

Bloomberg

VW 'Clean Diesel' Scheme Exposed as Criminal Charges Weighed

By Jeff Plungis

Sept. 18, 2015

Volkswagen AG's admission that it cheated to make nearly half a million diesel cars appear cleaner-burning than they are leaves the automaker facing billions in fines, its executives risking criminal charges and its U.S. expansion plans in peril.

VW admitted systematically cheating on U.S. air pollution tests for years, the Environmental Protection Agency announced Friday in citing violations that could add up to \$18 billion in fines. The company said it has also heard from the Justice Department, which the EPA said could pursue criminal prosecution.

The German automaker has struggled to gain a foothold in the world's second-biggest car market with a strategy built in part on touting the efficiency of fun-to-drive "clean diesel" vehicles now shown to be anything but.

"It's a huge black eye for Volkswagen," said Matt DeLorenzo, managing editor for news at Kelley Blue Book in Irvine, California. Consumer Reports magazine reacted by suspending its "recommended" rating of two diesel models.

Diesel versions of the popular Beetle, Golf, Jetta and Passat comprise more than a quarter of the brand's sales in the U.S. and are a vital part of the company's strategy for meeting tougher U.S. fuel economy standards going into effect in coming years. More than other carmakers, VW has chosen to focus on diesel technology instead of electrics or hybrids.

"They were counting heavily on diesels to meet the fuel-economy numbers," DeLorenzo said. "This brings that whole strategy into question."

Defeat Device

Volkswagen admitted it sold 2009-2015 diesel Volkswagen and Audi cars with software that turns on full pollution controls only when the car is undergoing official emissions testing, the EPA said, calling the algorithm a "defeat device." During normal driving, the cars pollute 10 times to 40 times the legal limits, the agency estimated.

Volkswagen, based in Wolfsburg, Germany, said it's cooperating with the investigation and unable to comment further.

The EPA, working with the Justice Department, is likely to push for a stiff fine because there are clear violations of the law and harm to the environment, said Margo Oge, former director of the agency's Office of Transportation and Air Quality. VW's competitors were spending more money on systems to comply with the law and help the environment.

"My hope is the agency will send a strong message to the rest of the industry," Oge said. "You want to make it clear that this isn't acceptable."

The closest parallel to the Volkswagen case was a group of truck makers who used devices to suppress diesel-pollution controls to improve fuel economy, Oge said. That case, settled 15 years ago, resulted in fines of more than \$1 billion, she said.

Potential Fines

The potential financial liability is unclear. The EPA could fine the company \$37,500 per violation, said Cynthia Giles, the agency's assistant administrator for enforcement. With 482,000 autos part of the case, the total could be more than \$18 billion. EPA allegations that automakers violated environmental rules often are settled for far less than the maximum possible fine.

Hyundai Motor Co. and Kia Motors Corp. agreed last year to pay a \$100 million civil penalty to resolve Clean Air Act violations based on their sale of more than 1 million vehicles that emitted more greenhouse gases than what they certified to the EPA.

Criminal Exposure

Lawyers familiar with automotive law say the company could face criminal exposure if prosecutors agree with the EPA's assertion about the defeat device. The Clean Air Act contains criminal provisions which apply to tampering with monitor devices, as well as making false statements to the EPA.

"What is so damning is that this was something actively pursued. This isn't an oversight," said Bloomberg Intelligence auto-industry analyst Kevin Tynan.

Someone at VW had to decide that cheating the system was going to be a better use of time, money and resources than meeting the regulatory requirements, Tynan said.

"It sounds pretty damning from what EPA said," said Carl Tobias, a products-liability law professor at the University of Richmond in Virginia. "I think they need to be worried about more than just the fines."

The Justice Department this month said it would step up its efforts to punish individuals for corporate criminal wrongdoing.

"It may be that DOJ will pursue some kind of criminal charge, and that could be very serious," Tobias said. The question will then be who in the corporate chain of command knew about the deception and when did they know it, he said.

Including diesel models from the company's Audi and Porsche brands, Volkswagen AG accounts for 63 percent of diesels sold in the U.S., he said.

Consumer Case

The reliability of auto emissions data has also been questioned in Europe. Last year, Mercedes-Benz was accused of overstating fuel economy performance of its vehicles by 40 percent compared with real-world results, according to a study by Brussels-based lobby group Transport & Environment.

Volkswagen was sued Friday in a federal court in San Francisco in a consumer class-action case alleging that the defeat device has caused vehicles to lose value.

Consumers wouldn't have bought the vehicles or paid as much as they did for them if they had known about the defect, and stand to spend more on fuel when the cars are modified to comply with emissions standards, according to the complaint.

Tobias, the products liability law professor, said it will be easier in some states than others to establish a class of consumers who can claim injury from Volkswagen's actions. Some drivers will have to show they specifically relied on the company's "clean diesel" promises, while elsewhere it will be enough that VW didn't live up to its representations.

But given the nature of the allegations, just bringing the lawsuit should provide suing customers with "leverage enough to exact some reasonable settlement," Tobias said. "There's a lot that's going to happen in the days ahead."

Global Giant

While Volkswagen is a global giant with the longstanding goal of surpassing Toyota Motor Corp. as the world's largest and most profitable automaker by 2018, it continues to struggle in the U.S., even after opening a \$1 billion factory in Tennessee. VW brand's U.S. sales fell 2.8 percent this year through August, while industrywide sales rose 3.8 percent.

Now the company's targets are at risk, said DeLorenzo of Kelley Blue Book. It's always been expensive and difficult to tune diesel engines in a way that meets pollution regulations, he said. VW may have found it easier to write software that passed EPA tests than compromise the way its diesels drive, he said.

The EPA and the California Air Resources Board said their investigations are continuing.

"We're not discussing what the California fines might be at this point," said David Clegern, a spokesman for the California Air Resources Board, in an e-mail Friday. "Our priority is to get these vehicles into compliance and proceed from there. A recall is really the only way to do that."

Creating Pollution

Volkswagen was deliberately creating more pollution for the people they were trying to sell clean diesels to, said Dan Becker, director of the Safe Climate Campaign, a Washington-based environmental group.

“This is one of the companies that’s been trying to get Americans to buy diesels,” Becker said. “They’ve banked their future in a significant way on diesel. They assumed the EPA would never catch them at it, and that was a huge risk.”

The company’s preferred shares fell 3.2 percent to close at 162.40 euros in Frankfurt Friday before the revelations by the EPA.

Consumers haven’t yet been ordered to return to their dealers for a recall, and it’s safe to keep driving the cars, said Janet McCabe, acting assistant administrator of the agency’s Office of Air and Radiation.

Last year Ford Motor Co. was forced to lower mileage estimates and compensate more than 200,000 customers. The Dearborn, Michigan-based company sent out payments ranging from \$200 to \$1,050. In 2012, an investigation led to Hyundai and Kia relabeling some of their top-selling U.S. models.

<http://www.bloomberg.com/news/articles/2015-09-19/vw-clean-diesel-scheme-exposed-as-u-s-weighs-criminal-charges>