



# VW emissions-rigging scandal

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## Insurance exposures

The cost to the insurance market of responding to the Volkswagen (VW) product recall, regulatory inquiries, criminal investigations/prosecutions, shareholder class actions and other fallout across the automobile industry could be staggering.

It is already reported that VW has set aside €6.5bn for the costs of the emissions-rigging scandal, which many commentators consider to be conservative. There will also be a significant reputational cost to VW, which will be looking carefully at its insurance policies to establish if/where cover is available. The two most obvious sources will be the product recall policy and directors' and officers' (D&O) policy.

This article summarises: (1) VW's role in the emissions-rigging scandal and (2) the potential impact on the insurance market.

### The scandal

VW has found itself at the centre of the latest rigging scandal. On 18 September 2015, the US Environmental Protection Agency (EPA) revealed that the car manufacturer had admitted installing illegal devices to manipulate emission tests, allowing its diesel cars to produce up to 40 times more pollution than is permitted by US legislation. This has been estimated to have produced 100m tonnes of nitric oxide and nitrogen dioxide

air pollution per annum. The devices are designed to detect when the cars are being tested and substantially reduce the car's level of emissions during the testing process, producing a misleading test result.

VW's US chief, Michael Horn, has been quick off the mark to concede that the company deceived its regulators and the public. Following the publication of these explosive revelations, VW's share price plummeted more than 30% in three days, shrinking VW's market capitalisation by about €26bn in just two days.

Originally, the German based car manufacturer had stated that the issue affected only 482,000 cars in the US; however, this figure has now been revised to 11m vehicles worldwide. VW has set aside €6.5bn to cover the initial costs of the crisis and it also faces a substantial fine from the EPA for its breaches in the US. In addition to the EPA's investigation, New York Attorney General Eric Schneiderman has revealed that VW will face a criminal investigation by the US Department of Justice, while authorities in Italy, Germany, France, Poland and South Korea have also announced investigations into VW's falsification of emissions data.

Outside of regulatory action, the car manufacturer will undoubtedly face legal

### Any comments or queries?

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action from customers and shareholders following the dramatic fall in their share price. As a result, VW's insurers will be primed for numerous notifications on the company's insurance programme.

### Product recall

It may be that VW self-insures for product recall and it is not clear at the moment whether any component manufacturers will become embroiled in this issue. However, product recall policy wordings can vary significantly. Most such policies, including automotive product recall, require at least a threat of personal injury or property damage to be triggered. Some do provide cover for a government or public authority ordered recall, although in most automotive cases in the US such a recall would be ordered by the National Highway Traffic Safety Administration and not the EPA.

Such a step does not have the appearance of a typical recall on direct safety grounds but obviously the purpose of emission regulation is to protect the public as well as the environment. Whilst the EPA has apparently said that the vehicles are safe to drive, a spokesperson for the EPA has said that VW's actions were "a threat to health".

Clearly any recall shown to have arisen from a dishonest or intentional act or omission on the part of an insured, or circumstances known to the insured prior to inception, will raise issues relating to the presentation of the risk and coverage available under a product recall policy.

### D&O

The implications for D&O insurers are potentially wide:

- VW and its executives can be expected to face criminal and/or regulatory investigations, in the US, Europe and in other jurisdictions.
- VW and its executives can be expected to face myriad civil claims globally, not least class action claims by investors alleging

that a failure to disclose the emissions – rigging to the financial markets led them to buy, or to hold onto, VW shares. Already 25 such actions are reported to have been made in the US.

- Companies that VW may have used to design, manufacture and/or install the devices behind the alleged deception, and their directors, may also find that they are the subject of similar investigations and civil claims.

D&O policies invariably provide directors and officers with cover for such investigations and civil claims (although, depending on the jurisdiction, not criminal fines for egregious conduct), and may also provide like coverage for the corporate entity itself, if parallel entity coverage has been purchased.

VW's US chief has admitted that the deception was deliberate, and insurers will therefore likely wish to investigate: (i) the presentation of the risk and the facts disclosed/representations made to insurers by the entity and insured persons; (ii) the potential application of public policy coverage defences; and (iii) any fraud or dishonesty-type exclusions, although this last category of coverage defence is unlikely to be available in the current market wordings until any deception has been established by court or arbitration proceedings, and even then only against individuals personally involved in any deception and only against a corporate entity if the conduct of such individuals can be attributed to the corporation itself.

In the meantime, until the relevant evidence has been extracted, insurers will be expected to advance the costs, at least in regards to anyone who does not admit to having been involved in a deliberate deception. Defence and investigation costs will be very significant, especially if numerous legal teams are appointed due to conflict of interest issues, as we have seen on a number of high profile current D&O claims. Insurers will be keen to co-ordinate the defence teams as far as possible to ensure that costs are controlled.

The various insureds are likely to make broad notifications across the entire insurance programme in an attempt to capture for coverage under the current policies any subsequent civil claims that may follow any adverse rulings in the expected criminal and regulatory investigations.

It is likely to be some time before the insurance market will know the true scope and costs of the emissions-rigging scandal.

For now, as the issues unfold, insurers should be considering their potential aggregate exposure and keep their fingers crossed that this is not a systemic issue across the whole automobile industry, as we have seen from scandals in the banking sector in recent times. However, insurers may take some comfort in the fact that Ford, BMW and Renault-Nissan have already issued public denials that they used “defeat devices” to rig emissions tests.

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