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PERSPECTIVE

Criminal VW case may get messy

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The scope of the Volkswagen "defeat device" scandal is shocking. Volkswagen has admitted to installing software in its diesel cars that disables emission control devices under normal driving conditions while allowing the control devices to function normally during emissions testing. Volkswagen installed these defeat devices on 11 million cars worldwide — with approximately 500,000 on cars driven in the United States.

The U.S. EPA has issued a notice of violation to Volkswagen alleging violations of the mobile source emission standards in Title II of the Clean Air Act. Civil penalties for the alleged violations will likely far exceed the $100 million assessed on Hyundai Motor Co. and Kia Motors Corp. in 2014, the largest Clean Air Act civil penalty to date. Volkswagen is also facing a raft of civil claims from consumers who purchased cars with the company's "clean diesel" engines, as they were characterized in Volkswagen's North American marketing campaign, but have now found out that the engines are anything but clean. Volkswagen is also responding to the first of what will likely be many civil cases filed by state attorneys general, filed in West Virginia.

And Volkswagen's U.S. legal troubles — not to mention its other legal issues in jurisdictions around the world — are unlikely to stop there. The company installed a device in millions of cars with the specific intent of circumventing air emissions control regulations. This is precisely the type of intentionally fraudulent conduct that criminal laws are designed to deter and to punish. Indeed, Volkswagen's conduct compares unfavorably to BP's actions in the Deepwater Horizon oil spill or Exxon's conduct in the grounding of the Exxon Valdez, where the impact on the environment was massive but the companies' actions were at worst grossly negligent or reckless.

This is all somewhat messy, as the Clean Air Act appears to permit the prosecution of automakers for making materially false statements while denying the EPA the authority to refer these violations to the DOJ for prosecution.

Given these facts, Volkswagen should expect criminal charges, right? A recent Wall Street Journal article cited a "loophole" in the Clean Air Act that excludes violations of the Title II mobile source provisions from the statute's criminal penalty provisions. This exclusion is found in several provisions of the Clean Air Act, including the general enforcement provisions in Section 113(a)(3), which authorizes the EPA to refer violations of other parts of the statute to the Department of Justice for criminal prosecution. Title II violations are also expressly exempted from the general criminal penalties provisions in Section 113(c)(1). At the same time, the statute authorizes criminal penalties for making materially false statements or omissions in connection with documentation of Clean Air compliance (see Section 113(c)(2)) and does not exclude mobile source violations from this provision.

This is all somewhat messy, as the Clean Air Act appears to permit the prosecution of automakers for making materially false statements while denying the EPA the authority to refer these violations to the DOJ for prosecution. Given this apparent procedural hurdle, which is significant because only DOJ may file criminal charges, federal prosecutors have been reluctant in the past to charge mobile source violations criminally. For example, when addressing similar allegations of the use of defeat devices by manufacturers of large diesel engines in 1998, the EPA and the DOJ resolved the case civilly, assessing penalties totaling $83.4 million and requiring the manufacturers to spend $1 billion to bring their engines into compliance with emission standards.

It is possible the EPA and the DOJ could take a similarly cautious approach in the Volkswagen investigation, but the fact that passenger cars (a consumer product) are involved may lead federal prosecutors to explore more aggressive options. This could include charging Volkswagen for making a false statement under Section 113(c)(2) of the Clean Air Act, notwithstanding the apparent limitation on the EPA's authority to refer Volkswagen for criminal prosecution.

Or, federal prosecutors could look beyond the Clean Air Act to file criminal charges against Volkswagen. For example, wire fraud (18 U.S.C. Section 1343) is an extraordinarily broad crime that can apply to any scheme to defraud using interstate wire communications in furtherance of the scheme. And, under the U.S. attorney general's new directive to focus its white collar prosecutions on individuals rather than companies, Volkswagen's executives may be the targets of such a prosecution. (See "DOJ shifts focus to individual misconduct," Daily Journal, Sept. 15).

The government's ability to prove that senior executives at Volkswagen had the requisite intent to defraud depends on the evidence showing their personal involvement in the design and installation of the defeat devices. Thus far, the investigation appears to be focused on Wolfgang Hatz, head of research and development at Porsche, and Ulrich Hackenberg, Audi's chief engineer. (Both the Audi and Porsche brands are owned by Volkswagen.) Hatz served as a member of Porsche's managing board and was head of engines and transmissions development for the Volkswagen Group. Hackenberg sat on the managing board at Audi. Both men were forced to resign in September.

To the extent these or other senior executives at Volkswagen knew that the defeat devices were being installed in millions of vehicles around the world, a wire fraud claim against them or Volkswagen could be an attractive option for federal prosecutors. That said, claims against Hatz and Hackenberg as individuals could be complicated by their German domicile and the difficulty of establishing jurisdiction in a United States court.

Procedural complications notwithstanding, this is an enticing criminal case for the government. It has all the ingredients that prosecutors look for — intentional conduct, evasion, actual harm to human health and the environment, and public appeal. Those factors may be enough for the government to take on the procedural challenges a prosecution would face, whether it be against the company or high-ranking individuals.

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