

REPRISK CASE STUDY

Volkswagen

Volkswagen's emissions cheating device scandal

What happened?

On September 18, 2015, the US Environmental Protection Agency (EPA) accused Volkswagen (VW) of using “defeat device” software that made their diesel-powered vehicles appear to have lower emission levels than they actually did. US regulators accused the company of violating the Clean Air Act and ordered VW to recall more than 480,000 VW and Audi vehicles.

In the days that followed, VW's stock value fell by 23 percent, and on September 23, 2015, Volkswagen's CEO Martin Winterkorn resigned.

The scandal then spread to other VW brands across the world, including Audi, SEAT, and Skoda, when the governments of Australia, Brazil, Canada, China, Germany, and nine other countries announced plans to investigate the emission levels of vehicles manufactured by the VW Group. An estimated 11 million cars worldwide were implicated in the scandal.

In the US, eight current and former VW executives were indicted by the Department of Justice. One executive was sentenced to seven years in prison in December 2017. In January 2017, VW agreed to pay USD 4.3 billion to settle with the DOJ over the scandal. The company has also agreed to pay a total settlement of USD 25 billion for claims from customers, dealers, and environmental regulators.

In South Korea, the Ministry of Environment fined Audi Volkswagen Korea KRW 17.8 billion (USD 16.6

Case Study Timeline

2013

March-June

RepRisk identifies reports of inconsistencies between CO2 emissions statistics released by VW and the actual levels of CO2 emitted by the company's vehicles.

2015

September 18

US EPA accuses Volkswagen of using a “defeat device” that lets its cars produce up to 40 times more pollution than legal limits without being detected.

September 21

USD 17.6 billion is wiped off VW's market capitalization.

September 22

Volkswagen admits that 11 million cars worldwide are fitted with the defeat devices.

September 23

VW's CEO, Martin Winterkorn, resigns.

September 28

German prosecutors begin investigating Martin Winterkorn over suspicions of fraud.

October 28

Volkswagen Q3 results show a deficit of USD 3.8 billion, the company's first quarterly loss in 15 years.

2016

January 4

The DOJ sues VW on behalf of the EPA for USD 45 billion in response to the emissions cheating.

June

VW reaches a partial USD 14.7 billion settlement with the US authorities.

RepRisk has published a series of Case Studies that demonstrate the materiality of environmental, social, and governance (ESG) issues – and how RepRisk can serve as an early warning system before these issues translate into reputational, compliance, and financial risks. For more Cases, please visit www.reprisk.com/publications or contact us at media@reprisk.com.

billion) and launched criminal proceedings against seven VW managers and four employees, including the Managing Director of Audi Volkswagen Korea, who fled to Germany in June 2017, and two of his predecessors. In January 2017, an executive of Volkswagen Korea was sentenced to one year and six months in prison.

In July 2017, EU and German anti-trust regulators began investigating a possible collusion between Volkswagen and other automobile manufacturers to use an inexpensive “dosage” strategy for a liquid solution that neutralizes the exhaust emissions of diesel vehicles.

In March 2018, Volkswagen, BMW, and Mercedes were criticized for financing experiments on primates and students in Germany and the United States in 2014 to test their reaction to diesel fumes. The aim was to present diesel as an inoffensive substance. The primates were reportedly locked in cages and forced to inhale exhaust fumes for six hours a day. Similar tests were reportedly conducted on 25 people at the laboratory of an Aachen University Clinic in Germany. The results were never made public because the tests reportedly proved that diesel fumes are extremely toxic.

Was it foreseeable?

For 2014, the Volkswagen announced record sales of EUR 202.5 billion (USD 228.4 billion), and in March 2015, Moody’s rated Volkswagen as “A2: stable” and forecast “improvement in Volkswagen’s operational performance in the next 12 to 18 months.”

However, as early as May 2013, and again in June 2013, RepRisk had identified reports of inconsistencies between CO2 emissions statistics released by VW and other car manufacturers, and the actual levels of CO2 emitted by the companies’ vehicles. Different reports by two non-profit organizations, the International Council on Clean Transportation (ICCT) and Deutsche Umwelthilfe (DUH), accused the companies of employing technical tricks to tamper with the emissions data in order to reduce vehicle and road taxes.

In September 2014, the ICCT Europe cited Volkswagen as one of the manufacturers of vehicles whose emissions during laboratory testing did not match

Case Study Timeline

2016

August

Ministry of Environment of South Korea fines Audi Volkswagen Korea KRW 17.8 billion (USD 16.6 billion) and bans the sale of 80 VW vehicle models.

2017

January

VW reaches a USD 4.3 billion settlement with the DOJ; eight VW executives are indicted in the US, while seven VW Korea executives and employees are indicted in South Korea.

July

First VW executive is arrested in Germany; EU and German anti-trust regulators investigate possible collusion to fix the price of diesel emissions treatment systems.

August

EU Anti-Fraud Office completes investigation into VW’s possible misuse of EU loans; total number of suspects investigated by German criminal fraud squad reaches 38.

September

Second VW executive is arrested in Germany.

December

First VW executive is sentenced to seven years in prison in the US.

2018

March

VW, BMW, and Mercedes were criticized for financing experiments on primates and students in Germany and the US in 2014 to test their reaction to diesel fumes. VW’s total costs to settle emissions scandal estimated at USD 30 billion.

RepRisk is the only ESG research provider that flagged the high risk exposure related to VW before the scandal broke: VW was considered “high risk” by RepRisk as early as September 2014, when the company reached a RepRisk Index (RRI) of 66.

those registered under everyday driving conditions. On September 17, 2015, the day before the scandal

broke, the German NGO Deutsche Umwelthilfe again accused Volkswagen of promoting its diesel vehicles as being clean while deliberately exceeding legal limits by up to 25 times.

In fact, RepRisk is the only ESG research provider that flagged the high risk exposure related to VW before the scandal broke: VW was considered “high risk” by RepRisk as early as September 2014, when the company reached a RepRisk Index (RRI) of 72 – well above the high-risk threshold of 50.¹ This was due, in large part, to systematic risk incidents related to anti-competitive practices, misleading advertising, corruption, and fraud.

Consequences for Volkswagen

At the beginning of 2018, Volkswagen appeared to be on the road to recovery, after completely overhauling the management team. Operational results have also been improving, with deliveries to customers increasing by 4.2 percent during the first semester of 2017 compared to the previous year.

However, as of March 2018, the company continues to face hundreds of thousands of lawsuits from owners of diesel cars and investors around the world, and is facing costs of around USD 30 billion to settle both criminal and civil lawsuits, as well as to buy back and modify vehicles affected by its diesel emissions fraud.

In April 2018, the Korean newspapers reported that Audi Volkswagen Korea and Porsche Korea face possible fines of KRW 14.1 billion (USD 13.16 billion) in fines for participating in the emissions fraud.

Volkswagen faces around 1,600 investor lawsuits in Germany that are collectively claiming EUR 8.6 billion (USD 10.19 billion) for the emissions cheating, as well as probes in the Netherlands and Austria.

Company Description

Volkswagen AG manufactures cars, trucks, and commercial vehicles for sale worldwide. The company also owns Audi, SEAT, and Skoda, which manufacture and sell cars in southern and eastern Europe, and Lamborghini, which makes sports cars in Italy.

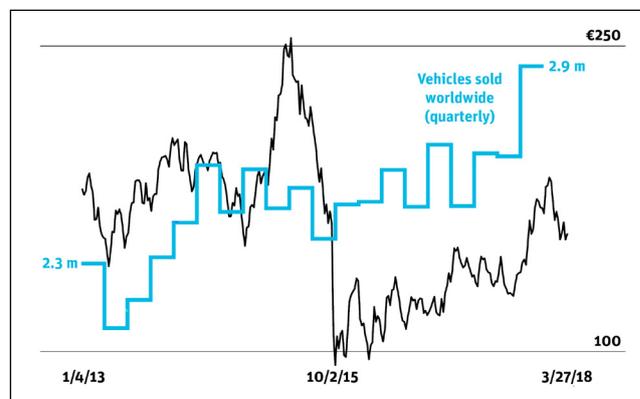


Figure 1: VW's share price plummeted but sales did not (graph adapted). Now, VW is said to be the No.1 carmaker globally despite the diesel cheating scandal. Source: [Bloomberg](#).

What RepRisk's data showed before the scandal

June 2013 A report by the NGO International Council on Clean Transportation (ICCT) claimed that carbon emissions declared by carmakers were on average 25 percent higher than the figures communicated. Reportedly, emissions for Audi, BMW, Mercedes-Benz, Peugeot-Citroen, Renault, Toyota, and Volkswagen were higher than the data published by the carmakers.

September 2014 In a report entitled *From Laboratory to Road*, also by the ICCT, it was alleged that car manufacturers in Europe, including Audi, BMW, and Mercedes-Benz, had falsified their fuel consumption statements by up to 50 percent in 2013.

September 2015 The German NGO Deutsche Umwelthilfe accused BMW, Daimler, and Volkswagen of being responsible for tens of thousands of premature deaths caused by air pollution from toxic diesel fumes in Germany. In particular, it criticized the companies for promoting their new diesel vehicles as being clean, while installing substandard catalytic converters and deliberately exceeding legal emission limits by up to 25 times.

¹ The RepRisk Index (RRI) is a proprietary algorithm that dynamically quantifies reputational risk exposure related to ESG and business conduct issues. It facilitates an initial assessment of the ESG and reputational risks associated with financing, investing, or conducting business with a company. The RRI ranges from zero (lowest) to 100 (highest). The higher the value, the higher the risk exposure: 0-25 = low risk exposure, 26-49 = medium risk exposure, 50-59 = high risk exposure, 60-74 = very high risk exposure, 75-100 = extremely high risk exposure.