.

Any action to restrict the entry certification of damaged vehicles is likely to invite considerable and vocal opposition from a small number of importers of these vehicles. However, the risk of these importers gaining significant traction with the media or public is low given the current environment.

On balance, we recommend **Option 3**. This is because it addresses the risks and issues fully, is low cost and fast to implement, and retains the option to repair a water damaged vehicle by replacing all potentially affected components.

Proposed action

In order to implement **option 3**, it is necessary to promulgate a minor VIRM amendment to remove the deviation process. This would need to be accompanied by additional information material for Repair Certifiers, Entry Certifiers and vehicle importers.

As part of the implementation of **option 3**, it would be beneficial to review repair requirements (i.e. the specifications for whether components must be replaced with new or used items), to ensure they are still appropriate and relevant. This would form part of the proposed VIRM amendment.

Consultation and engagement

Prior to implementing the policy change, it is recommended that some consultation be carried out. This could be achieved by circulating the draft VIRM amendment and explanatory material to affected parties including:

- Repair Certifiers
- Known major importers
- Vehicle shipping companies serving Australia
- The IMVIA
- The MTA
- The AA

We also recommend that the date of implementation of the change be advance notified to enable the repair certification of vehicles already purchased and imported (or in transit to New Zealand) to be processed. The timeframe should be the shortest practicable to avoid stockpiling of vehicles and possibly exacerbating the problem in the short term. This could be done at time of consultation.

A draft VIRM amendment/consultation document is attached. Consultation could be completed within 10 working days.

Considering the potential opposition to this change, it would be advisable to brief the Minister prior to the commencement of any consultation.

Recommendation

It is recommended that you:

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| <input type="checkbox"/> note the contents of this memo | Y / N / As amended |
| <input type="checkbox"/> agree to progress Option 3, remove the deviation process | Y / N / As amended |
| <input type="checkbox"/> agree that, prior to making a final decision to remove the deviation process, limited consultation should be undertaken with affected parties | Y / N / As amended |
| <input type="checkbox"/> agree that, should option 3 be implemented, an implementation date should be pre-notified to minimise the impact on importers that have already purchased water damaged vehicles on the expectation of being able to apply for deviation. | Y / N / As amended |

Additional actions

Consideration will also be given to whether enhancing the monitoring of repair certification activity is required to mitigate the potential risk of current practices being driven “underground” rather than stopping. The size of this risk requires more investigation.

There is also scope to provide better visibility of information on damaged vehicles to consumers. There are several ways this could be achieved, with varying degrees of effectiveness. An initial low cost/low effort action to improve access to currently available public information is in the process of being implemented, and this may lead to reduced marketability of previously written off vehicles. A more effective option is to require car dealers to declare previous damage to consumers via the Consumer Information Notice. We are engaging with MBIE, as the responsible Department, on this option.