Volkswagen Making Good Progress With Its Investigation, Technical Solutions, And Group Realignment

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The Volkswagen Group's realignment is well underway. The Group is making progress on all five of the priorities it set at the end of October: The technical solutions for customers in Europe have been devised, presented to the authorities, and positively evaluated by them. These solutions will begin to be implemented in January 2016. The emissions investigation is producing results, and initial consequences have already been drawn based on the findings to date. The implementation of the new structure is proceeding according to plan, and the process of developing a new strategy has commenced. The Chairman of the Supervisory Board of Volkswagen AG, Hans Dieter Pötsch, told the press in Wolfsburg today: "The Volkswagen Group is fully functional in every respect, even during these eventful days. How, and when we meet the current challenges is primarily – although not solely – up to us. In order to pass this test, we must make an enormous, common effort – and we are all ready to do so." The Chairman of the Board of Management, Matthias Müller, said: "We are doing everything to overcome the current situation, but we will not allow the crisis to paralyze us. On the contrary, we will use it as a catalyst to make the changes Volkswagen needs."

For the first time, the Company provided detailed commentary on the status of its investigation, which is being coordinated by a special committee of the Supervisory Board. Approximately 450 internal and external experts are involved in the investigations, which are being conducted in two phases. An internal review, being conducted by a task force of experts from various Group companies with a clearly defined mandate and a deadline, is focused on the mandate to Group Audit by the Supervisory Board and the Management Board to investigate relevant processes, reporting and monitoring systems, and the associated infrastructure. Group Audit will provide its findings to the external experts of Jones Day. The Supervisory Board has given this internationally respected law firm a parallel mandate to completely clarify the facts and responsibilities – i.e., among other things, it has been asked to conduct a forensic investigation. In connection with its work, Jones Day is being provided with operational support by the audit firm Deloitte.

Group Audit has identified process weak points

As reported on Wednesday, extensive internal investigations, which were subject to external independent review, did not confirm the suspicion of irregularities during the CO2 certification process. Now, the first significant findings in the investigation of the nitrogen oxide (NOx) issue are available. Group Audit's examination of the relevant processes indicates that the software-influenced NOx emissions behavior was due to the interaction of three factors:

- The misconduct and shortcomings of individual employees
- Weaknesses in some processes
- A mindset in some areas of the Company that tolerated breaches of rules.

It is clear that, in the past, deficiencies in processes have favored misconduct on the part of individuals. This is true, for example, for test and certification processes affecting our engine control devices, which were not suited to preventing use of the software in question. Group Audit has suggested specific remedies to correct this. We are concentrating on structuring these processes more transparently and systematically. For example, in the future, software for engine control devices will be developed more strictly in accordance with the 4-eyes principle. In addition, the bodies responsible for the release of such software are being reorganized. They will be given more sharply defined and binding powers and responsibilities. Deficiencies were also found in reporting and monitoring systems. The main problem there was that responsibilities were not sufficiently clear.Volkswagen will now further sharpen them. Group Audit also found deficiencies in some areas of Volkswagen's IT infrastructure. These deficiencies will also be remedied. Volkswagen will introduce IT systems that allow individual processes to be monitored with greater efficiency and transparency. This will simultaneously reduce our dependence on individuals when problematic processes have to be identified and, if necessary, escalated. As Pötsch stated: "Group Audit's investigation is producing valuable findings, which will help us create a structure that, rather than favoring breaches of regulations, will prevent them, or at least allow them to be detected early on."

The Company has already drawn a key conclusion based on Group Audit's findings, namely that its testing practice must undergo comprehensive changes.

Volkswagen has decided that in the future emissions test will be evaluated externally and independently. In addition, randomly selected real-life tests to assess emissions behavior on the road will be introduced. Chairman of the Supervisory Board Pötsch stated: “We hope that this will help Volkswagen regain lost trust.”

More time is required for the external investigation

Although Group Audit's analysis of the processes will be concluded shortly, Jones Day will need well into next year in order to finish its work. The external investigators will need more time for their investigation, for two reasons. The first is that they have a massive volume of data to screen. At present, 102 terabytes of information have been secured, which is the equivalent of the information contained in approximately 50 million books. More than 1,500 electronic data storage units have been collected from approximately 380 employees. The second reason is that their investigation of the facts takes legal responsibility into account. Therefore, their findings must not only be plausible and consistent, but must also hold up in court. Volkswagen plans to provide a status update on the external investigation at its Annual General Meeting on April 21, 2016.

The information that has been screened to date has largely explained the origin and development of the nitrogen oxide issue. It proves not to have been a one-time error, but rather a chain oferrors that were allowed to happen. The starting point was a strategic decision to launch a large-scale promotion of diesel vehicles in the United States in 2005. Initially, it proved impossible to have the EA 189 engine meet by legal means the stricter nitrogen oxide requirements in the United States within the required timeframe and budget. This led to the incorporation of software that adjusted nitrogen oxide emission levels according to whether vehicles were on the road or being tested. Later, when an effective technical process was available to reduce NOx emissions, it was not employed to the full extent possible. On the contrary, the software in question allowed the exhaust gas treatment additive “AdBlue” to be injected in variable amounts such that the NOx values were particularly low when vehicles were in the test bay, but significantly higher when vehicles were on the road.

Hans Dieter Pötsch stressed that, “No business transaction justifies overstepping legal and ethical bounds.” As a first step, nine managers who may have been involved in the manipulations were suspended. Pötsch emphasized: “I here and now guarantee that we will pursue our thorough investigation to its conclusion. I vouch for this personally, as does the entire Supervisory Board of Volkswagen AG.”

Technical solutions, which have been positively evaluated by the German Federal Motor Transport Authority (“Kraftfahrtbundesamt”), are now available for the European variants of the EA 189 engine type affected. Volkswagen is thus ensuring that the models affected in Europe will meet all legal requirements in the future. The costs of implementing these solutions will be manageable intechnical, manufacturing, and financial terms. The software of the 2.0 and 1.2 liter TDI will be updated. For the 1.6 liter TDI, a so-called flow transformer will be used that increases the measurement precision and, in combination with redesigned software, will optimize injection quantity.

Now that the technical solutions have been approved, Volkswagen is working intensely on plans to implement them. The recall of the highest-volume variant, the 2.0 liter TDI, will begin in January 2016. The recall of the 1.2 liter TDI is currently scheduled to begin in the second quarter. The implementation phase for the 1.6 liter models is planned to begin in the third quarter to allow time to prepare for the hardware modification. Under the current plan, the entire initiative will take at least all of calendar year 2016. Matthias Müller, Chairman of the Boardof Management, promised: "Volkswagen will not rest until this matter has been resolved once and for all to our customers' satisfaction.” Volkswagen will inform the owners of the affected vehicles individually as to when their vehicles will be updated. Volkswagen guarantees that the solutions will be implemented free of charge. The company waives any statute of limitations for the technical solutions, and will provide an appropriate replacement vehicle if required.

Due to far stricter nitrogen oxide limits in the United States, it is a greater technical challenge to retrofit the vehicles such that all applicable emissions limits can be met with one and the same emissions strategy. To this end, Volkswagen is cooperating closely with the United States Environmental Protection Agency (EPA) and the California Air Resources Board (CARB). The solution designed for North America will be presented as soon as it has been approved by the responsible authorities.

Implementation of the new Group structure commenced

Parallel to overcoming the crisis, Volkswagen is also instituting a comprehensive new alignment that affects the structure of the Group, aswell as its way of thinking and its strategic goals.

Volkswagen will be managed in a more decentralized fashion in the future, and its brands and regions

will be granted more independence. The Group's Board of Management is fully focused on its core task: advancing the major, global issues for the future, as well as synergies, controls, and strategy. Volkswagen will have significant input to the technical changes that have a major impact on its own business model, becoming more agile, and streamlining its decision-making processes. In addition, Volkswagen will become leaner and improve cost efficiency. All these structural changes ultimately aim to reduce managerial complexity and ensure that the Group can be effectively led over the long term.

At an organizational level, with the appointment of Dr. Christine Hohmann-Dennhardt, the Integrity & Law area will be represented as its own department on the Group's Board of Management in the future – a clear indication that these issues are extremely important to Volkswagen. Significantly more importance will be attached to digitalization, which will report directly to the Chairman of the Board of Management. Overall, direct reports will be reduced from more than 30 to 19.

The renewal of personnel in the Group has recently again been given new impetus. Since the beginning of 2015, the Group's Board of Management has seen six new members join, seven of the brands have had their top personnel changed, and eight departments falling within the CEO's area of responsibility now have new heads. Müller stated: "The team with which we wish to address the challenges of the coming months and years is in place." The details of the new structure are to be worked out in the first quarter of 2016. The new structure will be in place Group-wide by the start of 2017.

New mindset initiated

Müller noted: “We can have the best people, and a great organization, but we can do nothing without the right attitude and mentality.” During the upcoming process of change toward a new way of thinking, Volkswagen can build onits traditional strengths: quality consciousness, strong identification with its vehicles, and a high degree ofsocial responsibility. According to Müller, the future will be about more open discussions, closer cooperation, and a willingness to allow mistakes if they are understood as an opportunity to learn. The Chairman of the Board of Management stated, “We don't need yes-men, but managers and engineers who make good arguments in support of their convictions and projects, who think and act like entrepreneurs. I am calling for people who are curious, independent, and pioneering. People who follow their instincts and are not merely guided by the possible consequences of impending failure. In short: the future at Volkswagen belongs to the bold. We need a little more Silicon Valley, coupled with the competence from Wolfsburg, Ingolstadt, Stuttgart, and the other Group locations.”

New strategic destination under development

In addition, Volkswagen has initiated development of a new strategic target: “Strategy 2025”, with which Volkswagen will address the main issues for the future, is scheduled to be presented in mid 2016.

Müller explained, “We are realigning Volkswagen strategically and technologically. Our goal is to courageously and decisively participate inshaping the future of mobility.” Among other things, the Group aims to achieve a significant expansion of its sales outside of its current core business. Furthermore, a digitalization and an electrification offensive are being prepared.

In parallel, Volkswagen is currently doing everything it can to limit the effect the current situation has on its business performance. The operating business is meeting expectations, and the 2015 annual forecast, which was updated at the end of October, remains unchanged. The sales figures are very mixed as regards the various markets and brands. Müller explained, “Overall, the situation is not dramatic, but, as was to be expected, it's tense.”

In summary, the Chairman of the Board of Management stated: “Although the current situation is serious, this company will not be broken by it. We have a clear mission: we will create a new, better, and stronger Volkswagen. A company that uses its strengths to make the transition to the new world of automobiles. A company that now releases new forces, and takes better advantage of its huge potential. And, last but not least, a company that will be successful over the long term on the basis of strong values.”

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