
WHEN THE DEFIANCE OF BUSINESS ETHICS LAWS BECOMES THE NEW NORMAL: THE CASE FOR VOLKSWAGEN

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ABSTRACT

Over the years, corporations have pushed the boundaries of growth and making profit by shaping an organizational culture that is conducive to diminishing of the business ethics laws and letting it to become the new normal. This paper addresses the issues of concerns regarding the corporate ethics and the conscious practices by many corporations to turn a blind eye to corporate social responsibility and corporate citizenship. In recent years, there has been an alarming trend among the major corporations in various business industries to violate the public trust and willfully abate the rules of law. The paper highlights the Volkswagen's corporate citizenship by examining the triple bottom line – its profits, impact on individuals and on our planet.

Keywords: Corporate social Responsibility (CSR), Business Ethics, Business Law, Volkswagen, International law and jurisdiction.

INTRODUCTION

Corporate Social Responsibility (CSR) that falls under the arch of business ethics laws has long been the symbol of trust and security between business and society. While the businesses thrive by safeguarding such trust they would experience adverse consequences when there is a breach in that trust. In recent years, there have been number of instances where the business corporations betrayed the public trust by knowingly mislead the authorities and the public at large by falsifying the records and harming the social trust.

What has now become a classic example, is the case for the Volkswagen Corporation that was ordered in 2016 to make a payout of \$4.3 billion in fines and \$15.9 billion repair reimbursement to consumers for the breach of fiduciary duties and the lack of social responsibility. (Hotten,

2017). The VW case is one of the biggest financial settlement in history, which could have easily been avoided, had it not been for a culture that breeds corporate malfeasance. The company is still recovering from the loss of public trust as well as the significant losses in sales and related financial deficits.

Precedence to Corporate Social Responsibility

The intentional act of turning a blind eye to be in compliance with the law and quest for super profits, have already left a permanent stain on the public, shareholders, stakeholders and the corporations. Often times the lack of concern has shattered the trust between the parties to a point that reconciliation has frequently been deemed unlikely. Moreover, even with a renewed reconciliation, it is unlikely that the breaching party would be viewed with the same level of trust, despite of the additional safety measures to avoid reoccurrence of such breach.

The relationship between trust and security has been researched within the academic arena since 1945, long before the modern day CSR (Caroll & Kareem, 2010). The evidence, prior to the 20th Century can be traced as far back to 1750 B.C.E. through the Code of Hammurabi (Code of Hammurabi, n. d.) during the Babylonian civilization. The Code established the milieu pertaining the expectation of a businessman or a business, making it evident that the care given to the public was paramount, as that in itself was a safety measure for a sustainable business.

In spite of the potential harsh penalties for failing to uphold the Code, disregarding the code turned to be considered an advantage and thus accepted as part of the everyday life and internalized and embraced as a second nature (Aberdeen, 2010). Two such examples of the Code relating to business conduct are:

1. "If a builder has built a house for a man and has not made his work sound, so that the house he has made falls down and causes the death of the owner of the house, that builder shall be put to death..." x
2. "If a man has opened his ditch for irrigation and has been slack and has consequently caused the water to carry away his neighbor's field, he shall pay corn corresponding to the crop of the field adjoining it" (Code of Hammurabi, n. d.)

Unlike the recent misconducts of several corporations, the code of conduct during the era of the Code of Hammurabi shows no tolerance for unintentional falter, much less intentional acts of deception that created a foreseeable harm to the public.

Corporate Deceitfulness and its Adverse Impact

While there have been many instances of business practices to breach and violate the expected trust between the corporations and the public at large, the following cases highlight the devastating impact on the individuals, the society, and the community.

- In 2001, Enron, a house-based commodity energy and service company, filed for bankruptcy after its two CEOs, concealed the debts off the balance sheets. The shareholders lost \$74 billion followed by losses of retirement and jobs for thousands (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2002, WorldCom, a telecommunication company, inflated assets by \$11 billion which cost investors \$180 billion and a loss of up to 30,000 jobs (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2003, Freddie Mac, a federally backed mortgage company, falsely stated \$5 billion in earnings (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2005, AIG, a multinational insurance corporation committed accounting fraud to the likes of \$3.9 billion (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2008, Lehman Brothers, a global financial firm, disguised loans amounted to \$50 billion as sales (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2009, Saytam, an IT services company based in India, misrepresented its earnings up to \$1.5 billion (The Worst Corporate Accounting Scandals of All Time, n. d.).
- In 2009, a Toyota Lexus Sedan lost control due to its sticky pedals causing the family inside the car, fatal injuries (Here are some of the Worst Scandals in History, n. d.). Toyota admitted that it intentionally hid the truth from consumers and consequently paid \$1.2 billion in fines to avoid criminal prosecution (Here are some of the Worst Scandals in History, n. d.).
- In 2014, General Motors' engineers testified that they lied to the government and for at least a decade, they knew of the faulty switch in Chevrolet Cobalt that led to the death of at least 124 people (Here are some of the Worst Scandals in History, n. d.). Consequently, to avoid criminal liability, the company paid \$900 million in fines (Here are some of the Worst Scandals in History, n. d.).

These companies belong to different industries and are from various parts of the world. However, the shared and common denominator among them is the lack of high regards for the

social responsibility and ethical conduct. The top management and the leadership of these companies simply maltreated and ignored the public trust. Now, Volkswagen has joined their ranks.

The Volkswagen Emissions Case

After investigating the Volkswagen, due to suspicion for emission cheating, the EPA threatened to withhold approval for the 2016 Volkswagen and Audi diesel models (Volkswagen Emissions Scandal, n. d.). In September 2015 Volkswagen admitted to the United States Environmental Protection Agency, and later revealed to the public, that it had developed and installed a “defeat device” software in 10 million of its cars world-wide, approximately 500,000 in the United States, that allowed cars to cheat on emission tests (Hotten, 2015). During testing, the movement of the pedal and steering wheel were such that the software would detect the uniqueness, and the nitrogen oxides (NOx) controls would switched on, and produced low emission results that met the Clean Air Act (Plummer, 2017).

However, once the engine was in conventional driving mode, the emission controls would switch off and the cars would release 40% more NOx above the legal limits in the United States (Hotten, 2015).

The impact was not only staggering on the environment, but also on human lives.

Researchers at MIT and Harvard University, in the journal *Environmental Research Letters* projected that in about 10 to 20 years approximately 60 people would die prematurely from exposure to the excess emissions from Volkswagen (Chu, 2015). Jennifer Chu emphasized that if by the end of 2016, if each of the vehicle installed with the “defect device” was recalled, more than 130 additional early deaths could be avoided. Conversely, if the recall fails to occur, the excess emissions, compounding in the future, will cause 140 people to die early (Chu, 2015).

Additionally, there will be a rise in premature deaths and it is estimated that the excess emissions will contribute directly to 31 cases of chronic bronchitis and 34 hospital admissions involving respiratory and cardiac conditions (Chu, 2015). Moreover, the affected individuals will experience about 120,000 minor restricted activity days, including work absences, and about 210,000 lower-respiratory symptom days (Chu, 2015). In total, the research findings have revealed that Volkswagen’s excess emissions will generate \$450 million in health expenses and other social costs (Chu, 2015).

It was astonishing that Volkswagen, during emissions tests, intentionally deceived the government, thus breaching its fiduciary “duties of care” and trust to its shareholders,

stakeholders, and its social responsibility to the public. When the EPA announced it to the public, it was a far cry from the “news.”

The news of how the breach happened may have been a surprise. The news that a breach occurred, however, was not. The news reports suggested that corporations’ breaches of fiduciary duties are not rudimentary. One need not to go beyond the 21st Century to identify a slew of corporate scandals, where the breach of corporate governance and social responsibility has left a trace of devastation upon the shareholders and the public.

In modern society, the penalty for corporate fraud can lead not only to criminal liability but also billions in compensatory, special and punitive damages. The fear of failing, greed or blatant disregard for the vulnerable are some reasons that may propel businesses and corporate leaders to exploit acts leading to and creating the risk of corporate dissolution, insolvency or tarnished reputation. When the question was asked of Volkswagen as to why it chose to commit its fraudulent misrepresentation, Volkswagen Chairman Hans-Dieter Pötsch was very direct in his answer on December 10th, 2015:

“A group of the company’s engineers decided to cheat on emissions tests in 2005 because they could not find a technical solution within the company’s ‘time frame and budget’ to build diesel ran engines that would meet U.S. emissions standards. When the engineers did find a solution, he said, they chose to keep on cheating, rather than employ it.”

Noting that Volkswagen had suspended nine managers believed to be involved in the deception, Pötsch added that the scandal arose from ‘a mindset in some areas of the company that tolerated breaches of the rules (Goodman & Leah, 2015). Despite advice against the implementation of the software beyond a controlled condition, Volkswagen engaged in short- run profit maximization when it knowingly promoted and continued to sell a defective product for the sole purpose of profits.

According to Newsweek magazine, Robert Bosch GmbH admitted to supplying Volkswagen with the cheat software but warned Volkswagen not to use it in real world driving conditions (Goodman & Leah, 2015). Volkswagen Chief Executive in the United States, Michael Horn, reiterated that the decision to cheat the emissions tests was not a corporate one, but rather a decision by “a couple of software engineers” (Prodhan & Schwarz, 2015). However, according to the doctrine of respondent superior, any fraudulent misrepresentation committed by an employee within the scope of employment is deemed to be an action committed by the employer, thus making the employer liable.

Even if it were true that the decision came from a couple of software engineers to install the

software, there would have likely been a software testing audit unless the software was not tested and if it were, the auditors did not share the results (Merian, 2015). The mere fact that management and executives later approved the “defeat device” to be installed into at least 11 million cars and even if the original idea was not theirs, it shows the extent of the treachery from Volkswagen. According to German magazine Spiegel (Wednesday [October 14th, 2015], “at least 30 managers were involved in Volkswagen's (VOWG_p.DE) emissions test cheating”, citing internal and external investigations (Prodhan & Schwarz, 2015).”

The attitude of absolute intolerance from the corporate leadership has been one of the ways to create a positive corporate culture and to diminish the opportunity for corporate malfeasance. It was also reported by German Weekly, “Der Spiegel,” though denied by Volkswagen’s ex-CEO Martin Winterkorn, that he knew of the emissions cheating device prior to the scandal being made public, and this was confirmed by Volkswagen’s former Chief of Supervisory Board (Ex-VW CEO knew of emissions cheating before scandal broke: report, 2017). The practice of disregard for human life, for the sake of prioritizing profit seems to be a common trend among some of these corporations. Volkswagen profited from its calculated deception by marketing the ‘low emission’ as a selling point to those who were environmentally friendly, knowing that they would rely to their detriment on this falsehood.

The Criminal Effect

The consumers were not the only group affected by VW’s fiduciary breach. The company suffered a financial loss due a worldwide decline in sales, comprising a 10% decrease in the US market. (VW Sales Tumbling on Emission Scandal – Though not so fast, 2016). Employees and executives themselves faced criminal indictments. James Liang, who worked for the company in California as an engineer, plead guilty in September, 2016, for conspiracy to defraud the United States government and violating the Clean Air Act (Goldman, Tabuchi, & Ewing, 2017). The U.S. Attorney’s Office later announced charges against six executives of Volkswagen for conspiring to keep the truth from US regulators in regards to the VW cheating device. On January 9th, 2017, the Federal Bureau of Investigation (FBI) arrested Oliver Schmidt, one of the German executives and the former top emissions compliance manager in the United States (Goldman, Tabuchi, & Ewing, 2017).

Other executives are believed to be in Germany, where the United States does not have an extradition treaty with the government. However, the United States may seek an international arrest warrant, if they travel outside Germany and the EU zone. (Matussek, 2017).

On January 11th, 2017, pursuant to its announcement, the United States filed criminal charges against the executives and against the company for violating the Clean Air Act, and custom laws by making false statements regarding the entry of goods, obstructing Justice, and for conspiring to defraud the United States and committing wire fraud (U.S. v. Volkswagen, 16-CR-20394: Volkswagen Diesel Engine Vehicle Matters, 2017). The company pled guilty. “Analysts have said customer faith in Volkswagen’s namesake brand has been hurt by a stalled German vehicle recall and a stop sale of diesel models in the United States where seven months into the scandal, Volkswagen still lacks a technical fix for almost 600,000 cars.” (U.S. v. Volkswagen, 16-CR-20394: Volkswagen Diesel Engine Vehicle Matters, 2017). To mitigate the financial loss and damage to its reputation, Volkswagen decided to take its business to China, where the regulation of nitrogen oxide from emissions is not much of an issue. It sold more than 10 million vehicles in 2016, boosting its financial recovery, while undermining the damage to the environment and harming the human health. (Rauwald, 2017).

The Takata Link

The VW’s sentiment was once again echoed in the recent automobile scheme exhibited in United States of America v. Takata Corporation (U.S. vs Takata Corporation, 2017). In this case, Takata, based in Tokyo, Japan and one of the largest suppliers of airbags, falsified the test data related to its products’ safety. Takata Corporation Agreed to Plead Guilty and Pay \$1 Billion in Criminal Penalties for Airbag Scheme and Three Takata Executives Charged with Fraud and Conspiracy. While such action led to increased profits for Takata, it contributed to injuries and fatalities among many drivers and other occupants. Like VW, Takata case exhibits the fraudulent misrepresentation from a corporation that willfully refused to fulfill its corporate responsibility duties. The profit before safety culture led to three of Takata’s executives to be charged with wire fraud and conspiracy in the United States. The company has pleaded guilty and has agreed to pay \$1 Billion in criminal penalties (Takata Corporation Agrees to Plead Guilty and Pay \$1 Billion in Criminal Penalties for Airbag Scheme: Three Takata Executives Charged with Fraud and Conspiracy, 2016).

The Impact of Volkswagen’s case on Europe

Although many European states have implemented preventive measures, and are pursuing criminal cases against Volkswagen, the EU Commission has begun infringement procedures against Germany, the United Kingdom, Spain, Luxembourg, Czech Republic, Lithuania and Greece for the alleged failure of oversight in regards to Volkswagen’s emission test cheating (EU takes legal action against Germany, UK over VW scandal, 2016). “The Commission launches infringement procedures when a Member State fails to resolve an alleged breach of EU law

(Member State compliance with EU law improving, but more work ahead to unleash full potential of Single Market, 2016).” The EU’s standing to take legal action against these states premise on the ratified EU regulations that these states and 23 more have been put in place to ascertain accountability on their part or face liability, if breached” (EU takes legal action against Germany, UK over VW scandal, 2016). The breached regulation in question is Article 5 (2) of EC No 75/2007. “The use of defeat devices that reduce the effectiveness of emission control systems shall be prohibited. The prohibition shall not apply where:

- a. the need for the device is justified in terms of protecting the engine against damage or accident and for safe operation of the vehicle;
- b. the device does not function beyond the requirements of engine starting; or
- c. the conditions are substantially included in the test procedures for verifying evaporative emissions and average tailpipe emissions.” (Regulation(EC), No 715/20017 of the European Parliament and of the Council, 2007).

Although Volkswagen admitted that it installed a software to cheat and surpass the omission standards in the US as well as Europe, its software did not meet the definition of a defeat device in Europe (Ewing & Boudette, 2017).

“Defeat device’ means any element of design which senses temperature, vehicle speed, engine speed (RPM), transmission gear, manifold vacuum or any other parameter for the purpose of activating, modulating, delaying or deactivating the operation of any part of the emission control system, that reduces the effectiveness of the emission control system under conditions which may reasonably be expected to be encountered in normal vehicle operation and use.”(Regulation (EC) No 715/20017 of the European Parliament and of the Council, 2007).

The corporation argued that unlike the meddling of the emission control system that would create a violation under European standards, its cheat device, that detected movement of pedals and steering wheels, affected only the engine (Ewing & Boudette, 2017). Volkswagen disputed that, although the nitrogen oxides (NOx) controls would switch on based on the engine detections, and thus produced low emission results when the car was not in driving mode, the subject of foul play was again the operation of the engine, not the emission control system. Hence, the emission control system simply displayed a result of the tampering of the engine, not the result of the emission control system itself. Under strict construction therefore, it did meet the EC’s definition of defeat device.

Based on this argument and that Volkswagen did not install a defeat device, the VW contested

that there is no way it could be in violation of Article 5 (2) of EC No 75/2007, which requires a defeat device. Furthermore, the corporation argued that it recalled the affected vehicles, which is within its rights, when a company desires to cure a defect. Volkswagen continued to argue that, because it fixed the emissions problem, which was impossible in the US due its stringent laws, then its European customers did not suffer any damages (Ewing & Boudette, 2017).

Reports from across the European Continent, however, depicted a different picture. In Czech Republic, four have filed law suits and 500 are expected to join (Blazek, 2017). In Ireland, the value of a nurse's Volkswagen diesel car has plummeted and she has demanded compensation (Ewing & Boudette, 2017). In Germany, a seafood supplier shipped shrimp and cod via a fleet of Volkswagen 'clean diesel' vehicles, with the belief that he was being environmentally friendly (Ewing & Boudette, 2017).

In England, lawyers filed the British version of a class –action suit (Ewing & Boudette, 2017). Unlike Britain, most European countries do not have a provision for class action law suits and the consumer protections laws are weaker than U.S. in those countries. However, the consumer protection authorities from the European Union agreed to unify and pressure Volkswagen to offer relief to car owners (Ewing & Boudette, 2017). The VW took the stand that through recalls it has already fixed the defects of its vehicles that were releasing impermissible amount of Nitrogen Oxide. The company has reasserted that it has no intentions to pay damages to the car owners. Given that there are no class action provisions, the two-thirds of car owners who have taken on the mega-corporation alone, have lost their cases (Ewing & Boudette, 2017). Although some of the cases are being appealed, there is no guarantee that those courts will overturn the lower courts' decisions (Ewing & Boudette, 2017).

For Volkswagen, it is critical to win these cases that are appearing in the thousands from owners in different jurisdictions on the Continent. Unlike in the U.S., where this \$300 billion revenue a year company can afford to settle for approximately \$25 billion, it cannot do so in Europe. Approximately, about 8.5 million cars are affected in Europe and the liability ruling from the court could cost the company at least \$300 billion, creating a potential destruction (Ewing & Boudette, 2017). Across the Continent, Volkswagen also faces an expanding criminal investigation (Ewing & Boudette, 2017).

Despite the glum outcome thus far, the European Commission's decision to begin infringement proceeding against five Member States is an enormous step and the States must also be commended for their efforts in reaching to penalize the wrong doer. However, the EC took such actions against the Member States laws and Volkswagen because the citizens of those Member States were injured or at risk of being injured. "20% of European city dwellers are exposed to

unhealthy levels of nitrogen dioxide. In London, where diesel road traffic is responsible for 40% of NOx emissions, air pollution causes more than 3,000 deaths a year.” (Ewing & Boudette, 2017). Therefore, the pertinent position taken by consumers and jurisdictions would be that a violation against one country is a violation against all countries, especially if the act was to intentionally commit a crime or any violation against business ethics laws that fall within CSR.

The seriousness of the EU’s effort, however, is being challenged, given the appearance of non-unity, especially with Britain’s vote to exit. Germany has also challenged the EU law as weak, and has asserted that its procedures are stricter and have been in effect (EU takes legal action against Germany, UK over VW scandal, 2016). Accusations have stemmed from member states against others, regarding VW, creating upheaval.

DISCUSSIONS AND RECOMMENDATIONS

All the adverse publicity, criminal indictments, lawsuits and settlements, do not seem to be effective and/or substantial enough to deter the companies, that yearn for maximizing the profit, from infringing on the legal as well as the public safety and social responsibility. Despite grave human suffering, the piercing of the corporate veil to hold individuals liable is simply not enough.

Jurisdictions must send a message to businesses globally, that crimes intentionally committed by companies against one country will not be tolerated given that citizens of any jurisdictions do not have to be in its home geographic realm to be affected. A corporation’s purpose can never be met if breaches the trust of the public and stakeholders.

The rules, policies, and boundaries are created for protection. If the boundaries are not respected, then chaos is created. If there is a global impact to be felt on the part of the wrong doer, then defiance of business ethics laws simply will not remain the new normal.

To avoid another Volkswagen debacle:

- Consumers globally should take the stand that their lives are worth more. They can take the collective stand by taking actions such as boycotting all their products, forcing the violators to pay penalties and compensations and to rectify the problems.
- If the wrongful act was done in one country, there is no logical reason why the attempt would not be made in another. They may simply move its product from one continent to another, as he did when it moved its product to China, Asia.

- Universal international law and global jurisdictions needs to be established to help the implementation of the laws and criminal indictment of the violators.
- There seems to be more cases of corporate malfeasance in recent years and the common denominator among all is the quest for maximizing the profit. With each passing year the limits are tested, creating grandeur damage and more devastating financial losses and in, some cases, fatalities.
- Corporate Social Responsibility was put in place to protect not only the public, but also the corporation, especially from itself. There is always the temptation of testing the limits and the illusion that it will never happen to a corporation.
- “Today’s criminal charges of the Takata Corporation and three of its employees should be a reminder to other corporations and their employees that if they commit fraud, the FBI and its law enforcement partners will ensure they are held accountable for their actions, said Special Agent in Charge Gelios. Whether it is the manipulation of test results which impact customer safety, defective product development or any other type of fraud, we will continue to aggressively investigate corporate fraud allegations to protect consumers in the United States and elsewhere.” (Ewing & Boudette, 2017).
- Although this is a sincere attempt of reassuring the public, the human’s nature for maximizing the wealth has valued the risk of the potential liability to be worthwhile.
- Until the consequence of defying business ethics is greater than the benefit of the greed, noncompliance with such laws, may be treated as ordinary rather than abnormal.

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