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
- EPA/parser a barrier

2007
- Abandoned pollution control technology & hired Winterkorn

2011
- VW謄ouning illegal practice

2012
- U.S. to road VW direct and hired abatement results

2013
- EPA issues Notice of Violation To VW

2015-2017
- VW vehicle to handle 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
- Higher of the two boards
- Oversight/Monitoring function
- Provides control, approval, guidance
- Reports to the supervisory board
- Informs the supervisory board
- Manages the company

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
Necessary Tools
- Time
- Information
- Knowledge

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Cosmetic Independence
- Time
- Information
  - Lacked complete information
  - Engineers were isolated 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 Sites
  - 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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