

# Top Legal Issues Facing the Automotive Industry in 2018

Prepared by Foley's Automotive Industry Team

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The automotive industry continued to experience dramatic changes – including legal and regulatory developments – throughout 2017, and the road ahead shows no signs of slowing down. Being at the forefront of these developments will help you anticipate how those changes may impact your business.

Foley's Automotive Industry Team has prepared this report examining what the litigation, enforcement and regulatory landscape is likely to look like in 2018 and beyond. Inside, you will learn about:

- Managing warranty, regulatory and commercial litigation risks in the wake of two notable commercial litigation cases decided in 2017
- The uncertain outlook for antitrust enforcement in the United States under a new administration and a new merger enforcement agenda by the DOJ
- The top labor and employment issues facing the automotive industry, from sexual harassment and nondiscrimination policies to employee rights and pay equity
- Knowing the risks of international and domestic compliance issues in an increasingly complicated regulatory environment
- Navigating the new world of connected cars while developing, implementing and maintaining an effective auto cybersecurity program
- Foley's 2017 Connected Cars & Autonomous Vehicles Survey Results. The survey findings reveal great promise for automotive and technology companies in this rapidly evolving area, alongside barriers to these technologies reaching their growth potential
- Preparing your business for the continued aggressive enforcement by NHTSA regarding auto safety and the expected passage of the first federal legislation to regulate autonomous vehicles
- The prospects for another strong year for the automotive sector and related M&A activity, thanks in large part to positive macroeconomic factors and the continued development of and investment in emerging automotive technologies
- Potential pitfalls in the automotive industry in an era of increasing warranty and recall costs and continued consolidation in the supply base

We hope you find this report useful and informative. If you have any questions regarding its content or how it may affect your business, please contact your Foley attorney or any of the contributors listed in this program on Page 31.

## Table of Contents

2	<b>MANAGING WARRANTY, REGULATORY, AND COMMERCIAL LITIGATION RISKS</b> <i>Mark Aiello, Andrew Fromm</i>
5	<b>2018 ANTITRUST OUTLOOK – ANOTHER YEAR OF UNCERTAINTY</b> <i>Greg Nepl</i>
8	<b>TOP LABOR AND EMPLOYMENT ISSUES IN AUTOMOTIVE TO WATCH IN 2018</b> <i>Carmen Decot, Scott Allen</i>
12	<b>KNOW THE RISKS: DOMESTIC AND INTERNATIONAL COMPLIANCE</b> <i>Greg Husisian</i>
15	<b>NAVIGATING CONNECTED CARS CYBERSECURITY CONCERNS IN 2018</b> <i>Chanley Howell</i>
17	<b>FOLEY’S 2017 CONNECTED CARS AND AUTONOMOUS VEHICLES SURVEY</b> <i>Mark Aiello</i>
21	<b>NHTSA AND MOTOR VEHICLE SAFETY</b> <i>Chris Grigorian, Nick Englund</i>
25	<b>THE 2018 AUTOMOTIVE MERGERS AND ACQUISITIONS OUTLOOK</b> <i>Steve Hilfinger, Josh Munro</i>
27	<b>LOOKING INTO THE CRYSTAL BALL: POTENTIAL PITFALLS IN THE AUTOMOTIVE INDUSTRY IN 2018 AND BEYOND</b> <i>Ann Marie Uetz, John Simon, Tamar Dolcourt</i>
30	<b>LIST OF CONTRIBUTORS</b>

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## Managing Warranty, Regulatory, and Commercial Litigation Risks

*By: Mark Aiello, Partner, Andrew Fromm, Senior Counsel*

Elevated warranty expenses for OEMs are expected to continue in 2018. Automotive suppliers can continue to expect to pay a greater per-vehicle share of these expenses. Because OEM purchase orders and corresponding general terms and conditions contain highly OEM-favorable terms, exceptions and limitations to supplier warranties are difficult to negotiate.

Warranty risk management should start at the contracting phase. Specifications to which the product is to be designed and/or manufactured should clearly be set forth in the contract documents, and any inapplicable warranties, including warranties outside the scope of design responsibility, should be disclaimed. Consider documenting suggested alternative designs for a more robust or superior performing product that is declined by the customer. Additionally, the key documents relating to product testing and acceptance criteria, as well as which party is responsible for which level of testing, also should be preserved and readily accessible in the event of a dispute. Finally, additional protection from warranty risks should be considered during the contracting phase through the use of contractual provisions relating to insurance, indemnification, and dispute resolution.

If a warranty issue arises, the supplier needs to react quickly to identify the root cause(s), contain the problem, and establish clean points. Determine protocols for analyzing root causes for dealer repair codes that could implicate the product. Also establish an express protocol for handling warranty claims, including product return, inspection, and determining the root causes for the failure. The supplier must also understand the warranty period that will apply to the product, when the warranty period will begin to run, and what obligations the supplier has under the warranty claim.

If the claim involves multiple parties, the tier 1 supplier should work closely with the OEM to identify and document quality issues early and promptly communicate responsibilities. If the claim involves a downstream supplier, notice of the warranty claim, notice of a breach of applicable agreements, documentation of root cause(s) and documentary evidence supporting the supplier's damages are critical should litigation arise. These steps are key to ensuring that the supplier has the ability to demonstrate that it should only be responsible for paying a certain portion of the total recall costs and that the tier 1 supplier has the ability to pass through any costs that are the responsibility of the tier 2 supplier.

Automotive suppliers also should ensure that they have internal safety review procedures in the event the supplier makes a safety defect determination concerning its component that requires reporting to the National Highway Traffic Safety Administration (NHTSA). Where a potential defect may involve components supplied by lower-tier suppliers, the supplier must review all relevant purchasing contracts for provisions relating to recalls, decision-making, reporting, cooperation, design responsibility, and allocation of cost recoveries. Suppliers also should update their purchase order terms and conditions to ensure that they contain the appropriate contractual protections from their lower-tier suppliers.

If NHTSA commences a defect investigation, it is likely the OEM will be asked to submit confidential supplier information relating to design and engineering documents, and test data. The supplier should consider the confidentiality of such documents and request that the OEM seek confidential treatment of such information in accordance with NHTSA's regulations. In many cases, this will require an affidavit in support by the supplier setting



forth the basis for the confidentiality of the information under relevant Freedom of Information Act (FOIA) exemptions.

The supplier should develop its own position concerning whether the component or vehicle contains a safety-related defect within the meaning of the Highway Safety Act and NHTSA's regulations, taking into consideration past NHTSA recalls and investigations involving similar components. The supplier also should monitor new recalls and investigations, including OEM submissions and regulatory developments, that may affect the supplier or its products, such as proposals for new safety standards or amendments to existing standards.

Automotive suppliers also can take other simple steps prior to contracting to reduce the risk of litigation. For example, companies should confirm the specific corporate entity that will be the counterparty in the contract. The counterparty's litigation history, credit history, and reputation in the industry should be reviewed. Companies should also confirm that the written contract accurately defines all prior oral promises, negotiated rights, and obligations. If the contract involves a party outside of the United States, a forum selection clause or arbitration clause should be considered. Additionally, for long-term agreements, the party should confirm that the risks of early termination have been addressed.

During performance of the contract, the company should ensure that a point of contact has been tasked with ensuring compliance with the contract, and that applicable contract documents and relevant communications are readily accessible if, and when, needed. When a dispute arises, important conversations or meetings on the subject should be carefully documented, and confirming emails on the subject sent to the counterparty. If the dispute escalates into a claim, a point of contact should be designated as the lead for the claim and an early assessment of the claim should be performed. The company should also ensure that it has gathered all documents relating to damages, including documenting all travel and employee time spent addressing the dispute. While the above steps cannot eliminate the risk of litigation, they can reduce the likelihood of litigation and can better position the company for success when litigation is unavoidable.

Below are two notable commercial litigation cases decided in 2017 that may be of particular interest to companies within the automotive and manufacturing supply chain. The first case involves the difference between incidental and consequential damages, and the second case involves a claim for breach of an implied contract.



**Dietec Co., LTD v. Osirius Group, LLC, 2017 WL 6039557 (E.D. Mich. Dec. 6, 2017).**

In Dietec, the court highlighted the distinction between consequential and incidental damages. Dietec designed and manufactured dies that were to be used by Osirius for the production of interior door panels. Dietec alleged that Osirius failed to timely pay Dietec pursuant to the parties' payment schedule, and as a result, Dietec was required to obtain a high-interest loan to cover its own production costs under the contract. Dietec also alleged that Osirius' failure to promptly pay Dietec caused Dietec's financial performance to deteriorate and lose other business unrelated to Osirius.

Dietec sued Osirius for breach of contract and sought to recover damages stemming from its increased costs to perform under the contract and for its lost business as a result of Osirius' failure to timely issue the progress payments. Osirius argued that Dietec's lost business damages were consequential damages, and that while a buyer may recover both consequential and incidental damages under the UCC, MCL §440.2708(2) prohibits the seller from recovering consequential damages. The court agreed with Osirius, holding that, although there is no bright line between consequential and incidental damages, incidental damages are those damages that a party would

expect would result from its breach of contract, even without knowledge of any special circumstances of the other party. In contrast, consequential damages are those that the reasonable contracting party could expect only with special knowledge of the other party's circumstances.

The court held that Dietec failed to plead facts about which Osirius would anticipate that its failure to make timely payments on the project would result in Dietec losing other business and, therefore, that Dietec's lost business damages were consequential rather than incidental. The court, therefore, rejected Dietec's claim for lost business damages as unrecoverable consequential damages by a seller, but held that Dietec could recover its incidental damages relating to its increased costs of performance.

**Landstar Express America v. Nexteer Automotive Corporation, 319 Mich. App. 192 (March 30, 2017).**

In Landstar, the Michigan Court of Appeals affirmed the trial court's grant of summary disposition in favor of Nexteer Automotive Corporation (Nexteer). Landstar, a shipping company, sought to recover unpaid expedited freight shipping charges for automotive parts under an implied contract theory, despite the fact that Landstar's contract was with the supplier of the parts, Contech Casting, not the buyer, Nexteer. Landstar argued that merely by accepting the parts, Nexteer became liable for unpaid freight charges under the theory of "consignee liability." The court rejected this argument, holding that the express contract between Contech Casting and Landstar covering the same subject matter precluded Landstar from bringing an implied contract claim against Nexteer. The Court of Appeals also affirmed the trial court's dismissal of Landstar's unjust enrichment claim, finding that the only benefit that Nexteer received — the timely delivery of automotive parts — was nothing more than what the parties contemplated and that all parties contemplated that Contech Casting would be liable for the shipments.

## 2018 Antitrust Outlook – Another Year Of Uncertainty

By: Greg Neppl, Partner

**As 2018 approaches, the antitrust outlook in the United States continues to present uncertainty. This article identifies some sources of that uncertainty and offers some predictions.**

### Trump Administration Signals New DOJ Directions

**“AT&T IS BUYING TIME WARNER AND THUS CNN, A DEAL WE WILL NOT APPROVE IN MY ADMINISTRATION BECAUSE IT’S TOO MUCH CONCENTRATION OF POWER IN THE HANDS OF TOO FEW.”**

Historically, U.S. antitrust enforcement has been marked more by continuity than abrupt change. During the past few decades we saw an evolution away from blanket rules of per se legality or illegality (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 unacceptable competitive/consumer welfare consequences).

In his 2016 campaign for president, however, Donald Trump frequently expressed populist themes, rhetorically criticizing “big business” and “special interests.”

Candidate Trump also signaled an activist antitrust agenda with his comment in October 2016 that a major telecom deal (Time Warner/AT&T) would not be allowed: “AT&T is buying Time Warner and thus CNN, a deal we will not approve in my administration because it’s too much concentration of power in the hands of too few.” Candidate Trump is now President Trump.

Makan Delrahim, President Trump’s nominee for the Assistant Attorney General for Antitrust post at DOJ, was confirmed by the Senate in September 2017. The first major merger review for Delrahim to consider as AAG was Time Warner/AT&T, a review complicated by politics. Delrahim’s Senate confirmation was significantly delayed by a hold placed on his confirmation vote by Senator Elizabeth Warren (D-MA). Delrahim had pledged to the Senate Judiciary Committee that his enforcement decisions would be free from the political influence of the White House. In a letter dated October 12, 2017, following Delrahim’s confirmation, Senator Warren urged Delrahim to recuse himself from the Time Warner/AT&T merger review.

Delrahim declined this recusal request.

This merger review turned surprisingly contentious in November 2017, with Delrahim signaling to the parties that DOJ would require significant structural relief and stating publicly that behavioral relief, of the type historically accepted by DOJ (and FTC) to address vertical merger concerns, is now highly disfavored. In support of this view, Delrahim cited the difficulty to DOJ of enforcing behavioral relief. “Behavioral remedies presume that the government should serve as a roving ombudsman of the affairs of business; even if we wanted to do that, we often don’t have the skills or the tools to do so effectively.” He also cited a more general concern with the “regulatory” implications of DOJ requiring behavioral relief. “Like any regulatory scheme, behavioral remedies require centralized decisions instead of a free market process.”

On November 20, 2017, DOJ filed a complaint to enjoin Time Warner/AT&T. Questions regarding the antitrust merits of the complaint, the inadequacy of behavioral relief and political influence from the White House soon followed.

This DOJ challenge may or may not be tried in court. DOJ could still settle with the parties subject to some combination of structural and/or behavioral relief. The parties could abandon the deal.

However this DOJ merger challenge ends, a few lessons for this 2018 Antitrust Outlook are already in hand:

- 1 → Delrahim may pursue a merger enforcement agenda with potential surprises and new thinking;
- 2 → “traditional” antitrust enforcement expectations during a Republican administration may not be fulfilled; and
- 3 → efforts to apply political influence on merger matters may be present (although the impact of those influences on review outcomes may not be transparent).

At the same time, the Antitrust Division has for decades aggressively pursued per se illegal cartel conduct. This longstanding effort has generated an increasing number of criminal prosecutions, billions of dollars in fines, and significantly longer terms of incarceration for individual offenders. The number of grand jury investigations continues to be robust. It is unlikely that this criminal antitrust enforcement agenda will change during the Trump Administration, as this segment of DOJ’s enforcement agenda has wide bipartisan support and is significantly insulated from political influences.









# Top Labor and Employment Issues in Automotive to Watch in 2018

*By: Carmen Decot, Partner, and Scott Allen, Associate*

The Trump administration has already made a mark on labor and employment policy at the federal level in 2017, but employers can expect greater movement in 2018 once more of President Trump's nominees for federal agencies have taken office and begun to implement more business-friendly policy changes. In addition, recent media coverage about everything from racism to sexual harassment demonstrates that employers cannot ignore longstanding employment laws.

Below, we will discuss issues that are likely to remain front and center, as well as explain significant policy changes expected to occur in 2018. These include, among other things, developments in the wage and hour, equal employment, and labor relations areas that will impact automotive industry employers.

## 1. Addressing Sexual Harassment and Assault Allegations

Over the last year, more and more women and men have come forward to share their experiences of sexual harassment and assault – bringing down high-profile figures in politics, the media, and Hollywood. This trend has shown no signs of slowing, and it is more important than ever that employers take all complaints of harassment and discrimination seriously, conduct thorough investigations, and take appropriate action, where warranted, to discipline offenders and prevent future improper conduct from occurring.

This is particularly true given that allegations of sexual harassment or assault can have far-reaching, negative consequences for a company. Defending against lawsuits is costly, and failure to promptly and adequately address allegations can create a toxic culture and drive away talented workers. That is why all employers should review their nondiscrimination and harassment policies and ensure:

- There are sufficient and multiple avenues for employees to bring complaints or raise concerns about harassment or discrimination to the company, including the Human Resources Department, particularly if the alleged wrongdoer is in a management or senior position;



- Employees are aware of how to file complaints and understand that they will not face any retaliation for bringing forward concerns; and
- All complaints and reports about sexual harassment and other forms of harassment and discrimination are thoroughly investigated, and that appropriate action is taken against offenders so that any inappropriate conduct is remediated and does not recur.

### TAKEAWAYS

Employers should review their nondiscrimination and harassment policies and practices. Policies must be robust and should provide at least two reporting routes – e.g., to Human Resources, an anonymous hotline, or upper management. Additionally, policies should be communicated to employees at least once per year during training – in-person training (as opposed to online modules or webinars) is recommended. Where needed, employers should ensure compliance with any legal changes. Employers should also take steps to demonstrate that nondiscrimination and “no harassment” policies are priorities for the organization and have the support of top managers.

## 2. Joint NLRB and EEOC Guidance on Harassment and Protected Speech

In recent years, there has been some tension between equal employment laws, which prohibit harassment on the basis of any protected characteristic, and the National Labor Relations Act (NLRA), which protects employees' rights to speak freely about workplace concerns. During President Obama's time in office, the National Labor Relations Board (NLRB) sought to expand employees' rights under the NLRA and often ordered that workers who were terminated for using vulgar language or even racial epithets in the context of union disputes be reinstated. For example, in *Cooper Tire & Rubber Co. v. NLRB*, a federal appeals court in August 2017 upheld the NLRB's decision to reinstate an employee who was fired after making racist comments while picketing during a strike.

While certain impolite speech and behavior must be tolerated under the NLRA if it occurs in the context of protected activity, employers are required under Title VII to take steps to prevent unlawful harassment in the workplace, which may involve appropriate discipline for harassers. To address this concern, the NLRB and the EEOC are currently working on joint guidance to help employers understand how to fulfill their obligations to address and prevent harassment without infringing on employees' rights under the NLRA.

The Obama-era NLRB scrutinized policies in employee handbooks and issued guidance in 2015 which stressed that policies requiring workers to be "respectful" are unlawful because they may "chill" protected speech. However, in December 2017, the NLRB general counsel withdrew this 2015 guidance, and the NLRB issued a decision in a case involving *The Boeing Co.* that reversed precedent, finding that employee handbook policies were unlawful if employees could "reasonably construe" them as infringing on their rights. The new standard for employee handbook policies is more deferential and considers the employer's "legitimate justifications" for such policies.

This appears to be just the beginning of an aggressive reversal by the Republican-controlled NLRB away from the previous expansion of workers' rights. In December 2017, the NLRB reversed other key Obama-era rulings, including the standard for "joint employment," which was previously an expansive standard that made employers more likely to be held jointly liable for labor law violations committed by other "joint"

employers, such as contractors and franchisees. The NLRB also reversed the standard for "micro-units," which made it easier for small groups of employees to organize as a single unit for collective bargaining purposes. Expect the NLRB to continue to reverse major precedent in a pro-management direction in 2018.

### TAKEAWAYS

Stay tuned for the joint NLRB and EEOC guidance on harassment and protected speech. Employers with a unionized workforce or those dealing with a union organizing campaign need to be cognizant of these issues before disciplining employees who are engaged in union-related activities. Also, employers should stay on top of NLRB developments, as the agency is poised to issue major and consequential rulings in 2018.

## 3. Developments on Wage and Hour Laws

Last year, the Department of Labor issued new regulations, initially set to take effect in December 2016, that would have nearly doubled the minimum salary threshold required for administrative, executive, and professional employees to qualify as exempt from overtime under federal law. However, implementation of these regulations was initially delayed and then permanently halted following a federal court decision enjoining implementation of the regulations. Now, under the leadership of Secretary Alexander Acosta, the Department of Labor is again considering increasing the salary threshold for "white collar" employees, but this time around, such an increase is expected to be more modest than the \$47,476 salary proposed by the Obama administration in 2016.

On July 15, 2017, Department of Labor also solidified its new, pro-business direction when it withdrew guidance from the Obama administration that previously narrowed how the department would define an "independent contractor," resulting in greater potential liability for misclassification of "employees" as contractors. At the same time, the department (like the NLRB) withdrew its prior guidance on "joint employment," which had expanded employers' potential liability for wage and hour violations committed by the another "joint" employer such as a contractor or temporary staffing agency. The department's opinion letters providing guidance in both of these areas were withdrawn on July 15, 2017.

Looking forward to 2018, the U.S. Supreme Court will decide whether “service advisors” who work for car dealers may qualify as exempt from overtime under the Fair Labor Standards Act (FLSA). Oral arguments in *Encino Motorcars v. Navarro* have been scheduled for January 2018. While there is an exemption under the FLSA for “any salesman, partsman, or mechanic primarily engaged in selling or servicing automobiles,” the Navarro petitioners argue that service advisors do not fall within those categories. This ruling may finally bring certainty to auto dealers with respect to service advisors, although it may result in greater overtime pay obligations if the petitioners prevail.

#### TAKEAWAYS

While employers can breathe a bit easier now that the department has abandoned its aggressive positions on joint employer and independent contractor status, they are well advised to ensure that employees classified as independent contractors or “exempt” from overtime properly qualify as such under the law. Employers should consider asking legal counsel to conduct a review of contractor and exempt positions to ensure that workers are not misclassified. Misclassification can result in substantial liability for unpaid wages for two or more years, on top of liquidated damages and attorney’s fees, so it is crucial to get it right.

#### 4. Class Action Waivers and Arbitration

In recent years, the NLRB has held that arbitration agreements in which employees waive their right to bring class actions are unlawful because they restrict employees’ rights to engage in “concerted activity” under the NLRA. The Trump administration’s Department of Justice (DOJ) reversed its earlier position and sided with employers in the case, creating a rare situation in which two federal agencies (the DOJ and NLRB) argued opposite sides in a case before the Supreme Court.

In October 2017, the Supreme Court heard oral arguments in *Epic Systems Corp. v. Lewis*, which involves a dispute over whether employees may be required to enter into arbitration agreements in which they waive their right to file class or collective action lawsuits in the employment context. The court’s ruling is expected in 2018. With the addition of Justice Neil Gorsuch in April 2017, the court is expected to hold that, similar to its rulings in the consumer context, such agreements may prohibit employees from pursuing class relief.

#### TAKEAWAYS

The court’s ruling in *Epic Systems Corp. v. Lewis* will have major implications for employment agreements, and employers should be sure to involve legal counsel in reviewing and updating agreements to make sure they comport with the ruling. A well-drafted independent contractor or employment agreement can limit potential liability for employment-related claims, as arbitration is generally a less costly and more efficient forum for resolving employment disputes than litigating in court.

#### 5. Other Anticipated Hot Topics in 2018

Other anticipated hot topics for 2018 include immigration, drug testing, paid leave, LGBTQ rights, pay equity, and government contractor regulation.

**Immigration** will remain a hot topic in 2018. Among the Trump administration’s controversial immigration policies advanced last year was an executive order for a comprehensive review of the H-1B visa program. Under the current program, foreign skilled workers granted H-1B visas are authorized to work temporarily in the United States. The Trump administration proposes shifting the program from a lottery to a “merit-based” system that awards visas to applicants based on their skills and education. While the full impact of the proposed changes remains to be seen, in 2017, applications for H-1B visas declined for the first time since 2013, and the administration has already stepped up challenges to applications and ended a “fast track” process for certain applicants who paid a higher fee. Therefore, employers that rely on the H-1B visa program for work authorization for foreign workers should pay attention to further proposals by the administration to limit or restrict the use of H-1B visas in 2018.

**Mandatory drug testing** received scrutiny this past year, after OSHA issued guidance stating that mandatory, post-accident drug testing policies were suspect, and that automatically drug testing all employees involved in an accident of any kind may constitute unlawful retaliation for reporting workplace injuries. The theory underlying OSHA’s guidance is that automatically drug testing employees discourages individuals from reporting injuries, particularly where drug or alcohol use could not have, or is unlikely to have, contributed to the injury. As a result, based on



the prevailing guidance, employers were advised to modify their drug testing policies so that testing is not conducted in situations where there is no reasonable basis for concluding that drug or alcohol use is likely to have played a role in the accident.

However, OSHA recently provided notice that it is reconsidering its guidance on this topic, so stay tuned for a possible reversal that would allow mandatory post-accident drug testing again in 2018.

**Electronic reporting** of illnesses and injuries is now mandatory for all employers with 250 or more employees, as well as for employers with 20-249 employees in the “Automotive parts, accessories, and tire stores” industry. These employers were required to submit OSHA Form 300A summaries for 2016 by December 2017, and the 300A summaries for 2017 are due by July 1, 2018.

**Paid family and sick leave** will remain a key issue in 2018. The tax reform legislation signed into law on December 20, 2017, included a new tax credit for employers that provide family and medical leave to workers. Specifically, under the law, eligible employers can claim a tax credit for wages paid to employees while they are on paid family and sick leave for up to 12 weeks in any tax year. Employers that pay workers 50 percent of their regular wages while on paid leave would receive a tax credit for 12.5 percent of such wages, and this tax credit increases so that employers providing workers 100 percent of their regular pay during paid leave receive a 25 percent tax credit.

Congressional Republicans have also endorsed legislation that would exempt employers that offer workers a certain amount of paid time off from having to comply with state and local paid leave requirements. Such a law would make it easier for employers that operate in multiple states and localities from having to navigate varying state and local requirements, but in the meantime, state and local governments will continue to address this issue in 2018.

**LGBTQ employee rights** were a major issue in 2017, as the Seventh U.S. Circuit Court of Appeals (based in Chicago) held that discrimination on the basis of sexual orientation is prohibited under Title VII. Further, in an appeal before the Second Circuit (based in New York), the EEOC argued that sexual orientation discrimination is unlawful under Title VII, but the DOJ took the opposite position in a July 2017 brief and argued that sexual orientation is not protected under

Title VII. Because federal appeals courts have split on the issue, the Supreme Court may ultimately be called upon to decide whether Title VII prohibits discrimination on the basis of sexual orientation.

The rights of transgender workers has remained a controversial issue, as more than a dozen states have considered “bathroom bills” that would require individuals to use bathrooms, locker rooms, and similar facilities based on their sex assigned at birth. (Only North Carolina passed a “bathroom bill” into law, but it was repealed.) In 2014, the Obama administration issued an executive order prohibiting federal contractors from discriminating against employees on the basis of sexual orientation or gender identity, and later put forth guidance stating that workers must be permitted to use restrooms consistent with their gender identity. The Trump administration blocked a reporting requirement under this executive order, but it otherwise remains intact. This is another area that many automotive employers (as federal contractors) should stay on top of.

**Pay equity** will also continue to be a major issue in 2018. A number of states and cities – including California, Delaware, Massachusetts, Oregon, New York City, Philadelphia, and San Francisco – have recently passed laws prohibiting employers from inquiring about job applicants’ salary history. These laws are intended to address the gender pay gap so that employers do not use past salary information (already skewed since men earn more than women on average) to justify future disparities. At the federal level, employers will not be required to disclose employee pay data on their EEO-1 forms now that the Trump administration blocked an EEOC pay data reporting requirement that was set to take effect on March 1, 2018.

**Regulation of government contractors** may change by the end of 2018 if the White House has its way. In its fiscal year 2018 budget, the Trump administration proposed merging the Office of Federal Contract Compliance Programs (OFCCP) into the EEOC, but a number of groups including federal contractors have expressed concerns with the proposal. A merger of the two agencies would require Congress’ approval.

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## Know the Risks: Domestic and International Compliance

By: Greg Husisian, Partner

### **New administration, same enforcement priorities – but greater risks.**

An open question coming into 2017 was whether the aggressive enforcement posture that had characterized the Obama and Bush administrations would continue under the Trump administration. Any questions were answered with the announcement of the first billion-dollar export controls penalty at the outset of the new administration. With the Trump administration continuing to aggressively pursue anti-money laundering, economic sanctions, and Foreign Corrupt Practices Act (FCPA) antibribery enforcement actions, companies acting in the international realm are well advised to take all available steps to ensure that their international regulatory compliance is in good shape.

Other regulatory developments, however, have underscored that the Trump administration raises unique compliance concerns. Ongoing efforts to renegotiate the North American Free Trade Agreement (NAFTA) have emphasized the importance of customs compliance in a potentially new, higher-tariff environment. An aggressive international trade litigation environment under the new administration also underscores the importance of planning for potential business disruptions that can be caused by antidumping, countervailing duty, safeguard, and other international trade remedies. And with the foreign policy objectives of the new administration (and Congress) at times sharply changing from the prior administration, maintaining a nimble trade posture with countries that potentially will see major changes to economic sanctions regulations are essential.

The U.S. government has continued under the new administration to push a strategy of aggressively enforcing U.S. laws governing extraterritorial conduct. These include the FCPA, economic sanctions largely administered by the Office of Foreign Assets Control (“OFAC”), and export controls on U.S.-origin goods. These laws underscore the

premium that all multinational companies need to place on aggressively identifying and managing regulatory risk, particularly for their international operations.

These risks are especially prevalent in the automotive sector, which is a high-profile industry that often attracts special enforcement and regulatory attention. In addition to the well-publicized antitrust enforcement actions that have targeted the industry, high-profile FCPA investigations involving prominent OEMs and the prior enactment (currently suspended) of special OFAC sanctions that target the automotive sector and any such operations in Iran underscore the risks that automotive suppliers incur when selling or operating overseas. Similar developments are evident in the domestic domain as well, where the growing frequency and intensity of antitrust, False Claims Act, and government contract investigations present new challenges for manufacturers, suppliers, and service providers of all kinds.

Many automotive companies—reading the headlines and not the actual changes in the law—have mistakenly concluded that the recent easing of sanctions with regard to Cuba and Iran mean that these countries are “open for business.” This is especially true with regard to their non-U.S. operations, which often have only a hazy understanding of how aggressive and creative the U.S. government is with regard to applying these laws abroad. The reality is, the primary sanctions remain in place for both countries (especially Iran), meaning that the risk of dealing with these countries remains high.

Further exacerbating the risks is the ongoing hostility of President Trump to several of the signature economic sanctions easings of the Obama administration. The administration is required to certify periodically that the Joint Comprehensive Plan of Action (JCPOA), which is the agreement by which the major world powers agreed to ease the very tight economic sanctions on Iran in return for Iran sharply cutting back on its nuclear enrichment activities.

Although President Trump has continued (on the advice of his advisors) to certify Iranian compliance with the JCPOA, he continues to state at regular intervals that the JCPOA is a “horrible” deal that should be overturned. President Trump also is no fan of the easing of the Cuban sanctions.

Many automotive companies have taken advantage of the JCPOA-related easing, particularly through use of “General License H,” which allows U.S. companies to establish separately incorporated subsidiaries to deal with Iran, provided that they divorce these separate legal entities from the United States and the U.S. financial system (no U.S. nationals involvement without a license, no use of the U.S. financial system, no facilitation by U.S. persons, and so forth). These legal, but still risky efforts need to be carefully monitored, not only to determine that the rules are followed, but also to ensure that there are no changes in the regulatory structure that would once again disallow such methods for engaging with the Iranian economy.

### **Greater Risk Awareness Leads to Greater Exports and International Compliance**

U.S. laws governing exports and international conduct pose unique risks for the automotive sector. From the FCPA to ever-changing sanctions and export controls, companies involved in the automotive supply chain face an increasingly complex universe of requirements governing how and where they conduct business overseas. These regimes also shape business decisions at home, with the so-called “deemed export” rule compelling exclusively domestic companies to seek export licenses before disclosing controlled articles, data, software, and technology to their non-U.S. employees. Combined with new disclosure requirements for listed companies and government contractors, the regulatory environment grows more complicated with each passing day.

Enforcement trends amplify these risks. In recent years, U.S. government agencies have targeted automotive and automotive supply chain companies under a number of different regulatory regimes. Notable examples include FCPA enforcement actions against AB Volvo, Daimler AG, Fiat, Iveco, Ingersoll-Rand, and Renault. Sanctions enforcement is also on the rise with Toyota Motor Credit Corporation and Volvo Construction Equipment North America, both targeted by OFAC. Automotive companies like GM-Daewoo have even faced government enforcement actions in relatively obscure

areas like anti-boycott violations — a little-known legal regime that has both export and tax implications.

The importance of compliance also is underscored by the posture, reiterated by the new administration, that the Department of Justice will require that in investigations, companies identify individuals who participated in the conduct at issue. The goal is to bring an element of personal liability and responsibility into enforcement actions. Given that all of the laws that have major enforcement activity (FCPA, OFAC sanctions, export controls, antitrust, and anti-money laundering) all have resulted in criminal convictions of individuals, this increased focus on identifying persons who participated in violations is a sobering reminder of the stakes that arise from poor compliance with these laws.

Many companies in the automotive sector have attributes that contribute to elevated risk. Chief among them are large global supply chains, downstream manufacturing by worldwide affiliates, and frequent international trade in U.S.-origin goods, services, and technologies. Multinational business practices also raise concerns, with sales, operations, and joint ventures reaching into countries known for high levels of corruption, industrial espionage, and illegal export diversion. With U.S. companies increasingly liable for the actions of their overseas agents and affiliates, a risk-based, integrated approach to international compliance offers the best means of identifying, managing, and mitigating these risks.

### **Develop a Comprehensive Approach to International Compliance**

Faced with these challenges, automotive companies should carefully consider how U.S. laws impact behavior both within and outside the United States. This means identifying and addressing the risks that are likely to arise based on the nature of their business, the places where they conduct business, and the customers they serve. It also means evaluating the degree to which foreign parties — whether subsidiaries, joint ventures, or even contractors — engage in activities that expose their U.S. counterparts to civil and criminal liability. By taking a comprehensive approach, companies can best manage their risk and mitigate costs by conducting periodic risk assessments, crafting tailored internal controls, conducting frequent training, and coordinating common standards across their entire organizations.

The same principles apply in the domestic compliance context. Suppliers need to understand their areas of risk and rigorously monitor and enforce their compliance policies, procedures, and codes of conduct. Conducting periodic internal reviews, reviewing and updating written policies and procedures, and updating and enhancing training programs are all components of a robust compliance program. Encouraging your employees to report any improper, unethical, or illegal conduct is critical to uncovering any potential fraud within your organization. Clearly delineating responsibility for compliance with various policies and internal controls ensures accountability.

### **New Risks Arise in the Customs Arena**

Many automotive companies have come to rely on the tariff-free movement of goods within the NAFTA region. Beyond the dollar and cents implications of the potential renegotiation of NAFTA, it should not be overlooked that the renegotiation of NAFTA will greatly upend the compliance implications.

Under the current regime, which allows many automotive-sector companies to export and import to and from

Mexico and Canada without paying duties, it has become somewhat common for companies to pay less attention to the importance of customs compliance. But if the revised NAFTA raises tariff rates or changes regional content rules, missteps in classification, valuation, or tracking regional content could be magnified. Even something as simple as not having NAFTA certificates of origin in hand at the time of importation already can lead to major bills from customs. A shifting NAFTA environment likely will multiple such opportunities for missteps.

These risks arise in an environment where customs enforcement risks already are rising. After years of focusing on security issues and the C-TPAT program following the 9/11 terrorist attacks, customs once again is re-emphasizing revenue collection goals. Even in a low-tariff environment, customs compliance missteps can be costly, particularly if they involve failure to recognize and declare anti-dumping and countervailing duties (where special tariffs can exceed 100 percent of the value of the goods in some cases). Major importers who fail to adapt to the new customs reality could be due for a major wake-up call from U.S. Customs and Border Protection.





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# Navigating Connected Cars Cybersecurity Concerns in 2018

By: Chanley Howell, Partner

Cars today are sophisticated computers on wheels and are part of a complex information technology environment. In addition to vehicles, the connected car network includes onboard infotainment and other communication devices; mobile devices including smartphones, tablets and other IoT (Internet of Things) devices; and large external cloud computing systems. Gartner predicts that the production of new automobiles equipped with data connectivity will reach 61,000,000 and that a total of 20.4 billion connected devices (of which cars will be a larger percentage) will be in use by 2020. As an OEM or supplier accelerating to create products to meet industry demand, what challenges can you anticipate in 2018? This article describes where we believe your attention should be focused during the upcoming year.

As we all witness in our day-to-day lives, connectivity can provide tremendous advantages, conveniences and power. As we also know from the headlines (and likely from personal experience), these benefits do not come “free” and are accompanied by many risks. With significant advances in smartphone car connectivity and onboard infotainment systems, our cars are collecting more and more information about our daily lives and personal interactions. As a result, privacy and security concerns about connected cars have evolved and have quickly risen in the last year to become a top priority of carmakers and suppliers.

Failure to exercise proper data security hygiene can result in regulatory investigations and fines, claims from business partners, and consumer and class-action claims. As we have seen in other industries, a high-profile security breach can also result in significant damage to reputation, loss in company value, and firings and forced resignations.

Just as with any complex computing device or system, securing and protecting the data residing in and traversing the network are critical to mitigating these risks. Due to differing standards and fragmentation in the automotive supply chain, there are several challenges to addressing these risks, but also many existing and developing best practices.

## Cybersecurity Best Practices

In July 2016, the Automotive Information Sharing and Analysis Center (Auto-ISAC) released its *Automotive Cybersecurity Best Practices* for OEMs and suppliers. These best practices leverage and flow from various NIST data security standards and provide a very useful framework for developing, implementing and maintaining an auto cybersecurity program.

### 1. Governance

Effective data security is no longer the sole responsibility of the information technology department – senior and operational management of the organization must play a critical role. Regulators, courts and juries are demanding that senior management become involved in and accountable for data security. Cybersecurity is jeopardized if there is not a top-down message and implementation of data security. Governance also establishes an overarching process for managing data security and ensuring compliance with regulations, internal policies and external commitments. Toyota, for example, has developed its All Toyota Security Guidelines – initially for the Toyota companies, and more recently pushed down to suppliers. A good governance process will serve the dual purpose of enhancing the data security of vehicles and component parts while also bolstering the company’s defenses in the event of a security incident or investigation.

### 2. Risk Assessment and Management

Companies should start by utilizing a rigorous risk assessment methodology for identifying potential threats, vulnerabilities and risks to data and data security. This process catalogs and prioritizes the various sources of cybersecurity risk; implements a decision-making process to manage the identified risks; involves other partners in the supply chain; implements risk mitigating controls; and monitors the evolution of risks and risk mitigation in a continuous improvement cycle.

### 3. Security by Design

This is a concept espoused not only by the Auto-ISAC, but also by federal regulators, namely the National Highway Traffic Safety Administration and the Federal Trade Commission, as well as by industry self-regulatory organizations. With security by design, a company addresses data security controls from day one, while products, components and devices are still on the drawing board. Data security practices evolve over time, and the days of building a system first and then layering security on top are now over. Security should be designed with the nature and sensitivity of personal information and other data taken into consideration. Security design reviews and product testing should be conducted throughout the development process. Secure computing, software development and networking practices should address the security of connections into, from and inside the vehicle.

### 4. Threat Detection and Protection

Companies need to be proactive by continuously monitoring and detecting data security threats, vulnerabilities and incidents. Building off of the risk assessment process described above, organizations can implement measures to identify threats, vulnerabilities, attacks and other incidents as they occur. This in turn enhances and feeds information to the incident response team.

### 5. Incident Response

An effective incident response program will enable organizations to quickly respond to incidents, thereby mitigating (hopefully avoiding) harm to the organization, business partners and consumers. The ability to provide over-the-air updates and fixes is quickly becoming more prevalent and available. An incident response policy should identify in advance members of the response team, including IT security and forensics, engineering, legal, management, stakeholders, and public relations/communications. The policy provides guidance and details relating to the roles and obligations of the team members.

### 6. Collaboration and Engagement

Organizations should work closely with suppliers, industry associations, governmental agencies, academic institutions and researchers, and other business partners as part of a well-rounded cybersecurity program. Whether it is the finished vehicle or a component part, most companies

relevant to the data security ecosystem will rely on suppliers that play a role in data security. Hardware, software, development tools, assembly, integration and testing may all be provided by one or more suppliers. Companies impacted by this scenario should conduct appropriate due diligence and risk assessments with respect to their suppliers, both at the commencement of, as well as periodically throughout, the relationship. Contractual provisions should also be utilized to address data security requirements for relevant suppliers.

### 7. Awareness and Training

Last but certainly not least, companies should be sure to properly educate and train all relevant employees with respect to their role in the cybersecurity program. Engineering, information technology, research and development, and production teams should all be given appropriate resources and knowledge to effectively manage their involvement in the data security efforts of the organization.

### Conclusion

A comprehensive and holistic approach is essential to an effective connected car cybersecurity program. Virtually all facets of the organization will need to be involved in one manner or another. Laws and regulations impacting this area will continue to evolve, and companies should continue to monitor relevant developments. Following the best practices outlined above will provide a useful framework for developing and implementing your auto cybersecurity policies and practices.

# Foley’s 2017 Connected Cars & Autonomous Vehicles Survey

By: Mark Aiello, Partner

We’re in the midst of a rapid evolution not only in the way drivers operate their vehicles, but also in the operations, compliance, go-to-market strategy and cyber preparedness of the entire automotive industry. More than 70 million connected cars will be on the road by 2023, as predicted by IHS Markit, and autonomous vehicles aren’t far behind with current models equipped with semi-autonomous functionality, including auto-steering, self-parking, autonomous lane changing and collision-avoidance features.

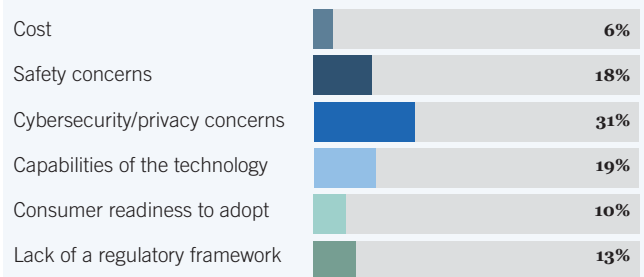
As these smarter, interactive and self-sufficient machines change our entire view of transportation and mobility, industry players are carefully weighing their competitive pursuits and market moves against the new regulations and industry standards coming down the pike.

Against this backdrop, in October 2017, we released a survey of leading automakers, suppliers, startups, investors and technology companies on the business and legal issues impacting the development of connected cars and autonomous vehicles. The perspectives and attitudes of respondents suggest that many automotive and technology companies are already forging ahead in spite of lingering regulatory uncertainty and other challenges. However, there remain barriers to these technologies reaching their growth potential and gaining acceptance by the general public.

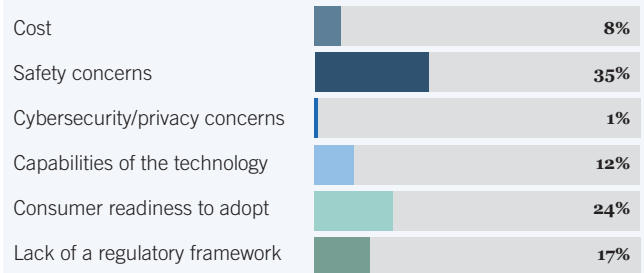
According to the survey, two things are for certain: 1) traditional automakers and suppliers have been joined by emerging and mature technology companies in the race to fill the streets with driverless cars; and 2) those that continue to innovate and build technological capabilities toward full connectivity and autonomy will be the most successful in this arena.

## Obstacles to Growth

### WHAT DO YOU SEE AS THE BIGGEST OBSTACLE TO THE GROWTH OF CONNECTED CARS?



### WHAT DO YOU SEE AS THE BIGGEST OBSTACLE TO THE GROWTH OF AUTONOMOUS VEHICLES?



While the terms “connected cars” and “autonomous vehicles” are often used interchangeably, they face different obstacles to growth, partly because the respective technologies are at different stages of development and implementation.

Connected car technologies are already prevalent today with increasing ease of access, convenience and affordability. Not unlike smartphones and other connected devices,

cybersecurity and privacy are a significant concern for connected cars, with the largest percentage of respondents (31 percent) selecting this as the biggest obstacle to adoption.

Alternatively, safety (35 percent) and consumer readiness to adopt (24 percent) topped the list of perceived barriers for autonomous vehicles.

“I expect automakers will develop autonomous capabilities in ways that comply with existing laws first (e.g., adaptive cruise control, lane assist, auto-brake), so even though the cars could be fully autonomous, it will take five to 10 years of people using these autonomous-lite features before they are comfortable with the idea of full autonomy.” – Banking Industry Respondent

### Impact of New Entrants

The business strategies and operations of traditional automakers and suppliers are clearly being influenced by emerging and established technology companies that see opportunities at every point along the supply chain. Only 15 percent of respondents believe that accelerated technological

innovation and new industry entrants are not disrupting traditional automotive supply chains.

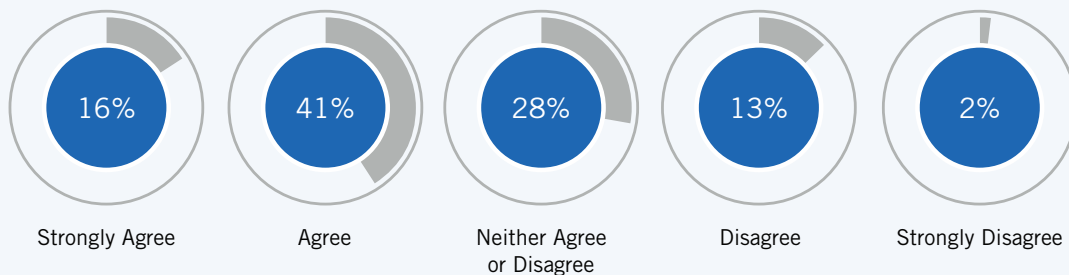
These emerging players are increasingly understood and viewed by traditional automakers and suppliers as direct competitors, but also as potential collaborators, signaling a growing acceptance of these new entrants in the automotive space.

“The next 15 years will be very interesting with a mixed field of technologies and approaches offering plenty of opportunities for new players to explore disruptive approaches.” – Startup Company Respondent

### A Stronger Regulatory Framework

Given the significant financial and safety stakes, the sophisticated nature of the technology and the likely pervasive impact on society, it is not efficient for 50 different states to dictate the development of connected cars and autonomous vehicles. Amid a growing patchwork of state requirements, lawmakers in Washington are catching up and close to setting the course for future development. The legislative packages working their way through Congress

#### TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: STARTUP COMPANIES AND/OR THEIR TECHNOLOGIES ARE DISRUPTING TRADITIONAL AUTOMOTIVE SUPPLY CHAINS.



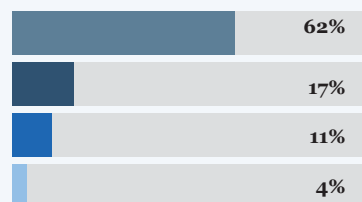
#### IN YOUR OPINION, HOW SHOULD CONNECTED CARS AND AUTONOMOUS VEHICLES BE REGULATED?

A set of nationally consistent rules created by the U.S. Department of Transportation

A self-regulatory organization created by the industry

Laws developed at the state or municipal level

No new regulations, but rather rely on existing laws





would address the deployment of self-driving cars and preempt state laws. The U.S. Department of Transportation and the National Highway Traffic Safety Administration also released new federal guidance in September 2017.

These are welcome developments for an industry seeking greater regulatory certainty and an alternative to differing state requirements. Nearly two-thirds of respondents (62 percent) believe that nationally consistent rules from the federal government are the best way to regulate connected cars and autonomous vehicles.

“Developing and fielding autonomous vehicle technology is going to become increasingly dependent on support of the federal government to develop national regulations.”  
– Automotive Supplier Respondent

### Key Business Challenges

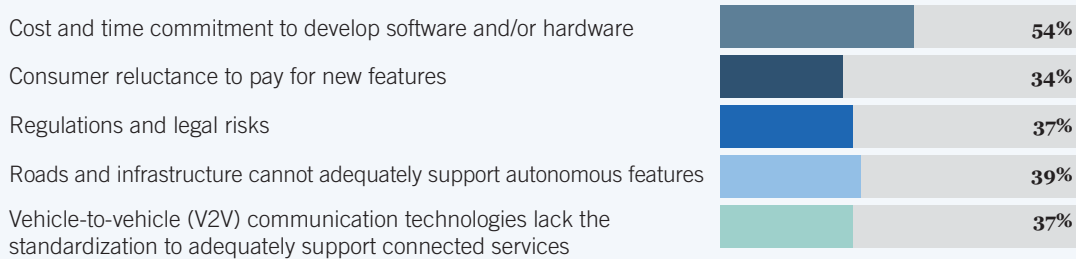
While most industry experts predict that autonomous vehicles will lag well behind connected cars in the timing of adoption, the survey responses reinforce the idea that resources must be devoted concurrently to both clusters of technologies in order to keep pace with competitors and specialized companies.

Current inventories, build schedules and launches, and investments require companies to focus on autonomous vehicles now to be best situated when these technologies become more mainstream in the future. In other words, success depends on the ability to live in today’s and tomorrow’s worlds at the same time.

While survey respondents underscored the importance of simultaneously devoting resources to connected cars and autonomous vehicles, more than half (54 percent) struggle to fund and commit the necessary time to develop and implement these technologies. Furthermore, the shortcomings of roads and infrastructure – and the resulting compatibility issues with autonomous features – are also a key challenge faced by companies (39 percent).

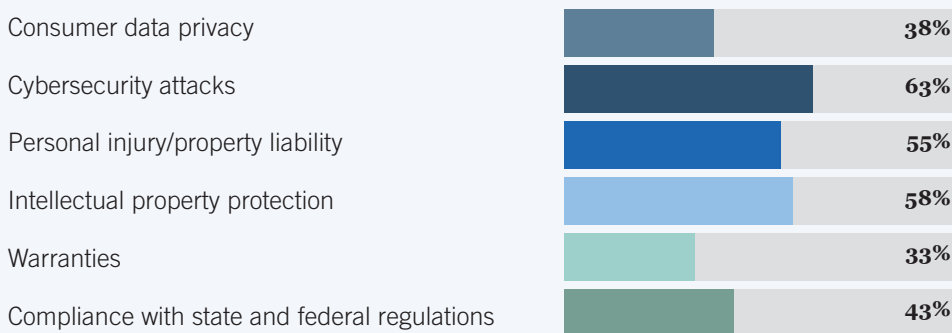
“It will be a long time before there will be critical mass of infrastructure capabilities and percentage of capable vehicles to make this a viable solution with broad acceptance.” – Automotive Supplier Respondent

#### WHICH OF THE FOLLOWING REPRESENT KEY CHALLENGES FACING YOUR COMPANY IN DEVELOPING OR IMPLEMENTING TECHNOLOGIES FOR CONNECTED CARS AND/OR AUTONOMOUS VEHICLES? (CHECK ALL THAT APPLY)



**Legal Liability Concerns**

**WHICH OF THE FOLLOWING LEGAL ISSUES ARE OF CONCERN TO YOUR COMPANY WHEN DEVELOPING TECHNOLOGY FOR CONNECTED CARS AND/OR AUTONOMOUS VEHICLES? (CHECK ALL THAT APPLY)**



With regard to legal risks, cybersecurity attacks emerged as the top concern for 63 percent of respondents. The second-highest percent of respondents (58 percent) selected intellectual property protection as a priority legal issue, as it provides a way for companies to differentiate and protect market share. Questions of liability over who is responsible for car accidents (i.e., the manufacturer or the owner) concern more than half of respondents.

As technology continues to evolve and support the growth of connected cars and autonomous vehicles, intellectual property protection has become an important issue for those developing and applying such technologies in order to differentiate and protect market share. Companies can mitigate risk in this area by setting clear guidelines for capturing IP and deciding on the form of protection, as well as having sound and consistent management of contracts and agreements when involved in joint collaborations.

The steady shift from human input toward autonomous operation creates unique and complex questions for not only the consumer, but also for fellow motorists, manufacturers and their suppliers. These questions will take years to work themselves through legal, business and personal evaluations.

“Regulatory issues and discussions about liabilities will make the transition to autonomous vehicles much slower than most analysts anticipate.” – Startup Company Respondent

Needless to say, there is both fierce competition and new collaborations among those racing to build a truly connected car, and ultimately the first completely autonomous vehicle. Keeping an eye on these emerging business and legal developments will be important in order for them to seize opportunities and manage risk in the new age of vehicle transportation.

*To read the complete Foley survey report, visit <https://www.foley.com/2017-connected-cars--autonomous-vehicles-survey-10-24-2017/>*

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# NHTSA and Motor Vehicle Safety

*By: Christopher H. Grigorian, Partner, R. Nicholas Englund, Special Counsel*

## Introduction

The closing years of the Obama administration saw a whirlwind of regulatory activity from NHTSA, including multiple consent orders, record penalties, and soaring recall numbers. Hailed as the “New Normal,” the more aggressive enforcement posture has largely remained in place as the Trump administration has been slow to bring in new political leadership to the agency. Although the Trump administration’s regulatory philosophy has been slow to emerge, the direction the agency will take is beginning to come into focus as 2018 gets underway. NHTSA is significantly boosting its investigative staff and implementing structural changes in its enforcement office, activities that are certain to lead to more defect investigations. NHTSA also recently revised its autonomous vehicle policy, setting forth twelve “Priority Safety Design Elements” for automated vehicles. This year, the industry expects to see passage of autonomous vehicle legislation, which has bipartisan support in both the Senate and House. Passage of such legislation will trigger a flurry of rulemaking activity at the agency as it races to meet congressionally mandated rulemaking deadlines. Thus, we expect 2018 to be yet another busy year for NHTSA and manufacturers.

## Strengthened Enforcement Staff and Enhanced Enforcement Tools

NHTSA is reportedly seeking to double the headcount in its Office of Defects Investigation by the spring of 2018. In conjunction with this potentially dramatic growth, NHTSA has also structurally reorganized its enforcement office. Previously, NHTSA divided its defect investigations among three divisions based on defect categories: the vehicle integrity division; the vehicle controls division; and the medium and heavy vehicle, motorcycle, and motor vehicle equipment division. Potential safety defects were prescreened by the Defects Assessment Division, which presented potential defect trends to the division with related subject-matter expertise. Collectively, they would determine

whether the agency should formally investigate a matter. While data informed these decisions, the agency’s decision-making often relied on subjective factors.

Recently, NHTSA decided to reform its investigative approach. The agency reorganized ODI into five investigative divisions – four of which are dedicated to passenger vehicles, with each division assigned to specific vehicle manufacturers; one division is dedicated to all issues related to medium and heavy vehicles, motorcycles, and motor vehicle equipment. Importantly, NHTSA will no longer divide the screening process from the active investigation process. The divisions will now handle all issues related to their assigned manufacturers (or vehicle/equipment types for the fifth division), including initial screening and active investigation. This approach approximates some of the work NHTSA has done with manufacturers under consent orders. These manufacturers have met with NHTSA on a regular basis to discuss all potential safety-related issues the manufacturer may be reviewing. NHTSA is looking to leverage what it has learned from these consent orders and apply similar techniques industrywide, including asking manufacturers that are not under consent orders whether they are willing to hold similar meetings with NHTSA.

In conjunction with ODI’s reorganization, NHTSA is seeking to leverage the mountains of information and data it regularly collects – vehicle owner questionnaires (VOQs or customer complaints sent directly to NHTSA), early warning reports, fatal accident reports, and more – using sophisticated data mining techniques. Additionally, NHTSA has begun working with manufacturers to identify new data sources that may assist in identifying potential safety issues sooner. Another aspect of this approach to data mining has been NHTSA’s increasing calls for improving data sharing along the supply chain, particularly between vehicle manufacturers and Tier 1 suppliers. NHTSA appears poised to continue greater outreach to the industry and consumer groups.

Underlying these structural changes is what could be a dramatic shift in NHTSA's investigations. The U.S. Department of Transportation's (DOT) Office of the Inspector General (OIG) has criticized the agency for lacking consistency in investigation decisions and outcomes. In response, NHTSA has begun developing a risk matrix that would inform its investigation priorities by providing an objective tool for evaluating risks based on the number of reported failures and the severity of the safety consequences.

As the agency is poised to further enhance its investigation capabilities, now more than ever, vehicle and component manufacturers should take the following actions to reduce their compliance risk:

- Implement (or update) safety compliance policies that provide internal guidance to company personnel for identifying and investigating potential safety defects and FMVSS noncompliances;
- Implement (or update) procedures for complying with all associated NHTSA reporting requirements (e.g., defect reporting, early warning reporting, and reporting other safety bulletins and customer communications);
- Revisit early warning reporting procedures to ensure they capture all relevant information (for suppliers, this means fatality claims and notices);
- Conduct thorough training of key personnel across the organization – domestically and globally – on these procedures and on the importance of bringing potential safety concerns to the attention of appropriate personnel or safety committees.

### Autonomous Vehicles

As vehicle technologies continue to push forward, the industry is keenly interested in how Congress and NHTSA will step in to provide relief from the patchwork of state regulations that are developing in this area and to address current federal regulatory obstacles to deployment of fully autonomous vehicles. While these questions remain open, proposed legislation and guidance from NHTSA are helping to bring some of the key themes related to these questions into focus.

### Autonomous Vehicle Legislation

On September 6, 2017, the U.S. House of Representatives passed the Safely Ensuring Lives Future Deployment and Research In Vehicle Evolution Act (SELF DRIVE Act), H.R. 3388. The SELF DRIVE Act is the first major federal effort to regulate autonomous vehicles beyond the previously adopted “voluntary” guidelines. The SELF DRIVE Act aims to improve NHTSA's “ability to adapt federal safety standards to this emerging technology, and clarify federal and state roles with respect to self-driving cars,” according to a press release. The bipartisan bill seeks to accomplish these goals by:

- Clarifying that NHTSA would regulate the design, construction, and performance of automated vehicles and systems, and expressly preempting differing or conflicting state laws;
- Requiring manufacturers to submit a safety assessment certification to NHTSA;
- Requiring manufacturers to develop a detailed cybersecurity plan for automated vehicles;
- Directing NHTSA to establish an advisory council dedicated to helping the agency stay current on emerging technologies;
- Requiring manufacturers to develop a written privacy plan specifying how data from automated vehicles will be collected, used, shared, and stored; and
- Expanding NHTSA's exemption authority to facilitate development or field evaluation of highly automated vehicles.

A few weeks after the House passed its bill, a similar bill, the American Vision for Safer Transportation Through Advancement of Revolutionary Technologies Act (AV START Act), S. 1885, was unanimously approved by the Senate Committee on Commerce, Science and Transportation. The Senate bill would exclude commercial trucks from the key provisions and contains several other differences that will have to be reconciled with the House version if the bill advances.

Because there appears to be bipartisan support for many of the ideas contained in these bills, autonomous vehicle legislation in some form could well make its way into law in early 2018. Final passage would be a welcome step forward in federal regulation, paving the way for the mass deployment of these exciting technologies that are expected to save thousands of lives. Manufacturers should ensure that they stay up to date with these developments.



### NHTSA's Revised Automated Vehicles Policy

On September 15, 2017, the DOT and NHTSA released their “Automated Driving Systems (ADS): A Vision for Safety 2.0,” 82 Fed. Reg. 43321, which updates and supersedes the Federal Automated Vehicles Policy (FAVP) released in September 2016. Believing they can play a unique role in supporting industry innovation and informing and educating the public about vehicle automation, DOT and NHTSA issued this policy document, referred to as ADS 2.0, to provide voluntary guidance as to what they believe

are design best practices for testing and safely deploying automated driving. Refining the design elements that NHTSA announced in its September 2016 policy, ADS 2.0 focuses on twelve design priorities for manufacturers.

In what the agency calls a “nonregulatory approach,” the voluntary guidelines address cybersecurity, human-machine interface, crashworthiness, consumer education and training, and post-crash behavior of vehicles with automated driving systems. Specifically, ADS 2.0 sets forth the following best practices:

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|--|--|
| <p><b>1</b> A robust design and validation process that includes hazard analysis and safety risk assessment;</p>   | <p><b>7</b> A cybersecurity plan that is built from the product's development and that will share information with the Automotive Information Sharing and Analysis Center (Auto-ISAC);</p> |
| <p><b>2</b> A description of the vehicle's operational design domain, including specific operating conditions for the vehicle, such as road types, speeds, areas, geo-fencing, and environmental conditions (weather, day or night, etc.);</p> | <p><b>8</b> Designs that continue to incorporate crashworthiness standards;</p>  |
| <p><b>3</b> A strategy for “Object and Event Detection and Response” that details how the driver or vehicle will detect and respond to any circumstance while driving;</p>   | <p><b>9</b> A post-crash strategy that contemplates how to handle and possibly move vehicles involved in crashes;</p>  |
| <p><b>4</b> A designed fallback or minimal risk condition that determines what the failsafe mode will be if and when it is triggered;</p>  | <p><b>10</b> A method for recording and preserving data that may be needed in crash investigations;</p>  |
| <p><b>5</b> A robust validation method that includes simulation, test track, and on-road testing;</p>  | <p><b>11</b> Educating consumers regarding how to operate these technologies; and</p>  |
| <p><b>6</b> A strategy for handling human-machine interface that determines when to alert the human driver to take over vehicle controls;</p>  | <p><b>12</b> Compliance policies for the mix of federal, state, and local laws.</p>  |



ADS 2.0 also encourages manufacturers to submit to NHTSA, and to the public, a Voluntary Safety Self-Assessment that demonstrates that the manufacturer is: (1) considering the safety aspects of automated technologies; (2) engaging with NHTSA; (3) encouraging industry safety norms for the technologies; and (4) building public trust, acceptance, and confidence through transparent testing and deployment of automated driving systems and vehicles. Due to persistent concerns regarding the safety of automated driving technologies, manufacturers deploying these technologies will likely look for ways to demonstrate conformity with these design principles through a safety self-assessment or similar public outreach. Publicly sharing aspects of a safety assessment or similar materials may be an important strategy in facilitating broad acceptance of these technologies, particularly as more of these assessments become public.

#### **NHTSA's V2V Communications NPRM**

The future of NHTSA's proposed rule on vehicle-to-vehicle communication in all-light duty vehicles is uncertain. On December 13, 2016, NHTSA floated its long-anticipated Notice of Proposed Rulemaking (NPRM). Under the proposed rule, the agency would issue a new federal motor vehicle

safety standard (FMVSS) No. 150, which would require new light vehicles to be capable of sending and receiving "Basic Safety Messages" related to the vehicle's speed, heading, brake status, and other information to and from other vehicles over short-range radio communication (DSRC) devices. In addition to vehicle positional and behavioral data, V2V and so-called vehicle-to-infrastructure (V2I) communications could potentially transmit environmental data, such as road conditions, to surrounding vehicles.

The future of the proposed rule remains uncertain under the Trump administration. In November 2017, there were published reports that NHTSA was going to axe the proposed rule. NHTSA later clarified that it was still considering the proposed rule and evaluating responses from the industry and the public. Whether a final rule is adopted and what such a rule would look like remains to be seen. Regardless, many in the industry have made significant investments in V2V technologies and will likely continue to develop them, regardless of whether the rule becomes final. As the technology develops and proves out its viability, expect NHTSA to continue to play a role in this area, as the agency occupies a unique position to solve potential coordination problems among competing technologies.





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# The 2018 Automotive Mergers and Acquisitions Outlook

By: *Steven H. Hilfinger, Partner, and Joshua M. Munro, Associate*

## Overview

2017 was another strong year for the automotive sector and related M&A activity, thanks in large part to positive macroeconomic factors and the continued development of and investment in emerging automotive technologies. The new automotive ecosystem in which traditional OEMs and automotive suppliers collaborate and integrate with established and emerging technology companies continues to mature as buyers across these sectors leverage strong balance sheets, relatively low borrowing costs and eager outside investors in order to participate in the race towards the development and full-scale market adoption of autonomous and connected vehicles. Given the various technological, legal and consumer-driven hurdles on the horizon, there is disagreement about the realistic timeframe for achieving full (Level 5) autonomy, but there is a clear consensus that the journey may be lucrative for those who can keep up and that staying on the sidelines is not a long-term option.

## Macro Factors

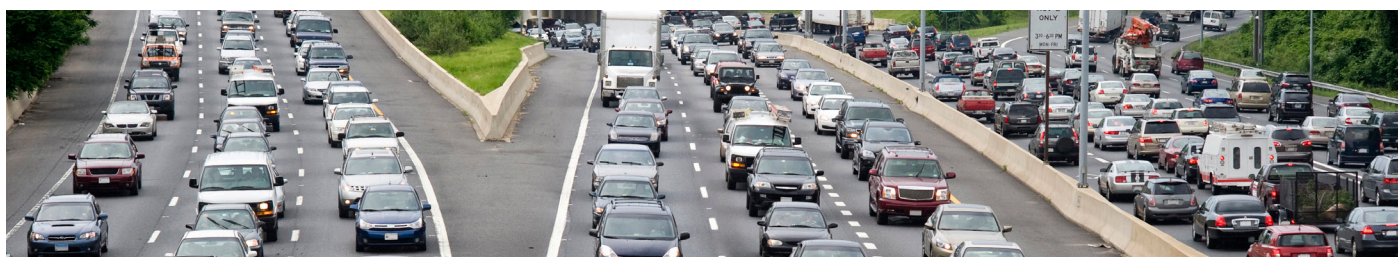
Following a hotly contested U.S. presidential election and a great deal of discussion concerning a series of impending interest rate hikes, sweeping changes to the tax code and major policy shifts to international trade agreements like NAFTA, we started 2017 with a lot of open questions and a great deal of uncertainty. One year out and many of these uncertainties remain. Changes to NAFTA remain a possibility that could have adverse consequences for the automotive industry in North America, as talks among the United States, Canada and Mexico to modify the agreement continue into 2018. Fortunately, U.S. officials have to date not indicated that they intend to take any steps to withdraw from NAFTA, despite continuing disagreements among the parties. Interest rates have ticked up slightly and additional modest increases are forecast as solid economic reports continue and unemployment rates continue to be near historic lows. Normally, and all else being equal, rising interest rates can slow deal activity as buyers who typically rely on debt face

higher borrowing costs and lower returns, which especially impacts financial buyers. Finally, some of the tax reform uncertainty was removed in late 2017 with the passage of the Tax Cuts and Jobs Act. And while the lower corporate rate, 20% deduction for pass-through entities like LLCs, and lower top rate will be welcome changes to dealmakers in 2018, the other macro factors in play (including where we are in the current cycle) are expected to be larger drivers of automotive M&A activity in 2018 than the tax cuts.

Overall, many continue to have optimistic views of the automotive industry into 2018. At a recent conference held by the Original Equipment Suppliers Association, panelist and chief economist of General Motors, G. Mustafa Mohatarem, was bearish on the global automotive industry, citing the overall strength of the U.S. economy, growth in China, the European Union continuing to avoid a debt crisis, and recessions in Russia and Brazil coming to an end. Mohatarem pointed to the strong 2017 U.S. production rate of 17.4 – 17.5 million units as indicative of a healthy market, but cautioned that macroeconomic factors like interest rate policies and the risk of future labor shortages in the industry are possible disruptors. The general consensus from the conference panel was that the next cyclical downturn is out there somewhere, but panelists remained optimistic if not cautionary for the near term. We are clearly past peak in the current cycle, so many potential automotive sellers who have been sitting on the sidelines are feeling an urgency to move now or miss out on this upcycle.

## Valuation Multiples Remain Strong

Deal multiples have remained strong in the automotive industry, driven in large part by skyrocketing multiples for automotive technology companies in the electronics and powertrain space. According to PricewaterhouseCoopers (PwC), EBITDA (earnings before interest, taxes, depreciation and amortization) multiples for deals in the automotive industry for the first half of 2017 generally ranged between five and 10, with deals in the automotive electronics sector drawing multiples as high as 25. In contrast, PwC has seen



deal multiples in the interiors sector averaging at a less robust five times EBITDA, due in part to more automakers bringing design and engineering work in-house. We see no reason for these trends not to continue through 2018 and would not be surprised if valuations for comparatively underperforming sectors like interiors stabilize or even rise as buyers spot value opportunities and as electronics and other technologies continue their spread through all vehicle production sectors.

#### **ACES Continue To Be an M&A Card Worth Playing**

The emergence of automated, connected, electric and sharing (ACES) automotive technologies and business models has been the most notable development in the automotive industry over the last several years and continues to be a primary driver of M&A activity. This is sometimes misportrayed in the North American market as Detroit v. Silicon Valley, when in reality this has resulted in Detroit + Silicon Valley. Many Detroit OEMs and traditional automotive suppliers have established Silicon Valley presences for access to software talent and startups, while many traditional Silicon Valley technology companies are establishing locations in Detroit for proximity to automotive customers, manufacturing engineering talent and the significant automotive R&D activity that is based in Detroit. (There are more than 2,200 automotive R&D facilities in Michigan, according to a recent report issued by MichAuto.) Large suppliers like Delphi have found that they can accelerate their R&D activities in this space by acquiring existing teams, such as the recently announced NuTonomy transaction valued at \$450 million. At the same time, traditional technology companies are also becoming increasingly invested in this space and helping to drive deal activity and valuations higher and higher, as is evident by Intel's \$15.3 billion acquisition of Israel's Mobileye, a maker of cameras, sensors and software targeted at the autonomous vehicle market, and Samsung Electronics' \$8 billion acquisition

of Harman International Industries. The M&A activity for component suppliers has exploded due to these auto-tech deals, with PwC reporting a fivefold increase between the first half of 2016 and the first half of 2017. We can expect these trends to continue as the convergence of the automotive and technology industries progresses and, with that progression, that a new technology-centric automotive ecosystem develops and matures.

#### **Lightweighting Will Continue To Gain Importance**

The move towards lightweight materials is another trend that should continue to bolster M&A activity in the automotive industry, albeit amid increased regulatory uncertainty under the Trump administration. The major contributor to the lightweighting push is of course government regulations to control vehicle emissions in an effort to address climate change. While the current administration has taken steps to roll back some of the CAFÉ targets put in place by the Obama administration, the rest of the world, including the EU, India and China, continues to adopt and stand by aggressive emission targets. The addition of new content to vehicles like driver-assist sensors and improved infotainment features will add more weight to vehicles that will need to be made up for with lightweighting materials. Research conducted by the Center for Automotive Research indicates that by 2025, around five percent of the curb weight of the U.S. fleet will be added to every vehicle for these safety and performance improvements, including an additional 200 to 300 pounds per vehicle for automated driving features. And as autonomous driving takes hold and fewer crashes occur, the acceptance of lightweight materials should continue to grow. As Teijin Limited's 2017 acquisition of Continental Structural Plastics Holdings Corporation (CSP), a major composite supplier based in Michigan, for \$825 million (at a high EBITDA multiple of 10.25x) suggests, the demand for advances in this space should drive deal activity and valuations in 2018 and beyond.



# Looking into the Crystal Ball: Potential Pitfalls in the Automotive Industry in 2018 and Beyond

By: *Ann Marie Uetz, Partner, John Simon, Partner, Tamar Dolcourt, Associate*

By all reports, the American economy has enjoyed a steady recovery. Third quarter Gross Domestic Product (GDP) increased by 3.3 percent, an amount economists believe indicates a robust economy. Furthermore, the unemployment rate was 4.1 percent as of November 2017, according to the U.S. Bureau of Labor Statistics. As the economy has improved and unemployment has fallen in the nearly 10 years since the Great Recession, North American vehicle sales volumes have also steadily increased. Even though sales in 2017 were slightly lower than in the previous two years, they nevertheless remain strong going into 2018. Estimated volumes for 2017 are approximately 17.1 million vehicles, with the majority being the more expensive and more profitable light trucks and sport utility vehicles, rather than passenger cars, Bloomberg reports. The volumes for 2018 are expected to be high as well – approximately 16.7 million vehicles, again with the majority being light trucks and sport utility vehicles, Bloomberg estimates.

Year	North American Sales Volume
2009	12,647,518
2010	13,968,733
2011	15,272,765
2012	17,159,182
2013	18,410,289
2014	19,511,022
2016	17,550,000 (approximate)

Due to the relatively high volumes of vehicle sales in the past few years, including the record-breaking 2015 year, the automotive industry has seen few high-profile bankruptcies in recent years. Notwithstanding the current robust and stable environment in the industry, however, individual suppliers may face particular problems that, if not identified and addressed, could force them into a bankruptcy filing or other workout situation and cause damage to the supply chain.

Certain trends appear to be driving instability in individual companies. First, there is the issue of increasing warranty and recall costs. In 2016, there were 50 million light vehicles recalled, according to a Stout Advisory report. Of those, 30 million were not related to the Takata air bag inflator recall. Experts suggest that the high volume of recalls is likely to continue because, as vehicles become increasingly complex and have electronic components supplied by many parties, failures and recalls become more likely. This is particularly true where several suppliers are providing components that are integrated into a single system during production. Recall liability can be costly for both OEMs and suppliers, and OEMs increasingly look to suppliers to bear a significant portion of the costs. A significant recall issue may negatively impact even a stable supplier, but for a supplier that is not in a strong financial position prior to a recall, the liability may push it into insolvency or bankruptcy.

Another trend that may negatively affect suppliers is consolidation in the supply base. As technology changes and innovations in vehicle technology become more expensive, the pace of consolidation activity is likely to increase. 2017 was a strong year for mergers and acquisitions, and this will continue as traditional suppliers purchase technology companies in order to obtain new products and market positions, according to a PricewaterhouseCoopers report on automotive trends. Consolidation will create winners and losers as the industry adapts, including through the

growth of autonomous and connected vehicles. However, if a supplier is an unattractive target for consolidation, either because of its financial position or the products it has available, it may find itself unable to compete with new, consolidated entities. Moreover, vertical integration is occurring, which has caused some suppliers to lose customers to competitors that have been purchased and integrated into larger suppliers' businesses. These risks can exacerbate underlying problems and lead to distress and potential bankruptcies.

### Identifying and Protecting Against Troubled Suppliers

As discussed above, the increased recall and warranty repair costs and industry consolidation may cause individual suppliers that are operating on thin margins to falter. A troubled supplier within a supply chain can cause significant harm to the upstream suppliers and ultimately the manufacturers. Customers should routinely evaluate the companies in their supply chain for warning signs of distress. Here, we identify some of the top warning signs of troubled suppliers, and discuss potential actions to reduce the disruption that may be caused by a troubled supplier.

#### a. Warning Signs of Supplier Distress

- Supplier requests for price increases, accelerated payment terms, customer financing support, or use of factoring
- Late deliveries or changes in product quality
- Requests for technical support
- Failure to update IT systems or to appropriately use existing technology in the industry
- Failure to effectuate cost reductions
- Deteriorating accounts receivable and accounts payable
- Employment of consultants and financial advisors
- Deteriorating market position
- Restatement or delays in issuing audited financial statements
- Changes in key management positions
- Renegotiated debt covenants, incurrence of new debt, fully drawn lines of credit and impending maturity dates

#### b. Action Plans for Customers of Troubled Suppliers

Where these signs exist, the exercise of common law and statutory remedies may allow a customer of a troubled supplier to achieve proactive changes to standard terms and conditions of new contracts (or negotiated changes to existing contracts). Through the use of these tactics, customers can prioritize, understand, and address troubled supplier situations with greater advance awareness, leverage and options.

Customers also should routinely analyze their contracts to maximize their position in dealing with potentially troubled suppliers. A customer's existing contracts with a given supplier have a substantial effect on the customer's rights and remedies, both pre-bankruptcy and post-bankruptcy. For example, the terms of the contracts govern critical issues such as:

- Each party's ability to terminate the contracts
- The supplier's ability to stop shipment and impose "hostage" demands
- A customer's ability to resource production to another, healthier supplier
- A customer's ability to utilize certain contract remedies, including to demand adequate assurance of future performance pursuant to section 2-609 of the Uniform Commercial Code (UCC), or consider the contracts repudiated by the supplier
- Whether a contract is considered an "executory" contract in bankruptcy, whether it is integrated with other contracts, and the impact of this on the duty to perform in bankruptcy
- The troubled supplier's ability to assume and assign, or reject, the contract in bankruptcy
- A customer's ability to recover its tooling
- Lien rights
- Setoff rights

Through the imposition and application of statutory and common law contract rights, manufacturers can avoid troubled companies' use of their own ordinarily broad bankruptcy rights to reject contracts for continued supply of goods. Where signs of financial distress are apparent, or a manufacturer otherwise has reasonable grounds to believe

that a supplier's future performance under a contract for the sale of goods is in doubt, a manufacturer may be able to demand adequate assurance of future performance from the supplier under section 2-609 of the UCC. If such assurance is not provided, a manufacturer may be able to consider the contract repudiated, enabling the manufacturer to resource or suspend shipment, or negotiate or impose more protective or otherwise better terms in order to "shore up" contract rights before a bankruptcy filing. These strategies can drastically alter the parties' rights after a bankruptcy filing and provide greater leverage in negotiations and better outcomes.

To preserve supply, manufacturers also may participate in a pre-bankruptcy workout, intended to keep a troubled supplier on the verge of bankruptcy from ceasing production of necessary parts, by restructuring the supplier's debt and capital structure. These transactions often include tripartite agreements among the troubled supplier, its significant customers, and its secured lenders to solidify the commitments of each party to keep the supplier operating while the workout (or bankruptcy) is progressing. These agreements commonly consist of access and accommodation agreements, and subordinated participation

agreements. Through an accommodation agreement, the customers may provide (often as a group) accommodations that solidify the lenders' collateral base through protections on inventory and receivables, commitments to continue sourcing of existing parts to the troubled supplier and limitations on setoffs while the lender agrees to provide working capital financing and not to foreclose. Furthermore, customer accommodations may include financing support, in which case the customer should obtain a participation agreement to obtain collateral for any financing it provides. An access agreement permits the customer, under certain circumstances threatening production and only as a last resort, to access the supplier's plant to produce parts using the supplier's own equipment and employees, pending transfer of the contract or facility to a healthier supplier.

Faced with increased demand for cost savings and warranty contributions, and the risks presented by consolidation in the industry, all parties need to be aware of any potential disruption in the supply chain. By actively monitoring vendors and taking the proactive steps outlined above, suppliers can protect the supply of critical parts and continue to fulfill their contracts with their own customers.





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