Prioritizing Process: How Poor Process Contributes to Compliance Failures

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Today

- Volkswagen Emissions Scandal
- Volkswagen’s Governance Structure
- Process Oriented Approach (POA)
- Volkswagen’s Poor Process
- Prioritizing Process
- Questions and Discussion
Staggering Statistics

- 11 million vehicles
- $30 billion in fines and buybacks
- 48 hours
- 6 executives
- 7 years in prison
- 3 years

Timeline

2005  Focus on Diesel Cars in the US, but EPA poses a barrier
2007  Abandoned pollution control technology & hired Winterkorn
2011  VW technician warned of illegal practice
2012  Ursula Piech appointed to the Supervisory Board
2013  WVU test on-road VW diesel emissions and finds abnormal results
9/18/15  EPA issues Notice of Violation To VW
9/15–11/15  VW admits to installing defeat devices
How Did VW Do It?

- Volkswagen, Porsche, and Audi Models
- 2009-2016
- 2.0L and 3.0L diesel engines
- Puts children, elderly, and those with respiratory diseases at risk

Source: Weitz & Luxenberg
https://www.weitzlux.com/consumer-protection/volkswagen-defeat-device/
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German Dual Board Structure

Supervisory Board

Higher of the two boards
Oversight/Monitoring function
Provides control, approval, guidance

Reports to the supervisory board
Informs the supervisory board
Manages the company

Management Board
Deutscher Corporate Governance Kodex (DCGK)

- **Standards of independence**
  - Non-independent if a supervisory board member has a conflict of interest
  - Limits the number of former management board members to two

- **Volkswagen lacked independence**
  - Porsche and Piech members have significant influence over the supervisory board
  - State of Saxony holds two seats
  - Qatar holdings has two seats
  - Guaranteed jobs for over half of the supervisory board

VW’s Risk Management System

- Funneled through Management Board
- Management Board decides whether to inform the Supervisory Board
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Process Oriented Approach

Step 1 Identification → Step 2 Analysis → Step 3 Choice of Response → Step 4 Approval → Step 5 Implementation

1. Identifying problems or opportunities
2. Analyzing problems or opportunities
3. Deciding on how to respond to the problem or opportunity
4. Approving the decision
5. Implementing the decision
Necessary Tools

- Time
- Information
- Knowledge

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Cosmetic Independence

- **Time**
  - 5 to 6 meetings per year between 2008 and 2015

- **Information**
  - Lacked complete information
  - Engineers were insulated in designing the diesel products
  - Disseminated to executives but not the board
  - Autocratic leadership

- **Knowledge**
  - Lacked firm specific knowledge
  - Limited technical knowledge
Step 1: Identification

- Executives and employees determine the information the Management Board received
- Management Board further filters the information passed on to the Supervisory Board
- These gatekeepers create the outer boundaries of the problems the Supervisory Board can identify
- Gatekeeper limitations include her:
  - Biases
  - Expertise
  - Goals

Diesel Success Goals

- In 2009 Volkswagen rolled out “clean diesel in America”
- In 2011, Volkswagen “continued to write the success story of diesel engines in other areas”
- Executives’ motivation to obscure or highlight a problem
Step 2: Analysis

- German courts require that Supervisory Board members – individually and as a group – carry out “independent risk analysis.”
  - More complex transactions require more analysis
- Supervisory Board passively accepted the Management Board’s proposals
- Failure to verify

Step 3: Choice of Response

- Decision to cheat was made over a decade before
- Organizational structure allowed culpable individuals to insulate themselves
- Management knew, but did not inform the Supervisory Board.
Step 4: Approval

- Supervisory Board blindly approved Management Board’s proposals
- Supervisory Board was more of a pawn than a monitor
- Supervisory Board composition made approval pro forma

Step 5: Implementation

- Supervisory Board oversight
- Actual implementation is almost completely within the purview of management
  - Bias
  - Control over zealous or lazy implementation
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Improvements

• Culture of Compliance
• Transparency
• Constructive Conflict
  • Devil's Advocate
• Independent Information Gathering Channels
  • Corporate Ombudsperson
• Open Communication Channels Between Silos
  • Open Electronic Access to Information
• Technical Experts on the Board
• A Seat at the Table for Compliance Professionals

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Questions
Volkswagen Law

- Fails the test for codetermination
- Lacks independence
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-Prioritizing Process