

WHITE COLLAR LAW & CORPORATE GOVERNANCE

Lessons From the First Indictment in the Volkswagen Crisis

By EDWARD J. HEATH and KELLY FRYE BARNETT

On Sept. 9, the U.S. Department of Justice publicly announced the indictment and guilty plea of James Liang, the first Volkswagen executive to be charged in connection with the company's ongoing emissions scandal. The plea was entered on the one-year anniversary of the DOJ's release of the so-called Yates Memo, which sent a stern warning to the business world that company executives were now more likely to be held individually accountable for criminal and civil liability arising from corporate misconduct. Even at this early stage in the government's investigation of Volkswagen, the prosecution of Liang reflects the DOJ's commitment to the philosophy of the Yates Memo and reveals some practical guidance for lawyers and other personnel responsible for corporate compliance.

The Yates Memo

Named after its author, Sally Quillian Yates, deputy attorney general of the United States, the Yates Memo is the most recent articulation of the DOJ's approach to investigating and resolving allegations of corporate misconduct. Its philosophy is crystallized in six steps that assistant U.S. attorneys should take in the course of handling investigations, and it places a heavy emphasis on individual accountability. It instructs DOJ lawyers to focus on individual criminal and civil liability from the inception of the investigation, and it directs that any settlement with a target company should not include a release of culpable directors, officers, or employees "[a]bsent extraordinary circumstances."



Edward J. Heath



Kelly Frye Barnett

The Yates Memo takes the position that culpable employees generally should not be allowed to escape liability to the government by hiding behind the corporate form, but it also can be read to urge DOJ lawyers to use individual employee liability as leverage to obtain a more favorable settlement from the target company. In articulating this strategy, the Yates Memo did not break new ground as much as it confirmed an evolving federal trend, of which the prosecution of Liang is the latest high-profile example.

Liang's Prosecution

News of Volkswagen's emissions crisis broke in September 2015, mere days after the Yates Memo was issued. It has become one of the most significant ongoing government investigations in the country, if not the world. At the core of the crisis is a decadelong conspiracy perpetrated on consumers and environmental regulators worldwide to use software in its vehicles to fraudulently defeat emissions testing.

Liang has now admitted to being a key figure in that criminal conspiracy. His employment with Volkswagen AG began in 1983 and focused on diesel development at the company's facilities in Wolfsburg, Germany. The DOJ has alleged that Liang and other company personnel realized that they would not be able to design a diesel engine that would meet both U.S. emissions standards and customer expectations. Liang and other company employees thereafter designed software or a "defeat device" that was to be installed in each vehicle. When the software detected emissions testing, the vehicle would perform in a mode that satisfied standards. Otherwise, the emissions control systems were scaled back, causing the vehicle to emit significantly higher amounts of nitrogen oxide pollutants, sometimes 40 times greater than U.S. standards.

In 2008, Liang moved to California as Volkswagen's leader of diesel competence. While in that role, Liang and other co-conspirators allegedly met with federal and state environmental regulators on several occasions to seek the certifications required to sell to U.S. customers the vehicles fitted with the defeat devices. Liang has admitted that during some of these meetings he and his co-conspirators knowingly misrepresented that the vehicles complied with emissions standards and intentionally hid the existence of the defeat devices.

Consistent with the Yates Memo, Liang was indicted under seal while the government and Volkswagen were involved in ongoing settlement negotiations. According to counsel for Liang, he is "one of many" at Volkswagen involved in the scheme, and it appears that he has been cooperating with the government's investigation. Approximately a month after Liang was indicted, Volkswagen reached a settlement with the DOJ under which it admitted wrongdoing and agreed to pay \$15.3 billion to its customers and regulators.

The settlement left open the possibility of criminal charges. Yates has since confirmed that the DOJ is looking at "multiple companies and multiple individuals" in this investigation. Liang's indictment may be the first of many to follow.

Compliance Warning Signs

It remains unclear whether and to what extent Volkswagen employees in supervisory or compliance roles may have been aware of the criminal conspiracy to which Liang has admitted. But his indictment and numerous media reports suggest that others may have been in a position to observe warning signs.

For example, a civil lawsuit filed in federal court in New Jersey last year cites German and French newspaper reports for the allegation that Robert Bosch GmbH, a business that supplied software and components to Volkswagen, warned the company in a 2007 letter that it would be illegal to use the emissions software in vehicles sold to U.S. consumers.

Other media reports indicate that one or more Volkswagen technicians may have warned the company in 2011 about concerns regarding emissions testing practices.

In 2012, West Virginia University received a private grant to perform emissions tests on a variety of diesel vehicles in the U.S. WVU tested two Volkswagen diesel cars, which repeatedly failed to match the company's marketing hype. That testing data was first presented at an industry conference in 2014 and was later provided to federal and state regulators, whose confrontation of Volkswagen was initially met with denials.

The indictment of Liang does not refer to any of those media reports or to the third-party testing, but it does rely heavily on incriminating internal emails exchanged between Volkswagen employees in response to their dealings with regulators. Referring to an engine at issue, one employee wrote in 2015, “We must be sure to prevent the [California] authority from testing the Gen 1!” An email also noted that if the Gen 1 engine were tested by regulators, “then we’ll have nothing more to laugh about!!!!” One Volkswagen employee sent Liang and others an email in 2015 seeking input on how to respond to regulators, stating (in German): “The key word ‘creativity’ would be helpful here.” Another employee email stated, “We ‘only just need a plausible explanation’ as to why the emissions are still high!!!”

Avoiding the Crisis

The scant information and allegations available to the public about the Volkswagen crisis already reveal some practical guidance for lawyers and other company personnel responsible for corporate compliance.

It is important for lawyers and compliance personnel to be “on the

ground” with company employees to the extent reasonably practicable, particularly with regard to employees involved in company initiatives that are subject to heavy regulation. Fostering a close and trusting working relationship with employees helps to maintain an open line of communication to share concerns, even those that come from outside of the company, such as from vendors or at industry conferences.

Lawyers and compliance personnel should also consider educating company employees about the internal and external risks of noncompliance, including the DOJ’s avowed commitment to pursuing individual liability, and the company’s existing reporting channels and whistleblower protections.

Regulators expect that supervisory and compliance personnel will swiftly respond to indications of possible employee misconduct. Acquiring the information necessary to make informed judgments is often challenging, but, as the emails cited in Liang’s indictment strikingly illustrate, reviewing employee emails can be an effective investigation starting point, even before any employees are questioned. Although

the primary mode of communication among employees in most companies, emails, unfortunately, are often sent with little or no forethought despite their permanence and likelihood of ending up as evidence in criminal and civil cases. That initial step of email review typically can be performed remotely through the company’s IT department and without advising the targeted employees of the review. If the volume of email generated by the employees is too great to review in short order, as will almost certainly be the case, keyword terms can be searched to expedite the review.

This kind of relationship building, internal education, and monitoring efforts are burdensome and time-consuming but, as Volkswagen’s woes have already demonstrated, the cost of compliance is always less than the cost of a crisis. ■

Edward Heath is a Robinson & Cole partner who chairs the firm’s Business Litigation Group and leads its Government Investigations, Corporate Compliance, and Criminal Defense Team. Kelly Frye Barnett, an associate in the firm, is a member of the Business Litigation Group and the Government Investigations, Corporate Compliance, and Criminal Defense Team.