

Diesel Issue

In agreement with the respective responsible authorities, the Volkswagen Group is making technical measures available worldwide for virtually all diesel vehicles with type EA 189 engines.

The regulatory offense proceedings of the public prosecutor's office in Braunschweig against Volkswagen AG, which began in April 2016, and that of the Munich II public prosecutor's office against AUDI AG have both been concluded with orders imposing administrative fines.

Special items totaling €–3.2 billion had to be accounted for in fiscal year 2018.

IRREGULARITIES CONCERNING NO_x EMISSIONS

On September 18, 2015, the US Environmental Protection Agency (EPA) publicly announced in a "Notice of Violation" that irregularities in relation to nitrogen oxide (NO_x) emissions had been discovered in emissions tests on certain vehicles of Volkswagen Group with type 2.0 l diesel engines in the USA. In this context, Volkswagen AG announced that noticeable discrepancies between the figures achieved in testing and in actual road use had been identified in around eleven million vehicles worldwide with type EA 189 diesel engines. On November 2, 2015, the EPA issued a "Notice of Violation" alleging that irregularities had also been discovered in the software installed in US vehicles with type V6 3.0 l diesel engines.

Numerous court and governmental proceedings were subsequently initiated in the USA and the rest of the world. We have since succeeded in making substantial progress and ending a great number of these proceedings. Detailed information on the pending court and governmental proceedings can be found in the Report on Risks and Opportunities, starting on page 177.

EXTENSIVE INVESTIGATIONS INITIATED BY THE VOLKSWAGEN GROUP

After the first "Notice of Violation" was issued, Volkswagen AG immediately initiated its own internal as well as external investigations; both have since been concluded for the most part.

The Supervisory Board of Volkswagen AG formed a special committee that coordinates this board's activities relating to the diesel issue on its behalf.

Furthermore, in September 2015 Volkswagen AG and AUDI AG filed a criminal complaint in Germany against unknown persons. Volkswagen AG and AUDI AG are cooperating with all relevant authorities.

The regulatory offense proceedings of the public prosecutor's office in Braunschweig against Volkswagen AG, which began in April 2016, and the regulatory offense proceedings of the Munich II public prosecutor's office against AUDI AG have both been concluded with administrative fine orders.

Work in respect of the legal proceedings that are still pending in the USA and the rest of the world is ongoing, still requires considerable efforts, and will continue for some time. Volkswagen AG is being advised by a number of external law firms in this connection.

The diesel issue is rooted in a modification of parts of the software of the relevant engine's control units – which, according to Volkswagen AG's legal position, is only unlawful under US law – for the type EA 189 diesel engines that Volkswagen AG was developing at that time. The decision to develop and install this software function was taken in late 2006 below Board of Management level. None of the members of the Board of Management had, at that time and for many years to follow, knowledge of the development and implementation of this software function.

In the months following publication of a study by the International Council on Clean Transportation in May 2014, Volkswagen AG's Powertrain Development department checked the test set-ups on which the study was based for plausibility, confirming the unusually high NO_x emissions from certain US vehicles with type EA 189 2.0 l diesel engines. The California Air Resources Board (CARB) – a part of the environmental regulatory authority of California – was informed of this result, and, at the same time, an offer was made to recalibrate the engine control unit software of type

EA 189 diesel engines in the USA as part of a service measure that was already planned in the USA. This measure was evaluated and adopted by the Ausschuss für Produktsicherheit (APS – Product Safety Committee), which initiates necessary and appropriate measures to ensure the safety and conformity of Volkswagen AG's products that are placed in the market. There are no findings that an unlawful "defeat device" under US law was disclosed to the APS as the cause of the discrepancies or to the persons responsible for preparing the 2014 annual and consolidated financial statements. Instead, at the time the 2014 annual and consolidated financial statements were being prepared, the persons responsible for preparing the 2014 annual and consolidated financial statements remained under the impression that the issue could be solved with comparatively little effort as part of a service measure.

In the course of the summer of 2015, however, it became successively apparent to individual members of Volkswagen AG's Board of Management that the cause of the discrepancies in the USA was a modification of parts of the software of the engine control unit, which was later identified as an unlawful "defeat device" as defined by US law. This culminated in the disclosure of a "defeat device" to EPA and CARB on September 3, 2015. According to the assessment at that time of the responsible persons dealing with the matter, the scope of the costs expected by the Volkswagen Group (recall costs, retrofitting costs and financial penalties) was not fundamentally dissimilar to that of previous cases involving other vehicle manufacturers, and, therefore, appeared to be controllable overall with a view to the business activities of the Volkswagen Group. This assessment by the Volkswagen Group was based, among other things, on the advice of a law firm engaged in the USA for approval issues, according to which similar cases in the past were resolved amicably with the US authorities. The publication of the "Notice of Violation" by the EPA on September 18, 2015, which, especially at that time, came unexpectedly to the Board of Management, then presented the situation in an entirely different light.

Extensive inquiries were also conducted at AUDI AG in relation to the potential use of unlawful "defeat devices" under US law in the type V6 3.0 l diesel engines and concluded for the most part.

The AUDI AG Board of Management members in office back at the relevant time have stated that they had no knowledge of the use of unlawful "defeat device" software under US law in the type V6 3.0 l TDI engines until they were informed by the EPA in November 2015.

Within the Volkswagen Group, Volkswagen AG has development responsibility for the four-cylinder diesel engines such as the type EA 189, and AUDI AG has development responsibility for the six- and eight-cylinder diesel engines such as the type V6 3.0 l and V8 diesel engines.

AFFECTED VEHICLES IN THE EU/REST OF WORLD

With the exception of the USA and Canada, around ten million vehicles with type EA 189 diesel engines were affected worldwide.

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AUDI AG has worked intensively for many months to check all relevant diesel concepts for possible discrepancies and retrofit potentials. The measures proposed by AUDI AG have been adopted and mandated in various recall notices issued by the Kraftfahrt-Bundesamt (KBA – German Federal Motor Transport Authority) for vehicle models with V6 and V8 TDI engines.

AFFECTED VEHICLES IN THE USA/CANADA

In the USA and Canada three generations of certain vehicles with 2.0 l TDI engines and two generations of certain vehicles with the type V6 3.0 l TDI engines are affected, which come to a total of approximately 700 thousand vehicles. Due to NO_x limits that are considerably stricter than in the EU and the rest of the world, it is a greater technical challenge here to retrofit the vehicles so that the emission standards defined in the settlement agreements for these vehicles can be achieved.

In the USA, in fiscal year 2018, the EPA and CARB issued the outstanding official approvals needed for the technical solutions for the affected vehicles with 2.0 l TDI and with V6 3.0 l TDI engines. In the case of 2.0 l Generation 2 diesel vehicles with manual transmissions, Volkswagen Group of America, Inc. elected to withdraw the approved emissions modification proposal, whereby owners were given the option of a buyback and lessees were given the option of early lease termination.

LEGAL RISKS

Various legal risks are associated with the diesel issue. The provisions recognized for the diesel issue and the contingent liabilities disclosed as well as the other latent legal risks are in part subject to substantial estimation risks given that the fact finding efforts have not yet been concluded, the complexity of the individual relevant factors and the ongoing coordination with the authorities. Should these legal or estimation risks materialize, this could result in further considerable financial charges.

There are no conclusive findings or assessments of facts available to the Board of Management of Volkswagen AG that would suggest that a different assessment of the associated risks (e.g. investor lawsuits) should have been made. A detailed description of these and other risks arising from the diesel

issue can be found in the Report on Risks and Opportunities starting on page 177.

OPERATING RESULT

Special items recognized in operating profit relating to the diesel issue amounted to €-3.2 (-3.2) billion in fiscal year 2018 and were mainly attributable to the legally final administrative fine orders imposed by the public prosecutor's office in Braunschweig against Volkswagen AG (€1.0 billion) and by the Munich II public prosecutor's office against AUDI AG (€0.8 billion), higher legal risks and legal defense costs, as well as higher expenses for technical measures.

The diesel issue led to total special items of €-29.0 billion in the years 2015 to 2018.