
Top Legal Issues Facing the Automotive Industry in 2021



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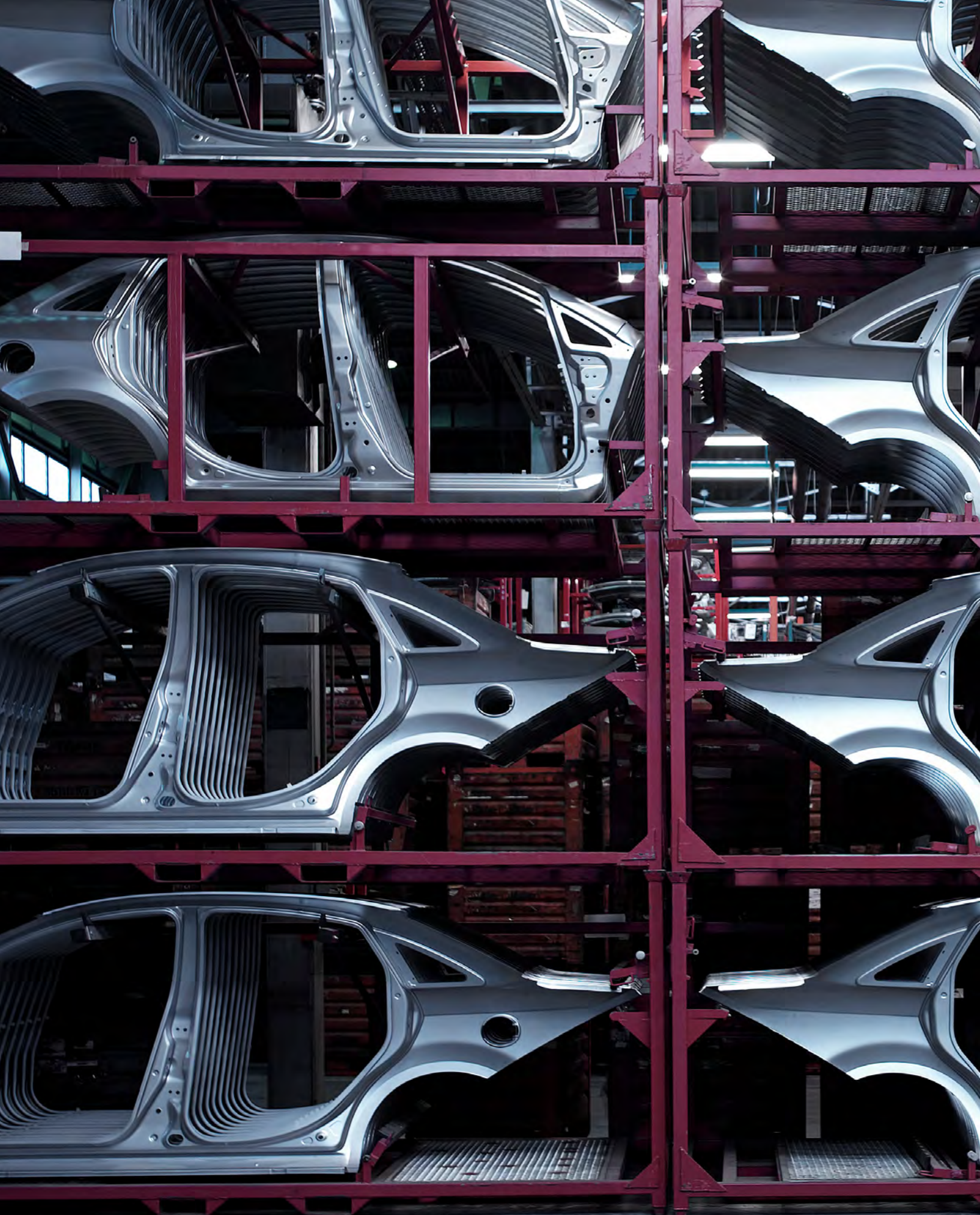


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Impacts of COVID-19 on Automotive Suppliers

One year ago, Foley launched its [Coronavirus Resource Center](#), created by its multidisciplinary and multijurisdictional team to respond to COVID-19 in order to help clients meet the legal and business challenges that the coronavirus outbreak had created for stakeholders across a range of industries. Given that the original epicenter of the coronavirus was the important worldwide manufacturing hub of Wuhan, China, the automotive industry was swiftly and seriously impacted in ways that continue one year later. The global spread of COVID-19 has impacted the global economy and supply chains in ways not seen since the SARS outbreak in 2003.

The impact was acutely felt by automotive manufacturers, who build vehicles on a JIT (just in time) basis and depend upon a timely and uninterrupted supply of materials and components. In the case of manufacturing, it just takes one missing part to shut down a production line, and the damaging ripple effect of a material or parts shortage quickly spreads throughout the supply chain. Looking back, one year later, this article identifies five of the top impacts of COVID-19 on the automotive industry.

Raw Material Shortages

As we have covered previously, earlier declines in demand for most raw materials during the early months of the coronavirus pandemic caused many suppliers to reduce capacity. This is now resulting in higher prices and more limited supply of many raw materials, such as steel and, more recently, microchips. Many automotive suppliers and other manufacturers face complications in procuring enough raw material, including the prospect of paying higher prices, to meet customer demand. A new whitepaper from IHS Markit predicts the global microchip shortage could cut 672,000 light vehicles from production industrywide in the first quarter of 2021. Lead times for all categories of chips are currently longer by one to two months, with certain high-demand, specialized



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chips requiring up to 26-38 weeks, according to IHS. Indeed, reported North American production shutdowns caused by the ongoing microchip shortage have impacted multiple carmakers.

In addition to these commercial considerations, companies also must consider the impact of Section 2-615 of the Uniform Commercial Code (UCC), which defines the doctrine of “commercial impracticability” and sets forth obligations concerning allocation of limited supply. The defense of commercial impracticability is available to a supplier of goods that is unable to make delivery as required by contract, either in whole or in part in certain circumstances. Specifically, the supplier must show that delivery of all goods required under a contract has been rendered commercially impracticable “by the occurrence of a contingency or the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation.”

Courts generally apply a three-prong test to determine whether the definition of commercial impracticability under UCC 2-615 is available to a nonperforming seller: (1) the seller must not have assumed the risk of some unknown contingency; (2) the nonoccurrence of the contingency must have been a basic assumption underlying the contract; and (3) the occurrence of that contingency must have made performance commercially impracticable. For more information on this impact, click [here](#).

Force Majeure Claims

It is quite common in supply chain contracts for the buyer and seller to have competing interests in negotiating key contractual provisions and protections. Before COVID-19, force majeure provisions were often just an afterthought in contract negotiations, with very little difference regardless of whether the manufacturing company was on the buy- or sell-side of the contract and without regard to the specifics in the supply relationship. Instead, manufacturers would copy the same, tired force majeure language across all of their contracts, which typically would be found buried at the bottom of the contract, in the “Miscellaneous” section.

In the current COVID-19 climate and, given the lessons learned as force majeure disputes continue to ricochet through supply chains across nearly every industry, force majeure provisions and related risks have a renewed focus. Going forward, manufacturing companies and their counsel will focus on mapping their supply chains and the related risks. Risks will vary, depending upon the volumes, timing of the program, the geographic location of the plant, suppliers and even sub-suppliers, whether the products are ordered on a JIT basis, whether the parts are sole-sourced or there are alternate suppliers available, and whether safety stock or inventory banks are accessible. Manufacturing companies will then use future contract negotiations and form commercial documents to allocate the various risks accordingly.

As with all divergent interests in supply chain contracts, the competing positions of the buyer and seller should be addressed during contract negotiations. For example, the party that agrees to bear risk if there is a force majeure event may leverage this risk against pricing or termination rights.

In addition to the language of the force majeure provision, there are other contract provisions that manufacturers should strengthen and best practices to implement as a result of lessons learned from COVID-19. When the pandemic began and various executive orders required manufacturers to shutter, there were a flurry of issues that impacted manufacturers. Force majeure notices were sent, but parts already were in transit—who pays for the costs to return those parts when there was no one on-site to receive them? There were situations where a plant in one location had to be closed, but other manufacturing facilities had capacity—who pays for the costs to tool up and ramp up at an alternate location or for employee overtime? Throughout the pandemic and the reopening phase, there have been additional costs incurred in manufacturing lines, including employee overtime and freight expedites—who pays? These are just some examples of the types of responsibilities and risks that can be allocated in supply contracts going forward. For more information on this impact, click [here](#).

New Challenges Related to Warranty Claims

While nearly every facet of the economy has been affected by COVID-19, the automotive industry remains one of the sectors most affected. The industry continues to face the double impact of declining sales and increasing costs, which has resulted in financial pain for both OEMs and suppliers. As so often is the case, many automotive OEMs are seeking to offset their own declining performance on the backs of their suppliers. One tactic commonly employed by OEMs is to take a more aggressive approach in pursuing suppliers for historical, or otherwise questionable, warranty claims. Going forward, it also remains to be seen whether the scramble by OEMs and suppliers to maintain



production in the face of supply chain disruptions, labor shortages, and new safety measures may result in a rise in additional warranty issues in the coming months and years.

Managing warranty claims, including both defending such claims and pursuing recovery from responsible sub-suppliers, has always been a critical task for automotive suppliers. This perhaps has never been truer than it is today. While many of the most critical issues involved in navigating a warranty claim remain unchanged, the impact of COVID-19 presents additional unique challenges and (in some cases) opportunities.

While litigation with a customer is not the preferred outcome in most disputes, suppliers should consider the impact of COVID-19 on the timing of any litigation. While courts in most jurisdictions are open and functioning, whether in person or via remote technology, many are still working through a backlog of cases and/or may not be operating at full capacity. This can add up to further delays in what often is already a long and drawn out legal process if parties are required to litigate their claims.

If an automotive OEM's primary motivation for asserting a warranty claim appears to be based on an effort to improve financial performance, suppliers should take note of this fact. If the customer's primary motivation is to "get cash in the door," this can have a significant impact on negotiations. For example, the OEM may be less willing to consider accepting payment through future price reductions. On the other hand, the OEM may be more open to taking a deeper discount on the claim if paid quickly.

While always a concern, particularly in the case of older warranty claims, the impact of COVID-19 may exacerbate issues relating to the availability of witnesses and information. Any staff reductions by the supplier may result in critical witnesses no longer being available to the company or, even worse, becoming hostile to the company. Employees still with the company, but working remotely, may have more limited access to files and may be limited in their ability to conduct additional testing. For more information on this impact, click [here](#).

Delay of Autonomous Technologies

In the months and years leading up to the COVID-19 pandemic, media outlets around the world projected the end of personal car ownership and the waning days of pizza delivery drivers. In the not-so-distant future, personal vehicles would be replaced by a fleet of self-driving cars, hailed by phone or virtual assistant. The consumer could sit in the back seat, working, sleeping, or otherwise entertaining him or herself while the car drives down the freeway at breakneck speeds. Similarly, our goods and takeout would maneuver the city in autonomous delivery trucks with drones dropping off packages and dinner at our front door without a single human interaction. That future is still possible, but the timeline appears to continuously get longer and more uncertain as the AV technology space faces development roadblocks and a black swan event no one could have reasonably predicted. The COVID-19 pandemic has not helped make the industry's futuristic ambitions any more tangible, but those dedicated to their development continue to push ahead in spite of the challenges and uncertainty facing today's marketplace.





Uncertain what the future would hold in the early months of the COVID-19 pandemic, companies around the globe slashed their research and development budgets, while outside funding opportunities and investors dried up, and the consumer's willingness to buy new products and take risks on cutting-edge technologies nearly evaporated. But, once the world began to settle into the temporary new normal of COVID-19, many industry players began to realize that the implications for autonomous technologies remain more important than ever before. While budgets and investment opportunities might not be back to where they were before the pandemic hit, development projects and new partnerships have started cropping up as companies look to leverage AV technologies in a world encompassed by social distancing, a wariness for ride-sharing and public transit, and the need for reliable and uninterrupted movement of goods. In fact, a recent study by the Consumer Technology Association noted that a quarter (26%) of consumers now view autonomous delivery technologies more favorably than before the COVID-19 crisis, although it did not note the reason for such a rise in favorable sentiment. That said, a recent [study](#) conducted by Boston Consulting Group estimated the broad commercialization of AV vehicles for consumers won't be realized until at least 2025-2026.

In our August 2020 post, [The Impact of COVID-19 on Adoption of Autonomous Vehicle Technology](#), we noted that, while the applications for consumer products might have hit some roadblocks due to COVID-19, AV technology has numerous applications beyond the purpose of consumers commuting and getting around town. From logistics to last mile delivery, the potential applications of AV technology are further-reaching than just shuttling soccer teams and families around their communities. For more information on this impact, click [here](#).

Resiliency Review

Finally, in the wake of COVID-19, many automotive suppliers are assessing their supply chain processes to determine areas to strengthen and ways to mitigate risk in the future.

The goal is to ensure a stable and resilient supply chain with key focuses on traceability and continuity of supply through diversification or other viable strategies. To assist companies in identifying significant risks and opportunities, which can be addressed through a phased approach and prioritized plan to implement changes, we have developed a customized, [online assessment tool](#). It describes risks and related considerations each company should review regarding supply chain process changes across five key categories:

- Just in Time (JIT) Production Model
- Single Source Production Scenarios
- Contractual Allocation of Risk/Force Majeure
- Shipping, Warehousing and Inventory Processes
- In-Housing Certain Operations and Services

Upon accessing the online assessment tool, you will have the opportunity to consider impacts specific to your company, including: Probability of Occurrence (PO) and Probability of Benefit from Change (POBFC), upon which the tool will calculate a Priority Value (PV). You will receive a priority level indicator of the importance for your company to address potential issues, and implement viable process change. Customized summary results can be emailed to you (and note that no data is stored). [Click here](#) for more on the framework to assess and update supply chain processes.

Recent Impacts to the Automotive Supply Chain and Change Drivers for 2021

The supply chain is the lifeblood of the automotive manufacturing industry. Disruptions to the supply chain caused by COVID-19 and component and material shortages, such as the semiconductor industry shortage, have put this into sharp focus. Given the recent impacts of the pandemic and shortages to companies' supply chains, we have seen a serious focus on supply chain strategy, which requires input and buy-in from supply chain managers, procurement and executives. There are a series of trends that we are seeing automotive manufacturers implement, which are discussed in greater detail below:

1. Procurement model that looks beyond the lowest cost supplier
2. Right-shoring considerations
3. Transparency in the supply chain
4. Enhanced cybersecurity

First, although pricing and cost always will be driving factors in sourcing decisions, automotive companies are beginning to lessen their focus on sole sourcing and Just-In-Time (JIT) delivery from the lowest cost supplier.¹ Many automotive companies are taking additional steps to ensure a more stable and resilient supply chain through strategic changes to their procurement model and/or contract changes. Where possible, many automotive companies are considering dual-sourcing, on-site and off-site warehousing options to ensure that they have a bank of parts available and taking steps to diversify their third-party logistics providers. On the commercial contracting side, as a result of tough lessons learned during the pandemic, automotive companies are reexamining the standard *force majeure* provisions in their contracts to ensure that they are properly tailored to: (i) encompass past

1 "The End of Just-In-Time," Reuters Events <https://www.reutersevents.com/supplychain/supply-chain/end-just-time>



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force majeure events and events that may cause disruptions in the future; (ii) focus on rights and obligations depending upon whether the company is a buyer or seller²; and (iii) allocate risk, including the series of costs that may not have been previously spelled out in the contract, like freight expedites, return costs, overtime, etc., that were necessarily incurred during the pandemic shutdowns and restart.

Second, for some components, automotive companies are considering options to move away from sourcing in China and analyzing the cost versus risk mitigation benefits from shifting their supply chains away from China to other countries. The term "right-shoring" refers to locating a business's manufacturing operations in localities and countries that provide the best combination of cost and efficiency.³ As started happening after the implementation of the tariffs and trade wars commencing in 2018, some automotive manufacturers were considering moving away from China as a major manufacturing hub and looking at other options. Alternatives include reshoring to the U.S., near-shoring to Mexico or Canada, or exploring options in parts of Southeast Asia (Vietnam and Thailand are key locations being

2 "Force Majeure Tug-Of-War: Competing Interests of Buyers and Sellers Negotiating Force Majeure Protections in Supply Chain Contracts," Vanessa Miller <https://www.foley.com/en/insights/publications/2020/07/force-majeure-competing-interests-buyers-sellers>

3 "Right-Shoring," Will Kenton, Investopedia <https://www.investopedia.com/terms/r/right-shoring.asp>



considered), India or Latin America (Brazil is a key location being considered).⁴ When weighing the pros and cons of locations, companies always will consider cost of materials, property prices, labor costs, labor regulations, IP protections and logistics. Notably, China continues to be the main manufacturing hub and sourcing location for certain key electronic components, which will continue to be sourced from China and will become increasingly important with the industry's movement to electrification.

Third, automotive companies are taking short- and long-term actions to create more visibility within their supply chains and increasing transparency throughout their supply chains in order to mitigate against future risks. Manufacturers that were able to successfully navigate the pandemic noted the importance of having transparency in all aspects of their supplier's supply chain, from material providers to facility locations to logistics. Companies that have not already done so are looking at options to digitize their supply chain in order to have real-time visibility into any potential or existing disruptive factors. Of course, this sort of transparency from raw material inputs to end-customer deliverables would require data from all sub-suppliers in a company's supply chain. Traditionally, certain aspects of an automotive supplier's supply base and

logistics have been considered to be proprietary and confidential information. However, we already are seeing pressure by OEMs to Tier 1 suppliers to provide more information regarding their sub-suppliers, sourcing locations and even pricing information. Although obtaining this level of detail into their suppliers' operations may be useful for navigating future issues and mitigating supply chain disruptions, we expect that automotive suppliers will resist providing certain pricing and cost details that would allow an OEM unwelcome insight into a supplier's pricing model or even present antitrust issues in the automotive industry.

Fourth, with growing technology in both the automotive supply chain and in smart vehicles, automotive companies need to plan to enhance their cybersecurity measures. Automotive manufacturers are rolling out detailed policies that incorporate industry best practices, including SAE guidelines.⁵

In short, there are a number of concerns and lessons learned that are driving changes in automotive companies' supply chain strategy and best practices. However, cost and pricing will continue to be the main considerations in any sourcing model.

4 See Patrick Van den Bossche et al., Trade War Spurs Sharp Reversal in 2019 Reshoring Index, Foreshadowing COVID-19 Test of Supply Chain Resilience, KEARNEY, https://www.kenarney.com/documents/20152/5708085/2020%20Reshoring%20Index.pdf/ba38cd1e-c2a8-08ed-5095-2e3e8c93e142?t=1586268199800&utm_medium=pr&utm_source=prnewswire&utm_campaign=2020ReshoringIndex

5 Society of Automotive Engineers. (2016). SAE Standard J 3061: Cybersecurity Guidebook for Cyber-Physical Vehicle Systems. (Web page). Warrendale, PA: Author. Available at <http://standards.sae.org/wip/j3061/>

Key Employment Issues Facing Employers in the Automotive Industry

Automotive companies faced unprecedented challenges in 2020. In the coming year, these challenges will continue as companies navigate the continuing COVID-19 pandemic, related leave/quarantine issues and new challenges brought on by vaccines. In addition, 2021 brings a new presidential administration, which will implement policies and priorities in direct contrast to the prior administration, including anticipated changes to the federal minimum wage, independent contractor analysis and NLRB focus and priorities. A theme of the year will be change and flexibility, as the pandemic will no doubt transform with the increased availability to vaccinations, and the Biden administration implements new regulations and laws.

1. Leave Issues

As the COVID-19 pandemic continues, automotive employers will continue to face challenges related to employee leave issues. In 2020, a myriad of federal, state and local laws were enacted that required leave in certain COVID-19-related scenarios, including a positive test result, exposure to an infected person, care for a family member, and school closures, among others. Key in the analysis of what leave may be required was the Families First Coronavirus Response Act (FFCRA), first enacted in the spring of 2020 and expired on December 31, 2020. The FFCRA was not renewed by Congress prior to its expiration. It should be noted that while employers are no longer required to provide leave under the FFCRA after December 31, 2020, if they chose to provide it, the Consolidated Appropriations Act, 2021, extended employer tax credits for FFCRA leave voluntarily to employees until March 31, 2021.

While President Biden has expressed support for its renewal, the FFCRA's leave requirements are no longer in effect. Despite the fact that federal leave requirements under the FFCRA have ended, employers still face a patchwork of state and local COVID-19-



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related regulations (some of which reference other standards like CDC guidance), sick leave laws and, of course, the usual FMLA and ADA leave issues. Looking forward, employers must continue to be vigilant in their knowledge of which leave requirements apply to their locations, as well as keeping up to date on any changes to those requirements. While vaccines are now beginning to be distributed, experts expect that it will be many months before employers likely see an easing of the COVID-19 pandemic. Until then, COVID-19 leave-related issues will continue, as will changes in state and local regulation of COVID-19-related restrictions.

2. Vaccine-Related Policies

As COVID-19 vaccines are increasingly available, automotive employers, like other employers, will soon face the question of what, if any, position to take with respect to vaccinations. Education will likely be a key component of any potential vaccine-related policy. In today's world, employees get their news from a variety of sources, including social media. As a result, misinformation regarding COVID-19 vaccines is an issue that employers will face if planning to implement a vaccine policy that either requires or encourages vaccines. An educational component will be key to the successful rollout of a vaccine-related policy.

Employers generally face the question of whether to mandate vaccines, encourage employees to get vaccinated or take no position. Each approach has

challenges. A vaccine mandate may face strong opposition from employees. Even setting aside the question of employee opposition to vaccination for nonmedical reasons, employers who choose to mandate vaccines will face issues related to ADA requests for accommodations for employees who are not able to be vaccinated due to a disability or medical condition. In addition, with availability of the vaccine in question in many geographic areas, a mandate may not be practical due to vaccine scarcity. Offering incentives for vaccination, along with educational programming, may be an alternative that does not face as much opposition while still having a positive effect on the percentage of vaccinated employees.

Any vaccine-related policy will also need to provide for continued health- and safety-related protocols. Some employees, especially those in a production environment, have been performing their work in person for months. However, others have remained working at home either on a full-time or part-time basis since the start of the pandemic. As employees who have been working remotely begin to return to the workplace, COVID-19-related safety protocols may need to be implemented for departments or teams that have not yet implemented such restrictions. A continued focus on safety will be paramount as the vaccine rollout continues.

3. Changes Related To The New Biden Administration

The new Biden administration is sure to set a new tone when it comes to employment-related issues. The pace of change will vary depending on the methods needed for implementation. On the horizon are likely changes to the federal minimum wage, change of control and priorities at the NLRB, and increased enforcement at OSHA, as well as changes to the newly finalized regulations regarding independent contractor classifications.

President Biden has expressed a desire to implement a \$15 minimum wage, which would more than double the current federal minimum wage of \$7.25. On January 22, 2021, he signed an executive order increasing the minimum wage for federal workers to \$15 per hour. The President has also proposed a \$15 minimum wage as part of his larger stimulus package. Even where employers pay more than the required minimum wage, a change may have a

cascading impact. An increase in the minimum wage may mean that employees who currently make close to that amount in a physically demanding job will have options to make the same amount for less work. As a result, in a competitive labor market, the increase in the minimum wage may have an impact beyond those currently making less than \$15 per hour.

Similarly, the Biden administration has signaled that it intends to implement a change to the rules regarding classification of independent contractors. It is widely expected that the Biden administration will stop a recently finalized rule regarding independent contractor classification from taking effect in March 2021. In its place, the Biden Plan for Strengthening Worker Organizing, Collective Bargaining and Unions specifically endorses California's "ABC" test. The California Labor and Workforce Development Agency describes the ABC test as follows:

Under the ABC test, a worker is considered an employee and not an independent contractor unless the hiring entity satisfies all three of the following conditions:

The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact;

The worker performs work that is outside the usual course of the hiring entity's business; and

The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

President Biden's plan states that the President will "work with Congress to establish a federal standard modeled on the ABC test for all labor, employment, and tax laws," eliminating the current - often confusing - structure in which various agencies use differing tests to determine whether a worker should be properly classified as an employee or an independent contractor.

The NLRB will also see changes with the change in control from a Republican to a Democratic administration. The five-member NLRB has three members from the President's party and two members from the opposing party. With President Biden's administration, the composition will change from three Republican board members to three Democratic board members. However, the replacement of the

Republican members will not be immediate. The first of three Republican members' terms does not expire until August 2021. It is anticipated that the President will appoint a replacement quickly. Once control of the NLRB is more heavily slanted toward Democrats, employers can expect an NLRB that more closely resembles the board under the Obama administration. Board priorities will likely include reinstatement of "quickie" elections and broad "joint employer" and independent contractor rules, as well as a more aggressive view of employee handbooks and policies, among other changes.

Similar to the NLRB's soon-to-be aggressive stance, OSHA has also taken a more aggressive approach to COVID-19-related issues. This increase in enforcement has already started and is likely to continue under the Biden administration. OSHA has adopted an emergency temporary standard on workplace safety during the pandemic. It has implemented more aggressive investigations and penalties for employers who do not follow COVID-19-related protocols.

In the longer term, under a Biden administration, employers can expect an increase in the number of OSHA investigations, which have been on the decline in recent years. Employers in the automotive industry should continue to closely adhere to COVID-19 workplace safety requirements and be mindful that the agency will likely increase the frequency and intensity of its investigations and enforcement in the coming year.

Summary

Automotive employers will continue to face challenges and uncertainty in 2021 brought on by the continuing COVID-19 pandemic, as well as changes to the legal landscape from a new presidential administration. One enduring factor will be frequent change in legal requirements on the federal, state and local level. The key to a successful 2021 will be vigilant analysis of the changes to come and an ability to be flexible in a changing environment.



Mexico's Role in the USMCA-Driven Consolidation of the North American Auto Industry

It's the beginning of a new year! 2020 is over, COVID-19 vaccines are being administered, the USMCA is in effect, and there is an apparent unofficial understanding that the auto industry is essential in North America (Mexico, the United States and Canada).

Building upon the findings of [Foley's September 2020 Global Supply Chain Disruption and Future Strategies Survey Report](#), it is clear that supplier relationships will be strengthened, likely by means of increasing transparency of both OEM needs and suppliers' ability to fulfill them, bolstering provider resilience over lean inventories, and preapproving alternate purveyors over a race to the lowest cost option.

In that context, we should not lose sight of the ways Mexico contributes to strengthening the North American auto industry: (i) quality outputs at the lowest cost in the region, (ii) free trade agreements with more than 60% of the world's GDP (52 countries); (iii) near-shoring advantages, (iv) skilled workforce with low absenteeism and in greater availability as Mexico's population ages, and (v) between a pandemic and ongoing trade wars, Mexico translates into **predictable access** to the North American market, under a solid foundation.

That said, with your company either already doing business in Mexico, or considering doing business in the country, here are a number of relevant issues to keep in mind in 2021:

1. COVID-19 Vaccines

Just as with labor (i.e., determination of essential or nonessential business activities), and mandatory health measures (i.e., establishment of on-site sanitary protocols), both the Mexican federal government and the Mexican states have concurrent jurisdiction regarding vaccinations.



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As of the date of this writing, the federal government has issued a national vaccination policy, under which the government plans to immunize the entire population in a span of 18 months, beginning late last year (2020) with frontline health care workers, followed by those 60 and older, then those in their 50s, 40s, and lastly, those 18 and older. (Progress to date casts doubt upon whether this is achievable.)

On January 25, 2021, the Mexican Ministry of Health issued high-level guidelines for individual Mexican states, **as well as private entities**, to acquire and administer vaccines as long as they comply with and contribute to the National Vaccination Policy, with more details likely forthcoming.

Furthermore, compliance with evolving health and labor regulations in manufacturing facilities will still be an important matter to consider, both in terms of continuing production and preventing lawsuits due to real or imaginary risk exposure.

2. Outsourcing/Insourcing Ban

On November 11, 2020, the Mexican president presented an initiative to, in practical terms, ban the current practice of outsourcing and insourcing in Mexico, through which companies avoid their 10% profit-sharing obligations by distancing themselves from their workforces through separate or related companies.

In a nutshell, the initiative would exclusively allow for “specialized services” to be outsourced, meaning those that are not part of the economic activity of the intended beneficiary; the Mexican Labor Department would have to grant a renewable authorization to specialized service providers in Mexico. In addition, simulated renderings of specialized services would constitute elements of proof towards the commission of criminal tax fraud.

This initiative will likely pass early in 2021, as the president’s political party (MORENA) controls both houses of Mexico’s Congress; a number of hypotheses are being discussed as to how companies will change their operations to comply with this initiative.

Most automotive businesses in Mexico use outsourcing operations to manufacture in the country. The new outsourcing rules will impose a need to reassess and restructure a number of labor, corporate and tax structures and short-term strategies.

3. VAT-Certified Maquila Benefits Diluted & Maquilas in the Spotlight

Maquila (aka IMMEX) companies in Mexico function under a governmental authorization that includes preferential conditions, both operational and fiscal. The highest degree of preferential treatment is granted to maquila companies that are VAT (Value Added Tax)-certified, which allows them to avoid paying otherwise applicable VAT upon the importation of goods used in their manufacturing operations (either raw materials or machinery and equipment).

Such preferential treatment will automatically be changing as soon as each individual maquila company renews its VAT certification, which occurs every one to three years, depending on the number of workers and machinery and equipment involved.

Upon VAT certification renewal, companies will, among other things: (i) no longer have the ability to obtain expedited 16% VAT refunds on their operational balance (capacity to continue temporarily importing without paying VAT remains, however); (ii) have a reduced time frame to use most temporarily imported goods (from 36 months to 18 months), although longer periods will apply to certain products, such as

containers, machinery and equipment; (iii) no longer be automatically enrolled in sectorial import programs (steel, motor vehicles, textiles, others); (iv) have to file weekly *pedimento* submissions, instead of monthly, and will not be able to temporarily import products without declaring serial numbers.

4. Mandatory Technical Standards (NOMs) No Longer Exempted

Prior to October 1, 2020, the importation of certain materials to be utilized in production processes, or which would not be sold to the public in the same shape or form as imported, were permitted to enter under “exemption letters” that would allow them to be imported without proof of NOMs compliance (not all imports are subject to NOM compliance, as per their relevant import tariff numbers).

Consequently, as of this date, importers are no longer allowed to use such exemption letters and, upon importation, are obliged to demonstrate compliance with relevant NOMs either prior to the importation process, or afterward.

A number of procedural rules apply to each of the aforementioned options, and some other requirements must be previously fulfilled in order to benefit from them. Also, Mexican authorities have issued, and continue to issue, administrative criteria to clarify their practical applications of this measure.

5. Labor Enforcement of USMCA Obligations

Mexico has amended its relevant labor laws to comply with USMCA, most importantly to guarantee the basic rights of freedom of association and collective bargaining, with the non-stated objective of increasing wages in the country.

There are immediate and intermediate obligations for employers pertaining **current** collective labor contracts. Regarding the former, (i) i.e. as of today, such contracts shall be free of “interference” from employers (it is considered interference to promote the establishment of workers’ unions dominated by an employer or an employers’ organization and to support, economically or otherwise, workers’ unions in order to place them under the control of an employer



or an employers' organization). Pertaining the latter, (ii) labor contracts need to be "legitimized" by May 1, 2023 at the latest, as per the process already issued by the Mexican Labor Secretary.¹

Because of the foregoing, there will be real, working unions, meaning that collective contracts signed with employer-friendly unions (commonly known as "protection" contracts, or contracts with "white" unions) will soon be eliminated, which will likely bring new leadership and more than one union to a company.

Determination of denial of freedom of association and collective bargaining rights may be made by a Facility-Specific Rapid Response Labor Mechanism; if such a denial of rights determination is made, the covered facility's goods or services could face a suspension of preferential tariff treatment, or the imposition of penalties. It would be convenient for employers to inoculate themselves (a timely term) against potential arguments from competitors, that such basic labor rights are being denied in their Mexico manufacturing plants.

6. Permanent Establishment Tax Rules

Recent tax reforms have expanded the scope of application of the permanent establishment rules in Mexico. This is a sensitive issue because foreign companies that are deemed to have a permanent establishment in the country for tax purposes shall be subject to levies (with respect to the revenue attributable to said permanent establishment). Therefore, companies already doing business, or that are considering setting up operations in Mexico, should evaluate these changes to the Mexican tax legislation to assess any potential risk of being considered to have a local taxable presence.

¹ See *Diario Oficial de la Federación* of July 31, 2019.

Renewed Biden Administration Commitment to the International Trade War Underscores Importance of Customs Compliance for Automotive Companies



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1. Customs Compliance Will Continue to be Essential Under the New Administration

Under the Trump administration, customs matters came to the forefront of compliance attention for many automotive companies. This was primarily due to three factors:

- Unprecedented implementation of high special tariffs, including section 232 duties on steel and aluminum and section 301 tariffs on nearly all goods from China;
- The pivot of Customs to emphasizing enforcement and revenue collection, given the much greater tariffs that were collected as a result; and
- The long-awaited completion of the Automated Commercial Environment (ACE) portal, which now gives Customs the tools to run sophisticated searches to find anomalies in import patterns, including the types of HTS misclassifications, undervaluation of entered value, and erroneous country-of-origin declarations that can lead to large underpayments of customs duties.

As a result, automotive companies that regularly act as the importer of record discovered the importance of customs compliance. All of which leads to the key question: Will these recent customs trends – and the need for careful vigilance in matters of customs compliance – be as essential under the new administration as they were under the old?

All indications are that importers of record should continue to pay close attention to customs compliance in the new administration. Some reasons for this include:

- President Biden and his proposed international trade team have telegraphed that they do not anticipate making any sharp changes to U.S. international trade policy in the near-term, as the focus of the overall administration will be on economic recovery and the pandemic. As a result, there is unlikely to be any material change in the current trade environment for at least a year or more.
- There is a bipartisan belief that the new administration needs to keep up pressure on China to deal with perceived Chinese government manipulation of the international trade, investment, and intellectual property norms. Thus, even though the Biden administration likely would not have imposed the Section 301 duties in the first place, there are strong incentives to leave them in place as a lever to force the Chinese government to the negotiating table. Any new agreement to take care of these issues is likely to take a year or more to negotiate and implement.
- Even if the Section 301 duties are lifted, the likely result will be a surge of petitions seeking the imposition of antidumping and countervailing duties on China, shifting the trade war to a new playing field and keeping the tariff burden on Chinese imports for covered products.
- The new ACE environment, and the heightened ability of Customs to find instances of underpayment through electronic searches and analysis, is a permanent fixture.
- Customs is continuing to emphasize whether companies properly are claiming free trade preferences, especially under the USMCA. Because of the newer, and more stringent,

originating requirements under the USMCA, the automotive industry – the most frequent claimant of such preferences – will continue to see outsized attention on its FTA claims.

- More stringent requirements for documenting originating status to gain free trade preferences under the USMCA will require companies throughout the automotive supply chain to carefully parse the rules for claiming free trade preferences, meaning that companies will lean on suppliers to carefully document and certify their compliance with USMCA requirements.

Because many automotive companies act as the importers of record, these factors all indicate the need for continuing vigilance on customs matters. To help with these tasks, the remainder of this update provides customs compliance best practices, including those gleaned from numerous customs disclosures and audits we have conducted over the prior year.

2. Customs Compliance Best Practices for the New Administration

Our recommendations for customs compliance are based upon the expectations of Customs and prudent best practices that tend to minimize compliance missteps. Some key items we recommend include the following:

- **Prepare a Customs Compliance Manual.** Based on our experience in recent audits, CBP expects importers to go beyond a simple compliance policy and instead to implement a comprehensive customs compliance manual that includes written, standard procedures and internal controls for each of the relevant elements of reasonable care. Importers that memorialize the measures in such a manual are less likely to have import-related customer errors and are in a better position to explain the scope and implementation of customs compliance programs to CBP auditors.
- **Create a Customs Classification Index.** We recommend importers regularly review the products they import and confirm the accuracy of the associated HTSUS tariff classifications codes. The U.S. government updates these codes periodically throughout the year, and new products may need new classifications. Importers should maintain the most current HTSUS classifications in a database that is available to their third-party customs brokers or other parties responsible for preparing customs entry filings.

- **Review Product Valuations & Declared Value.** Importers should review the methodologies used to calculate the *ad valorem* value of the products they import, paying particular attention to transactions involving related or affiliated companies. Special attention is also necessary to determine whether the valuation includes all relevant off-invoice items, such as royalties and assists.
- **Coordinate with Customs Brokers & Freight Forwarders.** Importers should engage with their freight forwarders and customs brokers to determine whether they are consistently following CBP requirements and should coordinate regarding required customs recordkeeping. These areas should not be left to customs brokers on their own, as the importer of record is ultimately the responsible party.
- **Conduct an Internal Customs Compliance Audit.** Larger importers or importers who are at a heightened risk for a customs inquiry or scrutiny should consider performing an internal customs audit to determine whether existing compliance systems are effective. A good starting point for such an audit may be found in the questionnaire at the end of CBP's Importer Self-Assessment Pilot Program publication.¹
- **Conduct Compliance Training.** Importers should train relevant employees on CBP requirements annually. Such employees typically include customs compliance staff, procurement personnel, and individuals working in the company's shipping/logistics departments. Relevant compliance topics include:
 - Importer of record responsibility;
 - Classifying imported goods;
 - Determining country of origin;
 - Making preferential tariff claims under the USMC and other FTAs;
 - Coordinating with customs brokers and freight forwarders;
 - Conducting post-entry checks and making corrections;
 - Tracking assists and other valuation issues;
 - Identifying and claiming relevant Section 301 exclusions; and
 - Recordkeeping responsibilities.

¹ U.S. Customs and Border Protection, "Office of International Trade Importer Self-Assessment – Product Safety Pilot Program Addendum, August 2014," <https://www.cbp.gov/sites/default/files/documents/ISAPS%20Handbook%202014v2.pdf>.

- **Evaluate USMCA/FTA Claims.** Importers should review their use of FTA or other tariff duty preference programs to determine whether they are applying the eligibility criteria properly and have the documentation necessary to support their claims. If the goods come from Canada or Mexico, then claims for preferential tariff treatments should be evaluated against the USMCA rules, which often differ from the older NAFTA requirements. Some of the key issues to consider include:
 - Whether the imported goods meet USMCA's regional content requirements;
 - Whether required certificates of origin are available at the time of entry; and
 - Whether the company maintains all of the required documentation to support free-trade preferences for the appropriate period of time.
- **Review Products for Antidumping and Countervailing Duties.** Finally, companies should periodically review their imported goods to determine whether they may be subject to additional tariffs under various antidumping or countervailing duty orders.

3. Dealing with Customs Requests for Information: Informed Compliance Letters

A recent development is the issuance of “informed compliance” letters by CBP, a tactic we expect customs will continue to use in the new administration. These letters often are issued to major U.S. importers to encourage them to review their recent entries and determine if they have treated entries correctly where they acted as the importer of record. These letters often are sent to major importers who have not been audited in the past decade or that are viewed as being at a higher risk for violations.

The receipt of an informed compliance notification letter means CBP has reviewed the data of an importer of record and likely identified specific problems with its import transactions, putting the company at an increased risk of a comprehensive audit. According to CBP officials, the expectation is that companies that receive these letters will soon be the subject of a “focused assessment” or other type of CBP audit in the near future. The letters thus are a way of encouraging major importers to enhance their compliance and file voluntary self-disclosures in anticipation of the

audit. To provide further “encouragement,” CBP has indicated that companies that do not follow up with a voluntary self-disclosure can expect any subsequently discovered violations will be subject to higher than normal penalties. The letters warn not only of potential monetary penalties, but also the prospect of seizure or forfeiture of imported merchandise.

Best practices in such a situation include:

- Preparing for a CBP audit;
- Reviewing its customs compliance policies;
- Reviewing the care taken by its customs brokers;
- Conducting a risk assessment, including with regard to the issues identified in the letter;
- Determining if its classifications are correct and supported by the product attributes;
- Determining whether any post-entry adjustments are needed;
- Determining whether free trade preferences are supported by FTA certificates of origin and appropriate regional content;
- Evaluating whether off-invoice items such as royalties and assists are appropriately recognized; and
- Considering whether there are any other issues in the company's import data to indicate compliance failures and penalty risks.

While the assessment should start with the issues identified in the letter, the review should be comprehensive. Further, the review also should cover the rigor of the importer's compliance measures and training, as these are evaluated by CBP in an audit. Any errors should be documented, and a plan put in place to strengthen the company's compliance procedures and internal controls to prevent their recurrence.

The company also should strongly consider filing a prior disclosure. This can be accomplished using an initial marker, which merely informs CBP that an investigation of potential compliance lapses is ongoing. This locks in voluntary disclosure credit while buying time to complete a thorough investigation and provide a subsequent full report.

As can be seen, in the current high-tariff environment, careful compliance with customs regulations and importer-of-record requirements is essential for automotive companies, which are among the nation's busiest importers.

Managing Data Privacy in the COVID-19 Environment – Navigating the Challenges of a Pandemic in 2021

Last year, the COVID-19 pandemic brought about a global market disruption across multiple industries, and manufacturers expect the pandemic to continue to affect the automotive industry through 2021. The pandemic has not slowed the technological innovations in the industry or the pace of increasing regulation affecting data privacy and security. In the midst of the pandemic, we saw significant changes to the privacy landscape, including a steady rise in California Consumer Privacy Act (the CCPA) litigation by private citizens, a successful ballot measure amending the CCPA to include significant new obligations for companies that often mirror those of the European General Data Protection Act (GDPR), and a major decision from the Court of Justice of the European Union in the so-called “Schrems II” impacting personal data transfers between the EU and the U.S., all of which impacts the automotive industry. As we have seen in recent years, consumer demand is driving the industry towards greater privacy protections and it is not likely to slow down.

2020 and the pandemic brought about changes not only to the regulatory environment, but also to business operations, with substantial periods of remote operations, implementation of tracking tools collecting sensitive health information from workforce employees, and fully remote automotive purchases changing the landscape of consumer interaction. Without notice or sufficient time to plan, companies were forced to shift abruptly to a remote work environment, exposing new vulnerabilities and creating new security risks with the increased usage of personal devices and insecure networks, increased phishing attacks, strained virtual private network resources, and economic impacts across industries limiting resources.



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Accordingly, we expect to see in 2021 that a company’s prioritization of budgets will be split between information technology and compliance departments and for any increased spending in resources necessary to address regulatory requirements or risks affecting consumer trust. As industry executives grapple with prioritizing budget constraints while responding to the new business and operational challenges under the pandemic, it is important for executives to keep in mind that noncompliance with privacy and security requirements can result in harsh monetary and legal penalties, including steep fines and potential civil liability, and can result in a loss of consumer trust potentially impacting a brand into the post-pandemic landscape.

As automotive companies tackle budget constraints and a changing regulatory environment with new compliance requirements, executives may find navigating data privacy compliance and security practices difficult. However, we outline below six critical focus areas to ensure the resiliency and security of your organization, to best comply with regulatory requirements, and to maintain consumer trust in the face of ever-changing data privacy laws.

1. Incident Response and Business Continuity Protocols

The pandemic created a colossal challenge globally for companies, which were unprepared for the first lockdown and had to quickly shift resources to ensure business continuity for their workforces in a remote environment. Few, if any, organizations included a global pandemic in their business continuity plans, leaving many companies staggering to respond to the increased demand on infrastructure resources posed by a remote workforce. This impacted the ability of companies at all tiers and in all areas of the automotive ecosystem to continue to effectively and consistently respond to security incidents, and to maintain and manage their cybersecurity practices and procedures. Looking forward, as more local, regional, or national disruptions and lockdowns are expected, automotive companies should ensure their incident response plans and protocols are updated for a remote workforce environment.

2. System Security and Access Controls

As companies shifted entire workforces to a remote environment en masse, companies often realized that the major constraints for organizations were remote-access capacity and access controls to enterprise systems. Many companies found that legacy systems were especially prone to problems with availability, scalability, and performance – all of which are required to run smoothly for effective cybersecurity for the workforce, as well as security for vehicles, connected hardware and components. Looking ahead, we expect companies to continue to prioritize short-term spending on security for remote workers. In addition, companies may consider deploying technologies and solutions that can be quickly adopted, such as cloud solutions and security services vendors; however, we suggest including relevant stakeholders, such as the security team, early in the process to ensure that all security benefits and risks are being considered in any such transition. Remote connectivity should further facilitate security practices, including over-the-air (OTA) updates and patches for vehicle software and electronic components. Companies should also consider enabling multifactor authentication, and updating security monitoring capabilities and log management rules to

ensure full visibility despite remote work conditions. The above considerations should be in addition to the core internal and external (product-based) security functions, such as patching, vulnerability management and cyber awareness programs.

3. Assess Security Hygiene of the Remote Workforce

The rapid shutdown early in the pandemic meant that not all departments in an organization were set up for a remote work environment. As additional local, regional, or national disruptions and lockdowns are expected, companies should look to addressing unsecure networks and personal device usage by employees. Looking forward, companies should require that employees install corporate security software onto any personal device prior to connecting to the corporate network and should establish or review remote access firewall rules, including file integrity monitoring and user and entity behavior analytics.

4. Third-Party Risk Management

As we have seen in the fallout from the SolarWinds breach, third parties can be a source of vulnerability for companies. This is a pattern that continues to repeat itself (remember the Target breach back in 2013?). In the SolarWinds breach, hackers were able to infiltrate the systems of SolarWinds' customers through a compromised update of the SolarWinds software. Most companies are not prepared for this type of vendor compromise as software that is digitally signed by the manufacturer (as here, SolarWinds) is inherently trusted by users. This type of risk can be particularly prevalent in the automotive industry due to the large amount of connectivity between organizations in the automotive ecosystem. Looking forward, companies can consider implementing zero-trust networking principles and expanding role-based access controls from users to include applications and servers, and limiting access to applications and servers that are necessary to minimize any potential impact to the corporate system. Companies should continue to implement security measures and practices that work to provide the best cybersecurity, including eliminating vulnerability early at the design stage and continuously monitoring and preparing for new or inevitable security threats.

5. Data Privacy and Compliance Best Practices

As the privacy landscape continues to evolve and become ever-more complex, companies continue to find compliance particularly challenging. For example, as companies have expended significant efforts towards California's CCPA compliance, the new amendment to the CCPA brings with it new obligations on companies operating within and outside of California, including new consumer rights, such as a limited opt-out on the use or disclosure of sensitive personal information except for what is necessary for the company to provide its goods and services, a category that includes geolocation information that may be collected by a vehicle. Cars today are, in essence, computers on wheels – very complex computers, smartphones, tablets and networks rolled into one. Under Schrems II, companies are required to assess on a case-by-case basis whether a data transfer using standard contractual clauses will meet the EU standards. Because privacy and security requirements in developed countries are converging, what happens in the EU can impact (and has impacted) what happens in the U.S. on the automotive regulatory and compliance front. For companies with diverse or widespread operations, understanding how their operations fit into these privacy schemes are crucial for regulatory compliance. Additionally, implementing and maintaining a robust privacy program that is adaptable to specific requirements in different jurisdictions will foster consumer trust and loyalty in a company's brand. That being said, while a robust privacy program may comply with certain notice requirements and consumer rights implemented by privacy laws, it does not protect a company from unauthorized uses or disclosures, and companies should continue to implement security practices that provide the best cybersecurity protection.



6. Customer Expectations

Consumers are becoming more aware of the risks of certain technologies in their automotive products, as shown by the niche industries popping up on Amazon offering faraday cages for key fobs. Companies should begin to distinguish themselves by making privacy and security a priority in their products and making that priority obvious to their consuming market. This will allow those companies to leverage that reputation as product offerings continue to trend towards fully autonomous features. For example, we expect to see this marketing technique utilized by the newest entrant to the automotive industry, Apple, Inc., which is widely known as a design-focused consumer products company. Apple customers are used to a seamless experience across devices with privacy and security by design built into the product, and we expect Apple to leverage its privacy- and security-focused reputation and seamless customer experience to market its automotive offering to consumers. As the industry moves towards an autonomous vehicle market, a company's privacy and security reputation will be key to adoption of these products by consumers, and the continued brand loyalty of those consumers.

Conclusion

2020 was a year of market disruption and significant challenge to the industry, and 2021 appears to be primed for continuing market conditions leading to a new normal. Budgetary constraints will continue to be a significant factor for companies going into 2021. Companies will need to adjust tactics to do more with smaller budgets while remaining compliant with regulatory requirements. Virtually all facets of an organization, and third parties as well, will need to be involved to properly plan and implement protections, and to prepare for compliance with new and expanding regulations and consumer demands. As consumer expectations continue to drive privacy scrutiny, there is an opportunity to lead the pack in this evolving area, but with new entrants primed to enter the market, that opportunity will not last very long.

2021 Antitrust Outlook – A New Administration and State Activism Present Enforcement Uncertainty

The antitrust outlook in the United States is marked by uncertainty. This article identifies some issues to watch.

Some Recent Surprises

Historically, U.S. antitrust enforcement has been marked more by continuity than by abrupt change. During the past few decades, we saw an evolution away from blanket rules of per se legality or illegality under federal law (e.g., resale price maintenance and inflexible merger standards), a greater emphasis on economic analysis of likely competitive effects, and an attempt to strike a balance between overly aggressive enforcement (which inhibits potentially procompetitive conduct benefiting consumer welfare) and overly lenient enforcement (which risks adverse consumer welfare consequences).

During the Trump administration, however, we saw some surprising Department of Justice (Antitrust Division) (DOJ), Federal Trade Commission (FTC) and state Attorneys General enforcement priorities, outcomes and clashes. These included:

- **Behavioral Relief.** DOJ's strong disfavor for accepting behavioral relief in merger reviews was reflected in its refusal to accept conduct remedies in, and subsequent failed effort to block, the vertical Time Warner/AT&T combination. DOJ recently reasserted this disfavor in a new [Merger Remedies Manual](#), released September 3, 2020, which declared that structural remedies "are strongly preferred in horizontal and vertical cases."
- **Agency Clash.** DOJ engaged in public criticism of and opposition to FTC's successful district court challenge of Qualcomm's licensing practices relating to standard essential patents addressing 4G transmission technologies, an outcome subsequently reversed by the Ninth Circuit in August 2020. Also note that DOJ issued the new Merger Remedies Manual noted above unilaterally, without separate adoption by the FTC.



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- **State AG Activism.** DOJ approved the merger of Sprint and T-Mobile, subject to significant divestiture obligations. That approval was followed by a failed litigation effort by numerous state AGs to challenge that very transaction and the DOJ-approved structural remedies.

New Administration Surprises?

The Biden administration will presumably bring new enforcement priorities and direction to both DOJ and FTC. While its proposals for new agency leadership have not yet been announced, those nominations should provide some insight into possible enforcement priority direction. Possible changes include:

1. The Consumer Welfare Standard

One fundamental question is whether the Biden administration will entertain proposals to reexamine the *purposes* of antitrust enforcement. For decades, federal antitrust enforcement has been driven by the "consumer welfare" standard, which seeks to evaluate both transactions and conduct based on their impacts on consumers.

At the same time, however, there is a broader debate over the scope of that established goal and whether the objectives of antitrust enforcement should change and the tools of enforcement should be expanded. Aggressive "reform" proposals have been advocated by 2016 presidential candidates Elizabeth Warren and Bernie Sanders. In 2017, Sens. Warren and Chuck

Schumer (and others) rolled out a “Better Deal” platform for the 2018 congressional elections. Sen. Sanders more recently proposed antitrust enforcement reforms that eclipse that “Better Deal” platform. The proposals, among other things, advocate replacing the consumer welfare standard with a broader standard that considers various merger impacts unhinged to “competition” or “competitive effects.” For example, some advocates have suggested that merger reviews should also address such issues as labor effects, environmental issues, racial impacts, and wealth inequality concerns. These proposals are sometimes referred to as the “hipster” antitrust movement. Such an expansion of the cognizable issues relevant to a merger review could substantially alter the predictability of agency merger enforcement efforts.

2. Agency Interest in Vertical Mergers

On June 30, 2020, the FTC and DOJ released their first jointly issued Vertical Merger Guidelines. These new guidelines did not disclose any significant policy changes, but they did elaborate on vertical merger review topics such as the evaluation of the “net effects” of the combination’s potential for foreclosure and other competitive effects such as the elimination of double marginalization. These new guidelines followed DOJ’s loss in its challenge of the vertical Time Warner/AT&T transaction.

Were the Biden administration inclined to increase scrutiny of vertical mergers, it presumably would nevertheless follow the analytical guidance set forth in the new (and unsurprising) Vertical Merger Guidelines. That increased scrutiny could come through a more concerted effort to review vertical transactions with the potential to foreclose competitors, raise rivals’ costs, or result in the exchange of competitively sensitive information. These vertical merger concerns are already articulated in the new Vertical Merger Guidelines.

3. State Attorney General Activism

Antitrust opposition by state AGs – at least in the form of an *independent* legal challenge in court – to a merger approved at the federal level by DOJ or FTC is unusual. Nevertheless, such a state AG challenge occurred in the Sprint/T-Mobile transaction. We also see considerable state AG activism in various investigations of “Big Tech,” raising the question of possible divergence between state AG and federal treatment of those matters.

Such state AG antitrust activism appears much higher today than in prior decades. We can expect such activism to continue during the Biden administration. One impact of such increased activism could be an increase in the consideration given by FTC and DOJ to state AG remedy recommendations in antitrust settlements. In contrast, the risk of unilateral state AG challenges in situations in which one or more state AGs are not satisfied with a DOJ or FTC settlement agreement will expose those transactions to greater timing and deal risk.

4. DOJ Prosecution of Cartel Behavior

Regardless of the Biden administration, DOJ will continue to investigate and, where appropriate, prosecute cartel behavior. This area of antitrust enforcement has wide bipartisan support.

We should not forget the lessons of DOJ’s long-running investigation of auto parts suppliers, one of the largest criminal investigations ever pursued by its Antitrust Division, which resulted in charges against some 48 companies and yielded almost \$3 billion in criminal fines. Settlements of class action and other private plaintiff claims have reportedly exceeded \$1 billion.

An effective antitrust compliance program, in addition to detecting and deterring cartel conduct, now brings additional benefits. While DOJ has historically not given credit for antitrust compliance programs in making charging decisions and sentencing recommendations, it announced changes to both policies in July 2019. These long-needed changes increase the legal benefits of implementing an effective antitrust compliance program.



NHTSA and Motor Vehicle Safety

Introduction

Over the past few years, the National Highway Traffic Safety Administration (NHTSA), the primary regulator of motor vehicles and motor vehicle equipment and their manufacturers, has been balancing its work of keeping pace with technology innovations against its work on compliance enforcement. As the Biden administration begins to take shape, the priorities of the U.S. Department of Transportation and NHTSA will shift to reflect the regulatory philosophy and priorities of the new administration. This change in administrations offers some particularly interesting differences, as NHTSA spent the entirety of the Trump administration without an administrator. One focus of the Biden administration will likely be changing environmental policies, which almost certainly will lead to another round of changes to the fuel economy standards.

With respect to safety standards and enforcement focuses, the incoming administration has, to this point, offered little indication as to what its focus will be. It has instructed all agencies to withdraw rules that have not been published in the Federal Register so that the rules may be reviewed and approved by the new administration's political appointees at the respective departments or agencies. See <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/regulatory-freeze-pending-review/>. Additionally, agencies have been instructed to cease sending rules to the Federal Register until the administration's political appointees have reviewed and approved the rules, to postpone for 60 days the effective date of any published rule that had not taken effect prior to January 20, 2021, and to comply with all executive orders, including orders issued by the new administration. These instructions indicate that the new political team at NHTSA, once in place, will take a fresh look at the agency's recent activities.



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Modernizing NHTSA's Regulations

Over the past two years, NHTSA issued a flurry of advanced notices of proposed rulemakings (ANPRMs) and proposed rulemakings (NPRMs) to amend federal motor vehicle safety standards (FMVSSs) aiming to reduce regulatory barriers and modernize performance requirements to facilitate the development and deployment of advanced technologies. As outlined in the DOT's policy statements issued during the Trump administration, the driving principles of this barrier reduction and modernization have been to:

- Prioritize safety, cybersecurity, privacy and data sensitivity, and accessibility;
- Promote innovation by remaining technology neutral and protecting U.S. intellectual property; and
- Ensure a regulatory approach that uses consistent standards and policies across the federal government.

During the closing days of the Trump administration, NHTSA released several notices that look to meet these goals.

The First General Exemption for an Automated Vehicle

In February 2020, NHTSA granted Nuro, Inc.'s petition for temporary exemption from three requirements in FMVSS 500, *Low-speed vehicles*. The exemption marked a significant moment for automated vehicles (AVs) as the agency's exemption permitted Nuro's R2X, a highly automated (SAE Level 4), low-speed vehicle (25 mph maximum speed), to be sold in the United States. The R2X is designed to carry exclusively cargo and operates without a human driver.

Significantly, the R2X is the first AV exempted under NHTSA's general exemption authority. As a condition of the exemption, NHTSA established a number of reporting and other terms of deployment for the vehicles – violation of which could result in NHTSA terminating the temporary exemption. These conditions include:

- Post-crash reporting;
- Periodic reporting requirements;
- Particular cybersecurity requirements;
- Nuro must remove from operation any vehicle it determines is not safe;
- The vehicles must comply with all state and local laws;
- Nuro must retain ownership of the vehicles; and
- Nuro must provide a hotline for safety concerns.

These terms are similar to terms the agency has imposed on noncompliant AVs that were imported under the 49 CFR Part 591 temporary exemption for research and demonstration purposes.

Granting the Nuro exemption, with the additional conditions, provides a look at how the agency may respond to similar exemption petitions in the future. Due to the low speed and lack of passengers, the burden on Nuro to demonstrate "safety equivalence" is lower than it would be for a vehicle that will carry passengers. Similarly, low-speed vehicles subject to FMVSS 500 are subject to fewer performance requirements than conventional motor vehicles. In comparison, NHTSA has not yet resolved a similar exemption petition by General Motors for a passenger AV based upon the Chevy Bolt, which was submitted to NHTSA in 2018. The greater complexity of passenger AVs in terms of safety equivalence, along with the greater number of performance requirements that apply to traditional (i.e., non-low-speed) vehicles,

understandably present more difficult challenges for the agency. (Late last year, GM withdrew its petition for the earlier generation of Cruise AVs and stated that it would be submitting a new petition for a limited number of Cruise Origin vehicles in the coming months.)

Special Exemptions for Noncompliant Vehicles for Research and Demonstration

In December 2020, NHTSA announced that it had submitted to the Federal Register an interim final rule that would extend the exemptions for noncompliant vehicles under 49 U.S.C. § 30114(A) for research and demonstration purposes to domestically produced vehicles. For many years, NHTSA's regulations limited exemptions under Section 30114(A) to *imported* vehicles, thus creating an uneven playing field between foreign and domestically produced vehicles.

The Fixing America's Surface Transportation (FAST) Act of 2015 added 49 U.S.C. § 30112(b)(10), which permits legacy manufacturers (i.e., manufacturers of FMVSS-certified vehicles as of December 2015) to operate domestically produced, nonconforming vehicles on public roads for testing purposes. But this provision is not available to manufacturers and developers that did not qualify as legacy vehicle manufacturers.

With the development of AVs, NHTSA believes that "creating a parallel special exemption program for domestically manufactured vehicles and equipment is warranted." Accordingly, the interim final rule would create Part 589 to enable manufacturers and other entities to seek temporary exemptions for domestically produced vehicles and equipment for research and demonstration purposes, thus providing a critical pathway for nonlegacy vehicle manufacturers, developers, and suppliers to conduct on-road testing of prototype vehicles and systems.¹

The interim final rule was signed by NHTSA's deputy administrator on December 31, 2020, but, as of January 27, 2021, has not been published in the Federal Register. Accordingly, the new administration's team at the U.S. DOT and NHTSA will need to review and approve it before it can be published in the Federal Register and become effective.

¹ Notably, manufacturers of vehicles that meet the requirements of § 30112(b)(10) can continue to rely on that statutory exception, rather than using the Part 589 special exemptions.

NHTSA's Interpretation Regarding Certification to FMVSS

On December 21, 2020, NHTSA published a notice of interpretation to provide guidance to manufacturers on applying FMVSS test procedures to nontraditional vehicles and equipment. 85 Fed. Reg. 83143 (Dec. 21, 2020). In the interpretation, NHTSA reaffirmed its position that manufacturers are not required to use the test procedures contained in the FMVSS when certifying compliance with that particular standard. The interpretation expanded on this long-held interpretation by further explaining that the certifying manufacturer does not need to ensure that the vehicle's equipment or design permits NHTSA to verify the certification using the test procedures in the applicable safety standard. The agency explained that if the manufacturer exercised reasonable care in determining compliance, it may so certify, "even if the vehicle were designed in such a way that the FMVSS test conditions and procedures cannot be performed." *Id.* at 83147. Where the test conditions and procedures cannot be performed, NHTSA would exercise its investigative authority to review the manufacturer's basis for certification, such as evaluating the alternative test procedures, simulations, and models used to make the certification as well as other salient factors the manufacturer relied upon in making its determination.

Amendments to the 200-Series FMVSS

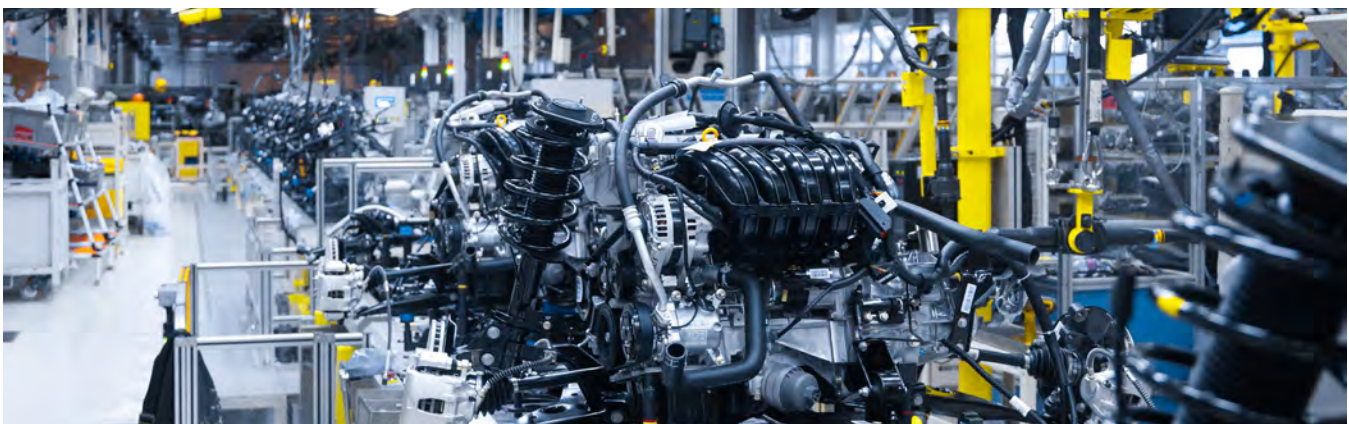
On January 13, 2021, NHTSA's deputy administrator signed a final rule amending portions of the 200-Series FMVSS (the crashworthiness standards) to remove barriers for AVs that lack traditional manual controls necessary for human drivers. The final rule is the result of multiple Federal Register notices,

public discussions with stakeholders, and a March 2020 notice of proposed rulemaking (NPRM). The notice, if it proceeds to a final rule under the Biden administration, would create increased opportunities for certain AVs by updating and adding definitions within the 200-Series standards, modifying the application sections of several standards (for example, stating that FMVSS 203, *Impact protection for the driver from the steering control system*, and FMVSS 204, *Steering control rearward displacement*, do not apply to vehicles without steering controls), and adjusting spatial references in procedures that rely on traditional vehicle controls that may not exist in AVs. The final rule would also exclude AVs that are designed exclusively to carry property from existing crashworthiness requirements.

Because this notice has not been published in the Federal Register, the final rule is subject to further review and approval by the Biden administration. While the regulatory priorities of the new administration will come into focus as political appointees join NHTSA, the career staff at NHTSA who conducted the work on these proposals remain with the agency. Moreover, the proposed changes are the culmination of several years of work between various stakeholders and NHTSA's staff. Any future regulatory actions by the new administration would likely build on the work already completed.

Updates to the New Car Assessment Program

NHTSA also released an unpublished Federal Register notice that would request comments related to proposed changes to its New Car Assessment Program (NCAP). The notice, if ultimately published, would implement four additional advanced driver assistance systems (ADAS) that NHTSA believes show potential



for advancing vehicle safety and further reduce deaths and injuries from vehicle crashes. The notice would include pedestrian automatic emergency braking (PAEB), lane keeping support (LKS), blind spot warning (BSL), and blind spot intervention (BSI) systems in NCAP. NHTSA explained that it planned to include these technologies because they “meet NHTSA’s four prerequisites used for considering technologies in NCAP: (1) the technology addresses a safety need; (2) system designs exist that can mitigate the safety problem; (3) the technology provides the potential for safety benefits; and (4) a performance-based objective test procedure exists that can assess system performance.” *Citing* 73 Fed. Reg. 40016 (Jul. 11, 2008), 78 Fed. Reg. 20597 (Apr. 5, 2013), 80 Fed. Reg. 78521 (Dec. 16, 2015). In addition, the notice will seek public comments on NCAP test procedures for a number of other ADAS functions, including forward collision warning (FCW), lane departure warning (LDW), crash imminent braking (CIB), and dynamic brake support (DBS).²

Manufacturers should keep abreast of the ADAS technologies included in NCAP, as the agency may incorporate what it learns in developing these tests into future safety standards, as NHTSA did prior to adopting FMVSS 126, *Electronic stability control systems for light vehicles*. Additionally, these technologies likely present many of the technological building blocks of more advanced systems that will comprise automated vehicles. Ensuring that NHTSA’s research and testing of these foundational technologies remains objective, repeatable, and technology neutral will help ensure that in the future any potential safety standards related to these technologies will not be hampered by faulty assumptions, dependence of specific technologies, and repeatability problems that could create regulatory barriers to advanced vehicle technologies and vehicle automation.

² CIB and DBS are often grouped together under the more generic term automatic emergency braking (AEB). Twenty vehicle manufacturers have agreed voluntarily to equip virtually all new vehicles with low-speed AEB that includes FCW by September 1, 2022. <https://www.nhtsa.gov/press-releases/nhtsa-announces-update-historic-aeb-commitment-20-automakers>.

Cybersecurity Best Practices

As vehicles and vehicle equipment become increasingly connected, ensuring the security of these systems will continue to play an important role in product development and maintenance. NHTSA recently released a “draft” update to the agency’s “nonbinding and voluntary guidance to automotive industry for improving motor vehicle cybersecurity.” Outlining “General Cybersecurity Best Practices,” the guidance favors a layered approach to cybersecurity structured around the principle functions “Identify, Protect, Detect, Respond, and Recover.” The agency believes the approach should:

- Use risk-based priorities to identify and protect safety-critical vehicle control systems;
- Where possible and feasible, eliminate risks to safety-critical vehicle control systems;
- Timely detect and rapidly respond to potential incidents in the field;
- Design methods and processes to facilitate rapid recovery from incidents; and
- Share lessons learned across the industry through effective information sharing, such as by participating in the Auto-ISAC.

The guidance reflects the agency’s belief that suppliers and manufacturers should create a culture of security and data privacy throughout their organizations. A key to this cultural approach is to demonstrate to all levels of the organization the seriousness of effectively managing cybersecurity risks. The agency believes that effective and appropriate cybersecurity requires manufacturers and developers to look to securing systems through the full lifecycle of the vehicle – conception, design, manufacture, sale, use, maintenance, resale, and decommissioning.

Although this guidance is nonbinding and voluntary, the agency would likely use these principles in evaluating the safety-relatedness of cybersecurity issues in the event of a defect investigation. Manufacturers should ensure that they can demonstrate these priorities in the event of an investigation. Suppliers should also be mindful of these principles and work with their customers to reconcile their approaches to cybersecurity and to ensure they are using state-of-the-art methods and procedures.

Automated Vehicle Legislation

In 2019, promising progress on AV legislation was made by staff from the Senate Commerce Committee and the House Energy and Commerce Committee, who led a bipartisan, bicameral effort to draft legislation. The 2020 pandemic and election seemingly halted any progress in this area. While passing AV legislation could reap significant benefits to the automotive industry by avoiding the patchwork of state vehicle regulations, it is unclear whether or when the new Congress would continue the work that has already been done.

Some of the issues that the effort looked to address, such as expanding exemptions for testing vehicles that are not certified as meeting all applicable FMVSSs, would become moot in the event the new NHTSA administrator publishes rulemakings NHTSA made public at the end of the Trump administration. How these planned actions by NHTSA may influence the new Congress will likely come into focus as the Biden administration determines how it will handle the unpublished and postponed rulemakings.

NHTSA Enforcement

NHTSA's enforcement activities remain robust, as recent consent orders between NHTSA and several major vehicle manufacturers demonstrate. These consent orders reflect NHTSA's continuing efforts to forcefully police violations and leverage its civil penalty authority to violators into full compliance. These consent orders demonstrate that compliance

with all of the various NHTSA reporting obligations, such as timely submission of complete and accurate information for recall-related reports and notifications, Early Warning Reports (EWR), foreign recall reports, and external communications (e.g., TSBs, etc.) remain important enforcement areas. The agency has the authority to stack up violations (regardless of how minor) to increase the penalty amount. For recall documents, NHTSA has increasingly used automated software audits to ensure that manufacturers' filings are complete and to issue follow-up inquiries to manufacturers whose reports contain gaps. A few minor slip-ups may not lead to an enforcement action. But NHTSA does track these issues, and a history of seemingly lax compliance can quickly undermine a manufacturer's reputation with NHTSA, raising the risk of an investigation.

To reduce their enforcement risk, it is critical that manufacturers ensure that their internal safety evaluation and reporting procedures are up to date and that key personnel are properly trained to identify and escalate potential safety defects and other potentially reportable events. These procedures should also include a process for confirming that all filings are timely and complete, and that amendments or updates to reports are timely submitted. Periodically auditing recall submissions to ensure that they are complete may be useful to ensure that current recall procedures are meeting NHTSA's expectations. Manufacturers should address any deficiencies identified during these internal audits and update policies and training as necessary.



Leveraging E/AV Patent Portfolios During a Pandemic

Like many industries, the pandemic has impacted the automotive industry, including electric and autonomous vehicle (E/AV) research and development. E/AV companies have laid off workers, delayed testing, and postponed the launch of some vehicles. Also during this time, there continued to be uncertainty around patenting AI technology, and the U.S. Patent and Trademark Office sought public feedback on the impact of new AI technologies on current intellectual property laws, and whether current patent laws should be amended to address same. In spite of the negative impacts of the pandemic, and the uncertainty around AI-related patents, E/AV companies continued to innovate at a breakneck pace, and leverage their patent portfolios to secure significant funding amidst the pandemic.

Some initial negative consequences of the pandemic included:

- Two ridesharing companies each laid off about 20% of their workforce, and an autonomous vehicle joint venture laid off about 10% of its workforce.
- Due to declines in vehicle purchases, original equipment manufacturers (OEMs) and investors reduced funding and production, and shifted their focus to financial issues.
- Multiple automotive companies postponed or suspended their self-driving vehicle testing and deployment, and shut down ridesharing services, setting back progress in AV technology development.

As the very premise of AV technology is to improve public safety and provide societal benefits, AV companies stepped up to the plate by applying their technology to solve unique problems posed by the pandemic. The following are some illustrative examples of the top applications of AV technology to the pandemic:

- Companies deployed AVs to deliver medical supplies, food, and packages. Companies also



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deployed AVs to disinfect areas, and formed partnerships to accelerate the development of AV technology to mitigate the spread of the virus. Some companies repurposed their technology to assist with various efforts, including charitable deliveries.

- Robotaxi services were deployed to provide an alternative transportation system for people, and were modified to provide a temperature measurement and take disinfection measures. In another example, using a software patch configured for vehicle self-sterilization, a company was able to disinfect its fleet of vehicles.
- As the applicability of AV, 5G, and AI technology towards mitigating the spread of the virus has become increasingly apparent during the pandemic, countries have found newfound incentives to advance legislation that facilitates AV research and development.

As illustrated above, E/AV companies continued to innovate and gain traction for their technology throughout the pandemic, and continued to seek funding in order to accelerate the rate of innovation. To stand out amongst their peers and attract investors during the pandemic, E/AV companies can leverage their deliberate, strategic patent portfolios development strategy. A patent portfolio is a key asset owned by the company and is often highlighted to investors as an indication of a company's innovativeness and robust research and development pipeline.

The following charts overlay the number of patent filings/month with funding events for 2 well-funded E/AV companies that raised funds during the pandemic. Funding events are according to [CrunchBase](#), and patent filings are determined from the USPTO's public patent database, both as of September 2020. It should be noted that patent applications typically do not become public until 18 months after filing, so the following charts represent patent filings as of February 2019.

Xpeng had an initial funding event of about \$20 million in March 2016. Thereafter, Xpeng consistently filed patent applications almost every month until August 2018. After August 2018, Xpeng increased its patent filings to upwards of 80 patent applications in a single month until a large funding event in November 2019 for \$400 million, which was subsequently followed by two more funding events for \$500 million and \$400 million during the pandemic in 2020.

Each of these well-funded E/AV companies had a spike in patent filings either right before or after a significant funding event, and the optics of a consistent, deliberate patent program can help attract investors or result in a more significant raise. However, since E/AV companies increasingly leverage artificial intelligence-related inventions to perform a wide range of tasks, such as image recognition, autonomous navigation, obstacle avoidance, battery management, etc., the uncertainty around patenting AI-related inventions may pose challenges to consistently building out a patent portfolio.

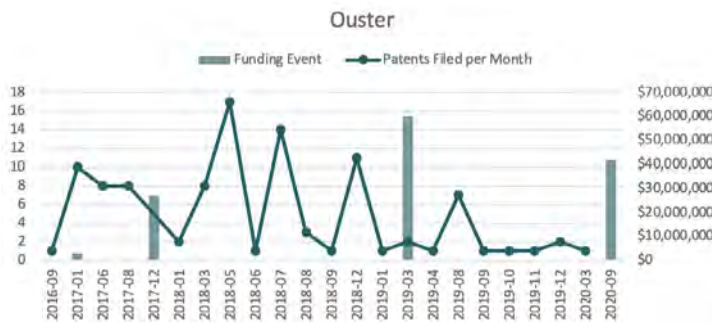


Figure 1: Ouster patent application filings/month and funding events

Ouster, from the start, ramped up its patent filings to 10 applications filed in January 2017 contemporaneously with its first funding event for \$3 million. Ouster continued with two more months of filing eight patent applications per month until its next funding event of \$27 million in December 2017. Again, Ouster continued its patent program by filing 17, 14, and 11 patent applications in May 2018, July 2018, and December 2018, respectively, which was followed by its biggest funding event of \$60 million in March 2019, and the latest funding round of \$45 million during the pandemic in September 2020.

It can be challenging to obtain patent protection for certain AI technologies due to U.S. patent law deeming them to be abstract ideas that may be ineligible for patent protection under certain circumstances. This area of patent law has been in flux for several years, and there have been mixed results from courts attempting to provide clarity on the issue. With the goal of maintaining U.S. leadership in innovation in emerging technologies by promoting the understanding and reliability of IP rights in relation to AI technology, the U.S. Patent and Trademark Office published a [report](#) titled “Public Views on Artificial Intelligence and Intellectual Property Policy” in October 2020, summarizing the feedback it received concerning issues of patent policy for AI technologies. Among other topics, the report sought feedback on the ability of current U.S. patent laws to address: 1) whether inventions including an application of AI are eligible for patent protection, and 2) whether inventions “made” by AI are eligible for patent protection.

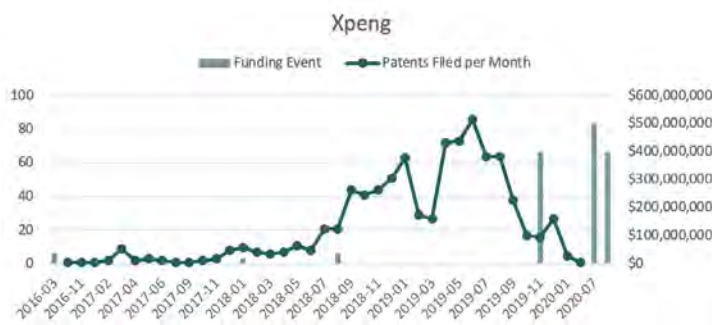


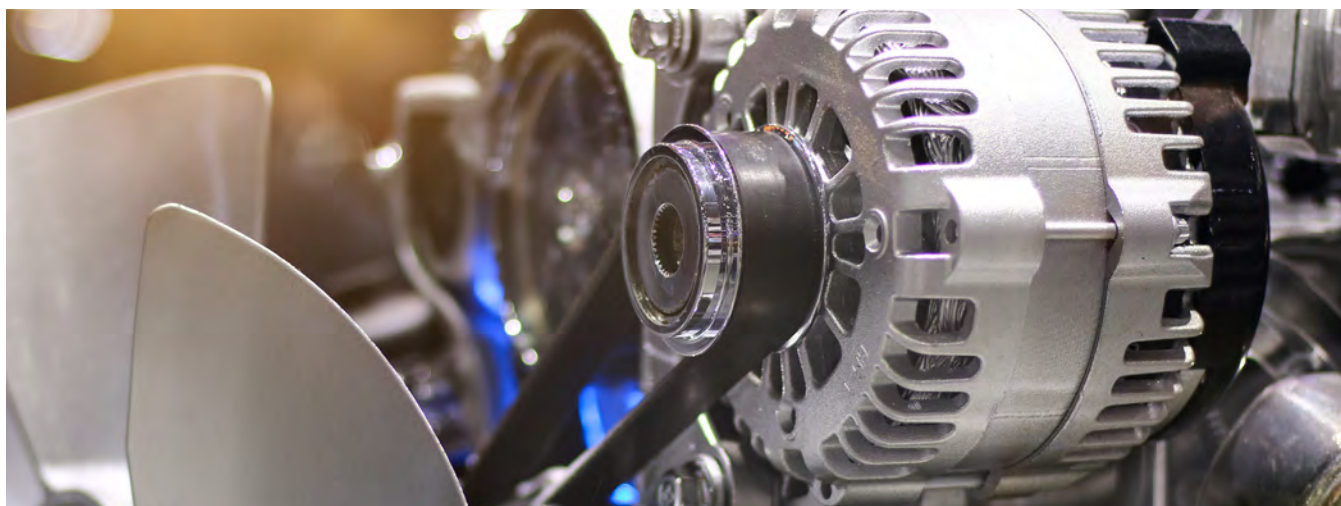
Figure 2: Xpeng patent application filings/month and funding events

Generally speaking, the commenters agreed that AI does not have a universally recognized definition, and that the current state of the art is limited to “narrow” AI systems that perform individual tasks in well-defined domains (e.g., image recognition), as opposed to artificial general intelligence (“AGI”) akin to that possessed by humankind. Since AGI has not yet arrived and humans remain integral to the operation of AI, the commenters suggested that AI was just a tool used by humans to make an invention and AI cannot yet invent without human intervention, making humans integral to the operation of AI. According to the report, the consensus for now appears to be to punt on whether an invention conceived of by AI is eligible for patent protection because AGI does not appear to be on the near-term horizon.

On the more pressing issue of whether U.S. patent law is well-equipped to analyze whether inventions that include an application of narrow AI are eligible for patent protection, the majority of commenters agreed that since AI can be viewed as a subset of computer-implemented inventions, the current USPTO guidance on patent subject matter eligibility is applicable. Commenters suggested that AI inventions should not be treated any differently than other computer-implemented inventions. Further, it was noted by a commenter that the complex algorithms that underpin AI inventions have the ability to yield technological improvements. And, even if a claim in a patent application is directed to an abstract idea, the claim is still patent eligible if the additional claim elements, considered individually or as an ordered combination, amount to significantly more than the abstract idea so as to transform it into patent-eligible subject matter.

Another potential hurdle to patenting AI-related inventions is the requirement to adequately describe the invention in the patent application. However, the majority of commenters shared the sentiment that there are no unique disclosure considerations for AI inventions. Indeed, one commenter noted that the principles regarding computer-implemented inventions are similarly applicable to AI-related inventions as to conventional algorithm solutions. That is, AI inventions that include claims to computer-implemented inventions should provide sufficient detail in the specification regarding the hardware, as well as software, to show that the inventor had possession of the full scope of the claimed invention (e.g., disclose one or more of the detailed steps, detailed procedures, formulas, diagrams, or flowcharts).

In conclusion, while the pandemic had negative impacts across numerous industries, E/AV companies continued to innovate and were still able to achieve their business objectives with the help of their patent portfolios. And, as E/AV technology increasingly leverages AI-related innovations, it appears that the consensus from the USPTO’s report is that aspects of these technologies will continue to be eligible for patent protection when claimed and sufficiently described in a patent application pursuant to the requirements set forth by the U.S. patent laws and USPTO requirements. Having a consistent and strategic approach to developing a patent portfolio through uncertain times can facilitate an E/AV company to achieve its business objectives.



M&A Survives and Thrives in 2021: Dealmakers are Charged Up Heading into the New Year

With 2019 seeing modest slowdowns in both M&A deal volumes and deal values compared to 2018, industry participants entered 2020 cautiously optimistic about the potential for automotive M&A deal growth. Although 2020 wasn't predicted to be a breakout year for M&A deals, many saw autonomous and electrification technologies driving industry activity as consumers continued to warm to the thought of self-driving cars and the idea of replacing gas stations with charging stations. In the background, consolidation of suppliers and producers in the internal combustion engine sector were likely to continue driving underlying activity in 2020 and for years to come.

As 2020 turned out, the COVID-19 pandemic had a dramatic impact on M&A activity generally, with a disproportionate impact on the automotive sector as communities around the world closed down, OEM plants and auto dealers were shut down, and consumers were forced to stay home. With the Great Recession still fresh in the minds of many in the automotive industry, companies took dramatic action early on in the pandemic, drawing on credit facilities and shoring up weak balance sheets as strong players prepared for distressed M&A opportunities among the expected bankruptcies within their supply chain and competitive base. Many deals paused during the first half of the year as COVID-19 weighed down markets around the globe, lockdowns were eased and businesses started to reopen operations. However, M&A activity in the automotive sector saw explosive growth in the second half of 2020, though it remained tempered by the possibility of COVID-19 surging back. Surprisingly to many, lenders were far more accommodating of borrowers than they were during the Great Recession, helping troubled companies stay afloat with the assistance of CARES Act programs, including the PPP. As a result, the tsunami of distressed M&A and bankruptcies remained far below expectations. Going forward, many industry



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participants are wary of lenders' willingness to accommodate continued financial difficulty through 2021, and many worry the distressed company wave may have just been delayed, not avoided.

As 2020 came to a close, with a new administration entering the White House and the light appearing (though a bit dimly) at the end of the COVID-19 tunnel via the vaccines coming online, deal makers were taking a cautiously optimistic look to a new year of M&A activity in the automotive sector.

2020 Was a Year No One Expected

The COVID-19 pandemic was a leading factor in the decline of both automotive M&A deal values and volumes in 2020 compared to 2019, dropping 32% and 18%, respectively, according to PwC. Similarly, M&A activity as a whole saw declines in both aggregate value and volumes, with total deals falling 8% and aggregate values declining 7% compared to 2019, according to estimates from Refinitiv. That said, 2020 still saw almost 45,000 announced M&A deals with an aggregate value exceeding \$3.4 trillion, while the automotive sector saw over 620 deals with an aggregate deal volume of over \$41.3 billion.

With a soft first half of 2020, dealmakers assessed the economic impact of COVID-19 and entered the second half ready to take advantage of improved cash reserves, cheap costs of capital, and new methods of conducting acquisitions. While global M&A saw a nearly 40% decline in deal value in the first half of

the year, values swiftly recovered in the second half of 2020, to end the year with values down only 7% compared to 2019. Similarly, the third quarter saw over \$23 billion in deal value in the automotive sector alone, but fourth quarter activity slowed as uncertainty about COVID-19 and the presidential election weighed heavily on the minds of dealmakers.

A bounce back in third quarter activity was largely driven by the emergence of special purpose acquisition companies (“SPAC”) as a preferred method for private companies to access the public capital markets. In the automotive sector, the use of SPACs heavily favored the automated, connected, electric and sharing (“ACES”) automotive technologies and business models through the end of 2020. Automotive companies such as Nikola, Ouster, Arrival, Electric Last Mile Solutions, Fisker, Lordstown Motors, Canoo, and XL Fleet Corp led the way with SPAC transactions in 2020, accounting for over \$6 billion raised. Without accounting for industry, SPACs accounted for \$74 billion in M&A activity, with traditional IPOs accounting for \$218 billion in deal value. Over 242 SPAC entities were listed in 2020, four times the amount introduced in 2019, with an average size of \$335 million, nearly 10 times the value of the average SPAC value listed in 2019.

Many industry analysts predict SPACs to accelerate further M&A activity in 2021 and beyond, largely driven by the transition to 100% electrification and the expectation that this transition will cost over \$2.5 trillion and that the push towards automation will cost even more. Traditional M&A activity did not sit on the sidelines unabated in 2020, accounting for the overwhelming majority of transactions compared to SPACs. Even in the face of economic headwinds and COVID-19’s impact on automotive sales, megadeals still occurred with Intel’s Mobileye unit acquiring Moovit for \$900 million, Amazon spending \$1.2 billion to acquire Zoox, Uber acquiring Postmates for \$2.6 billion, BorgWarner purchasing Delphi Technologies for \$3.3 billion, and Volkswagen’s heavy truck unit Traton acquiring Navistar for \$3.7 billion.

Although large-cap and megadeals stole the headlines for automotive M&A in 2020, middle-market deals continued to move in step with the rest of the industry. While middle-market deals suffered through the first half of 2020, as economies emerged from lockdowns

entering the third quarter, so did middle-market dealmakers. While financial buyers proved to take the lion’s share of transactions in 2020, accounting for all deals in the second quarter alone, strategic buyers reentered the market in the third quarter. Total middle-market deal volumes for the third quarter exceeded \$664 million through 97 transactions, compared to \$543 million and 158 deals in the first half of 2020, with auto dealership transactions accounting for the majority of deals throughout the year as traditional dealers continued a trend of consolidating.¹

Electrification and Autonomous Continue to Drive Excitement

The push towards electrification and automation continued to drive M&A activity for the automotive industry in 2020, and is only expected to accelerate going forward. No longer the new kid on the block, Tesla’s emergence as one of the leaders in automotive innovation and marketing (capped off by its addition to the S&P 500 late in 2020) continues to capture the hearts and minds of consumers and dealmakers alike. Hoping to replicate the success of Tesla, in both product adoption and valuation explosion, traditional automotive manufacturers and new market entrants are looking to capture the next Tesla through a rapid series of acquisitions and partnerships in 2021.

Riding the coattails of Tesla’s success, the anxiety over electric battery charging and computers navigating our vehicles down the roadways slowly dissipated in 2020, and this trend will likely continue throughout 2021. But it hasn’t just been the success of Tesla, whose market cap at one point in 2020 was higher than the seven largest automakers combined at the start of the year, which has driven the adoption of EVs and the excitement of dealmakers for this space. A combination of stricter regulations against gas-powered vehicles, the expected environmentally focused agenda of the Biden administration, including fossil fuel elimination, a growing comfort for plug-in vehicle purchases, drastic improvements in technology, and the benefits of scale, have led more consumers to embrace electric vehicles and provided dealmakers with a better business case for entering the EV space.

¹ See Greenwich Capital’s deal studies: <https://greenwichgp.com/2020/08/03/q2-2020-automotive-industry-update/>

Not wanting to miss the EV boat, traditional OEMs realize the growth of EV is still a long and difficult road, but one they cannot simply sit back and watch pass them by. Encumbered by the image of being legacy manufacturers, many traditional OEMs are seeing their own market valuations depressed compared to more recently listed public companies like Tesla and Nio, each of which see a per-vehicle market valuation of \$1.1 million and \$1.6 million, respectively, compared to GM and Volkswagen, whose per-vehicle market valuations are \$9,000 and \$10,000, respectively. While this is easily explainable by the drastic difference in vehicle sales between the legacy OEMs and new entrants, it demonstrates the upsized valuations investors are putting on EV-focused companies even when vehicle deliveries and operating fundamentals would not begin to justify such valuations.

While 2019 might have been the year of the autonomous vehicle, 2020 was the year of electrification, and it might not be turning back to the internal combustion engine any time soon. That said, the development of new technologies and M&A activity in the AV space continued to move forward in 2020. While Tesla has largely focused on a camera-based AV technology platform, LIDAR has been championed by players such as Aurora and has been the technology of choice for recent 2020 SPAC-merger companies Velodyne, Luminar, Aeva, Innoviz, and Ouster. Although industry participants are starting to realize the road to full automation might be longer than the road to full electric vehicles, development continues to push ahead in conjunction with smart city projects around the globe.

2021 - A Year of Cautious Optimism

As the world enters 2021, dealmakers have been looking forward with a gaze of cautious optimism. Even with the COVID-19 vaccine beginning to roll out, many dealmakers have tempered their optimism surrounded by a resurgence in COVID-19 cases and civil unrest throughout the United States, including with the transfer of power in Washington, D.C. Coming out of 2020, strong companies managed to shore up their balance sheets and take advantage of access to continued cheap capital and accommodating fiscal policies in the United States and Europe. Having over two quarters to assess the impact of COVID-19, many buyers are on the lookout for potential distressed opportunities at reasonable valuations with highly motivated sellers.

The uncertainty over COVID-19's continued impact still weighs on the minds of dealmakers as 2021 charges ahead. The change of guard in the White House and President Biden's first 100 days are certain to be dramatic and full of sweeping changes on multiple fronts, including in environmental, energy, labor and employment and other areas that will dramatically impact the auto industry. With Democrats in control of the presidency, the House, and the Senate, many are expecting the Biden administration to make drastic changes to Trump's 2017 tax plan as well as expand various environmental restrictions that will have impacts on the automotive sector. These changes are likely to come swiftly and early on in the Biden administration's first 100 days. The continued shift towards EV is likely to drive consolidation in legacy internal combustion players seeking to drive down costs and expand market share while facing continued pressure to transition to new technology and the expected new world of governmental regulation.



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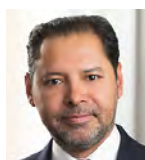
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Our Core Values

Citizenship

We embrace our responsibilities to our communities and profession and will lead by example through civic, pro bono, professional and charitable service.

Clients First

Our clients are our first priority. When we provide quality work, value and superior service to our clients, our own success inevitably follows.

Diversity

We embrace diversity and are committed to the inclusion of our diverse attorneys and staff and to the success of all our people.

Our People

Our people are our most valuable asset and their quality, creativity and dedication are indispensable to our success.

Integrity

We will adhere to high standards of ethics, professionalism and integrity and safeguard the reputation of the firm at all times.

Trust and Respect

The success of our partnership stands on a foundation of trust, mutual respect, collegiality, communication and teamwork.

Stewardship and Accountability

As stewards of the firm, we are accountable to one another and will commit our time, talent and energy to the firm's success, growth and long-term prosperity.

Professional Satisfaction

Our work should be professionally satisfying and provide competitive financial rewards while affording the opportunity to achieve a reasonable balance between professional demands and personal commitments.



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