

Morgan Lewis

REPORT

INNOVATION, REGULATION, AND LITIGATION

THE AUTOMOTIVE INDUSTRY'S ROAD TO 2024

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INNOVATION, REGULATION, AND LITIGATION: THE AUTOMOTIVE INDUSTRY'S ROAD TO 2024

The automotive industry as we know it is rapidly transforming. From the proliferation of electric transportation and technological leaps in vehicle automation to increasingly complex regulations and expanding class action litigation—these developments have brought not only new legal challenges and considerations, but also opportunities for the sector, particularly as technology continues to evolve and Washington seeks to put its stamp on the industry's future.

Morgan Lewis's 2023 [Automotive Hour webinar series](#) explored the impact of these and other developments on manufacturers, suppliers, and lenders and shared how the industry can adapt to these trends to take advantage of what lies ahead.

THE AUTOMOTIVE INDUSTRY

Hot Topics in Automotive Class Actions

As the types of automotive class actions have evolved, so too have the types of class action trends and developments. Some of the hot topics in the auto class action space in 2023 included the following:

- **Types of Claims:** Automotive class actions often asserted claims for purely economic damages due to overpayment at the point of sale, avoiding individual issues associated with needing to prove physical injury or property damage. Plaintiffs often assert that automobile manufacturers wrongfully induced vehicle purchases by misrepresenting or concealing the alleged defects and that consumers would not have purchased the vehicle or would have paid less had they known.
- **Key Defenses:** Several defenses that have been raised in automobile defect class actions—at the motion-to-dismiss or summary judgment stage, at class certification, and even at trial—include requiring proof of an actual design defect under applicable state law, challenging personal jurisdiction, and requiring a showing that all class members have been harmed by the alleged defect, among others. Affirmative defenses, such as the statute of limitations and the existence of arbitration agreements for absent class members, have also been raised to show that any class trial would be overrun with individual issues.
- **Classwide Damages:** Plaintiffs turned to a variety of theoretical models to attempt to show damages and injury for all class members, which led to large certified classes and high exposure, and at times illogical results. Conjoint analyses are the current favorite for plaintiffs. There are many ways of attacking these damages models, and such challenges should not lose sight of common-sense principles.
- **Beyond Class Certification:** Remember that certified classes can be decertified or narrowed in advance of trial. Class claims can also be tried. It is critical that plaintiffs are held to their classwide burden at trial.

For more information on recent trends and developments in class action litigation involving auto companies, read our Insight [Trends in Automotive Class Actions](#).

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Human Rights and the International Supply Chain

Similar to many other global manufacturers, auto manufacturers, particularly those involving electric vehicles (EVs), continued to face a host of challenges related to their international supply chains in 2023, with some of the most difficult and sensitive ones pertaining to human rights violations. Adding to the complexity is a myriad of overlapping, and sometimes conflicting, regulatory regimes that are present in domestic and global supply chains.

Failure to comply with these varied laws (or even allegations of such noncompliance) could result in increased governmental oversight and action, from detention of products at the border to fines and outright bans on importation, in addition to adverse consumer action in the form of boycotts and other demonstrations that could cause reputational damage.

The US Congress has seen bipartisan support in taking affirmative action to address supply chain concerns, including ones relating to human rights and trade practices. Companies can expect this issue to continually be a major focus of regulatory enforcement efforts for the foreseeable future.

Finally, China continues to present a dynamic in which automakers must balance supply chain integrity with market access, which is critically important for non-Chinese automakers to achieve growth and remain viable players, particularly in the increasingly vital EV space. Given the complexity of operating between the diverging interests of the United States and China, companies' responses to labor and human rights-focused inquiries must remain deliberate and fact-based.

For more information on global supply chain risks and enforcement activity, read our key takeaways of [Human Rights and Supply Chain Issues: Impacts on the Automotive Industry](#).

Developments in Auto Finance and Consumer Protection

US federal agencies such as the Consumer Financial Protection Bureau (CFPB) and Federal Trade Commission (FTC) have increased their scrutiny of auto loan servicing activities, particularly regarding auto dealers that engage in unfair, deceptive, or abusive acts or practices (UDAAPs).

In cooperation with their state counterparts, these agencies used novel legal theories to aggressively pursue claims against dealers for assessing excessive "junk" fees, failing to refund guaranteed asset protection (GAP) overpayments, making deceptive statements, and double billing, among other discriminatory practices. This has resulted in a number of lawsuits against dealers and financial institutions, as well as the promulgation of new agency regulations and stricter state legislation, particularly in California.

Auto dealers, banks, and other institutions that handle auto loan financing should be wary of the following key themes and take proactive steps to ensure that they are in compliance with the latest regulatory regimes.

- **Parallel Enforcement:** Expect continued cooperation (or collusion) between federal regulators such as the CFPB, FTC, and their state counterparts. This is a now-frequent occurrence seen across multiple industries.
- **Junk Fees:** While "junk" is a subjective and ultimately meaningless term, federal regulators are placing heavy scrutiny on fees that are passed onto consumers both in originations and servicing contexts.
- **Understand Third-Party Risks:** Conduct due diligence on prospective lending partners, dealers, servicers, repossession agents, and other parties. Identify key risk indicators and monitor for changes.

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- **Litigation:** Be alert that California often stands apart from other states in finding ways to provide additional protections for consumers.

For more information on considerations and best practices for compliance management during this era of increased regulatory scrutiny, read our Insight [Latest Developments in Automotive Finance and Consumer Protection](#).

Warranty Claims and Trends

To protect business interests, auto manufacturers must understand the applicable law of the jurisdictions in which they operate. When it comes to express warranty claims, it is important to remember that these claims are governed by state law, and the rules and regulations differ from state to state.

- **Review your warranties for compliance with the Magnuson-Moss Warranty Act:** Magnuson-Moss is the main enforcement mechanism for addressing the right to repair and regulates consumer warranties, including vehicle warranties. Violations of Magnuson-Moss can also give rise to violations of the FTC Act, which prohibits unfair, deceptive practices in connection with competition.
- **Avoid explicit or implicit tie-ins in your warranties:** Remove problematic language that may tie where and how repairs are made to the warranty.
- **Carefully craft technical service bulletin language to avoid expanding the warranty:** A technical service bulletin typically covers parts or processes that malfunction but are not considered safety issues.
- **Stay up to date on “right to repair” laws:** As technological developments, including EVs, have advanced in recent years, “right to repair” laws have taken on greater significance.
- **Review new vehicle warranty language:** Ensure that such language includes clear notice and presentment requirements.

For more information, see our key takeaways for [Warranty Claims and Trends in the Automotive Industry](#).

ELECTRIC AND AUTONOMOUS VEHICLES

What Impacted the EV Industry in 2023

Despite electrification efforts by the US transportation sector progressing at a strong pace in 2023, there are still some underlying issues that could affect widespread adoption of EVs, including an absence of education for potential consumers on opportunities and concerns involved. Key issues the EV market faced in 2023, many of which will carry over into 2024, included the following:

- **Range Anxiety:** Defined as the fear that an EV will not have a charge sufficient to complete its trip, this continued to be one of the greatest barriers preventing fleets from going electric. Range anxiety is driven by three issues: (1) a lack of public charging stations, (2) a reduction in the reliability of charging stations, and (3) an overall lack of public charging infrastructure throughout the country. To address these issues, the Biden administration allocated \$7.5 billion for the development of charging stations in the 2021 Infrastructure Investment and Jobs Act. However, the solicitation process was delayed while states awaited guidance from the White House on the National Electric Vehicle Infrastructure Formula Program. This guidance was [published in February 2023](#), and the first of those federally funded charging stations [came online in December 2023](#).

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- **Battery Component and Critical Mineral Supply Sourcing and Recycling:** Funding opportunities for battery and mineral refining, processing, and manufacturing under the Bipartisan Infrastructure Law and Inflation Reduction Act (IRA) are contingent on qualification criteria and impose certain conditions on funding recipients. The US Internal Revenue Service (IRS) and US Department of Treasury have issued [proposed guidance](#) on how they will apply the Internal Revenue Code's Section 30D critical mineral and battery component thresholds for the purposes of determining whether an EV is eligible for tax credits. What the final guidance will look like and how it will be interpreted by manufacturers and the courts will be something to keep an eye on in 2024.
- **Data Protection and Cybersecurity:** The proliferation of increasingly connected vehicles has raised concerns about the extent to which EVs and EV infrastructure may be used as an entry point for hackers or bad actors to disrupt the US electric grid. Current cybersecurity and data protection standards for EV infrastructure are underdeveloped, which may create vulnerabilities. To address this, the Joint Office on Energy and Transportation released [suggested cybersecurity procurement language](#) for EV service provider contracts. It remains to be seen if this suggested language will be widely adopted by the industry.
- **Vehicle-to-Grid Market Access:** Bidirectional charging has enabled EV customers and fleet owners to utilize vehicle-to-grid capabilities, which can facilitate market access and create new revenue opportunities. However, EV owners, whether individuals or fleets, must be mindful of market access rules and market participation requirements.
- **Inflation Reduction Act:** The IRA, which came into effect at the beginning of 2023, built on the framework started by the Infrastructure Investment and Jobs Act. For EVs, the IRA encourages investments through three different tax credits: new clean vehicle tax credits, used clean vehicle tax credits, and commercial clean vehicle tax credits. Since the IRA did not follow traditional legislative history with extensive committee reviews and debate, federal agencies have been left with the task of publishing further guidance as the regulations and funding opportunities roll out. In October 2023, the IRS and Treasury released [guidance](#) on how consumers can transfer clean vehicle credits directly to car dealers, lowering costs for EV purchasers at the point of sale. It remains to be seen if these incentives will be enough to meet the federal government's EV adoption goal of 50% of all sold vehicles.
- **A Carrot-and-Stick Approach:** The federal government is using both incentives and disincentives to drive EV adoption. For example, while the IRA green energy tax credits and federal funding represent the carrot, the US Environmental Protection Agency introduced the stick in April 2023 with significant [new proposed tailpipe emission standards](#) for post-2026 vehicles for light-duty and medium fleets.

For more information, read our Insight [Issues and Opportunities for the Electric Vehicles Industry in 2023](#) and our key takeaways from [2023 Congress: Potential Impact on EVs](#).

Emerging Legal Issues in Vehicle Automation

The autonomous vehicle (AV) segment stands to revolutionize the personal mobility space, from the profound (decreasing the number of on-road fatalities) to the mundane (increasing commuters' personal time). However, mobility stakeholders should continue to anticipate and prepare for novel and complex issues that may expose them to legal liabilities stemming from AV technologies, as legislators and regulators have been increasingly active in pursuing market oversight.

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There already have been several attempts to pass federal AV legislation in the United States, including the SELF DRIVE Act and the AV START Act. While those and subsequent federal legislative efforts failed, Congress persisted in contemplating AV issues. Many states are in various stages of proposing and enacting laws to regulate the driving and development of AVs, including Arizona, California, Florida, Michigan, Oklahoma, Pennsylvania, Texas, and West Virginia.

Safety is a central tenet of the effective development of AV technology and will be key to inspiring consumer confidence and increasing adoption of AVs. Therefore, mobility stakeholders must establish a culture of safety compliance from the initial stages of product development. This includes in-house trainings on AV safety, top-down engineering process assessments, and functional safety workshops to test automatic protection systems. AV manufacturers should also consider developing robust safety driver manuals for the many applications managing AVs. These manuals serve as guideposts, allowing AV applications to make lightning-quick decisions in response to various stimuli on roadways.

While the United States does not have specific laws or regulations on the safety architecture for these systems, mobility stakeholders have developed globally accepted standards for various AV applications that should underpin all safety driver manuals.

For more information on the business opportunities, labor-protective legislation, and best practices for mitigating risk, read our Insight [Navigating Emerging Legal Issues in Vehicle Automation](#).

Open-Source Software, Artificial Intelligence, and the Auto Industry

Software is essential to modern vehicles, especially EVs and AVs. Nearly a quarter of all modern vehicle commercial applications are based on open-source software (OSS), and this figure is only expected to grow. While there are a number of advantages to OSS, such as low cost and flexibility, it also comes with major risks that automobile manufacturers and other developers in the industry must keep in mind as they continue to grow the suite of software that controls EVs and AVs.

For example, vulnerabilities in OSS could compromise applications and expose confidential information. Poor OSS license compliance can also trigger litigation. Even more alarming, and of particular concern for EVs and AVs, poor OSS quality can impact vehicle and passenger safety.

To mitigate these risks, auto manufacturers and other developers can take proactive steps to mitigate these risks, including

- adopting policies and procedures to detect and address security vulnerabilities and avoid license conflicts;
- training their developers on the risks of OSS;
- diligently tracking OSS use throughout the manufacturing pipeline; and
- being aware of the key issues open-source litigation usually presents, such as standing, copyright preemption, covenants versus conditions, and damages, whether monetary or some sort of injunctive relief or specific performance.

Auto manufacturers should also be cognizant of the legal liabilities inherent in the rapidly developing area of generative artificial intelligence (AI) programs as they continue to use AI for a number of use cases, from vehicle navigation to design and manufacturing. For example, when developing and training AI programs, companies should be cognizant of the source and any restrictions surrounding the data sets used, which may have access restrictions and underlying third-party rights.

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If using AI programs to generate new content, companies should be wary of the various copyright infringement claims this can raise. Currently, AI output is not copyrightable, per the US Copyright Office, unless there has been sufficient human authorship.

As this caselaw develops, auto manufacturers should remain thoughtful when using AI and consider implementing best practices such as regular employee trainings on copyright law and the firm's AI policy to reduce the risk of infringement.

For more information on the risks and benefits of OSS and AI in the auto industry, read our Insight [Accelerating Innovation: Open-Source Software, Artificial Intelligence, and the Auto Industry](#).

LOOKING AHEAD TO 2024

A host of technological advancements, from electrification to AI, as well as regulatory developments aimed at preventing human rights violations and encouraging the adoption of cleaner and safer vehicles are shaping the future of the automotive industry. Navigating this new landscape will present both challenges and opportunities for industry players but, with careful planning and collaboration, auto manufacturers and distributors can maximize these changes to their benefit.

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