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The Volkswagen Disaster: Designing Global Compliance Practices to Avoid a Crisis

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MANUFACTURING LAW GROUP MEETING
MARCH 30, 2016

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Preliminary Considerations

- This platform should not be used for activities prohibited by antitrust law.
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- Attendees should not share information, have discussions and/or make arrangements on, among other things, pricing, market conduct, terms of sale, individual manufacturing costs and costs of sale, output, or supplier or customer relations/allocation.

Why Does The VW Crisis Matter?

- Well-respected/trusted brand
- Known for quality, innovation and integrity
- Apparent extensive compliance failures
- Major, ongoing harm to reputation and finances
- Civil and criminal exposure
- Significant indirect costs to German economy

What Caused The Crisis?

- Over a decade ago, VW Group CEO Martin Winterkorn developed a strategic plan to surpass Toyota as the world's top car manufacturer
- Key plan element was to develop new diesel engine
- Prototype needed a **\$350 per vehicle modification** to meet U.S. emissions standards
- Cost was apparently determined to be too high

What Caused The Crisis?

- Last September, VW executives and engineers admitted that the company installed “**defeat devices**” in many models beginning in **2009**
- VW’s software allegedly activates full emissions controls when the testing process is detected and then turns off controls during real-world driving, producing emissions as much as 40 times over the legal limit

What Were The Warning Signs?

- 2007: Bosch, which supplied software and components to VW for test purposes, **wrote** to VW saying that using those items in vehicles to be sold in the U.S. would be **illegal**
- 2011: VW engineer reportedly **warned one of its managers** about possible illegal emissions practices—may have been connected to an internal audit

What Were The Warning Signs?

- 2011: European Commission's Joint Research Centre Report concluded that VW vehicles exceeded the emissions standard. Report **was shared with VW** and various EU government agencies
- 2014: International Council on Clean Transportation Report likewise found emissions discrepancies in VW vehicles, and **report was sent to VW** and EPA
- 2014/15: EPA **raised concerns with VW**, who insisted repeatedly to EPA that discrepancies were mere technical glitches

What Fallout Has Occurred So Far?

Class action lawsuits by end-users and investors

- Over 400 class-actions filed in 60 different districts across the U.S.
- Claims for fraud, breach of contract, unfair competition, and false advertising seeking multiples of sales, punitive damages and fees
- Institutional investors filed a \$3.6 billion lawsuit in Germany

Government investigations and enforcement actions/lawsuits

- DOJ/EPA lawsuit seeks tens of billions in penalties
 - Possibly 2x annual VW profits
- Lawsuits brought by AGs in multiple states
- Possible, but unlikely, criminal prosecutions of VW and employees

What Fallout Has Occurred So Far?

Other costs:

- Internal investigations
- Employee discipline and turnover
- Employee lawsuits - wrongful termination/whistleblower
- Negative publicity/brand tarnishing
- Loss of business
- Significant harm to German economy

What Fallout Has Occurred So Far?

Some notable figures:

- \$1.8 billion loss in Q3-2105 (further reports postponed)
- 20% of German exports are car-related, mostly from VW
- 600,000 employees worldwide
- 25% drop in VW share value
- 64% of U.S vehicle owners do not trust VW
- 4x annual profits could be award in DOJ/EPA lawsuit
- **\$350**/vehicle cost vs. **\$35,000**/vehicle penalty

What Has VW Management Said?

“We have broken the trust of our customers and the public [as a result of] the terrible mistakes of a few people.”

– VW Group CEO Martin Winterkorn (resigned)

“We've totally screwed up. Our company was dishonest with the EPA, and the California Air Resources Board and with all of you.”

– VW America CEO Michael Horn (resigned)

What Has VW Management Said?

“Those people who allowed this to happen, or who made the decision to install this software—**they acted criminally**. They must take personal responsibility.”

“We only found out about the problems. . . shortly before the media did. . . So we need to find out **why the board wasn't informed** earlier about the problems when they were known about over a year ago in the United States.”

- VW Group Board Member - Olaf Lies

What Has VW Management Said?

VW America CEO Horn told Congress:

- “This was not a corporate decision”
- It was “a couple of software engineers”

When asked during Congressional testimony how it is possible that VW’s top management did not know about the scheme, Mr. Horn replied:

- **“I agree, it's very hard to believe.”**

What Lessons Can Be Learned From VW?

- “Culture of Compliance” vs. “Culture of Win at All Costs”
- Clear ethical expectations
- Employees feel they will be heard
- Channels exist to receive reports and detect/deter wrongdoing

Why Have A Global Compliance Program?

- Ethical companies generally outperform unethical ones
- Purpose is broader than compliance with laws; it sets the ethical structure for the company
- A practice may be legal but inconsistent with the company's ethical norms
- If an issue is not reported, the company cannot address it

What Guidance Has Law Enforcement Provided?

- U.S. Sentencing Guidelines
- Principles of Federal Prosecution of Business Organizations
- FCPA Guide
- Yates Memo
- Remarks of DOJ's new Compliance Counsel

Seven Pillars of Global Corporate Compliance

1. Visible High-Level Commitment
2. Clear, Current, Particularized Standards
3. Regular, Targeted Risk Assessments
4. Annual, Live and Remote Trainings
5. Scheduled Auditing and Active Monitoring
6. Prompt, Thorough Investigation and Remediation
7. Continuous Improvement

1) Visible High-Level Commitment

- Is there an appropriate level of commitment from the Board of Directors/relevant committee?
- Is senior management familiar with the specifics of the compliance program?
- Is senior management actually committed to the entire program?
- Does the senior individual responsible for oversight have respect, authority and access?
- Are employees aware of these details?

2) Clear, Current, Particularized Standards

- Are the Compliance Program's written materials easy for the average worker to understand (i.e., brief, simple, and free of legal/technical jargon)?
- Are employees reading and understanding them?
- Do the materials match/reinforce the company's values?
- Do they specifically track current operations?

3) Regular, Targeted Risk Assessments

- When was the last time risk assessments were performed for Compliance Program purposes?
- Since the program was implemented have there been changes in the law, enforcement priorities, and the company (e.g., new acquisitions, markets, or business partners)?
- Would a regular annual report of risk assessments, enforcement priorities, and compliance issues and resolutions be beneficial (e.g., for the board, management, compliance or in-house lawyers)?

4) Annual, Live and Remote Tailored Training

- Are employees willing to report concerns and do they know how (and to whom) to make a report?
- Do they understand what should be reported?
- Is Compliance reaching everyone?
- Is training up-to-date? Does it match the evolution of the company, and the relevant laws and enforcement trends?
- Would a compliance survey be beneficial?

5) Scheduled Auditing and Active Monitoring

- Are there independent, targeted audits that can be performed on a set schedule?
- Are there regular reports/certifications from managers about compliance?

6) Prompt, Thorough Investigation & Remediation

- Does the Compliance Program require a prompt, thorough, independent, and right-sized investigation of each compliance issue?
- Is that process followed consistently?
- How are the results documented and tracked?
- Does the Compliance Program address when and to what extent the CEO and Board should be notified of a compliance issue?
- Are reputation management considerations a formal component of the general crisis response?

7) Continuous Improvement

- Are there tailored systems in place to ensure regular Compliance Program review?
- Is there a 24-36 month compliance calendar in place – including training, audits, policy and procedure review, etc.?
- Is there a commitment to the continuous development of simplified IT-based compliance solutions to remove human error?