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WHITE COLLAR AND GOVERNMENT ENFORCEMENT DEVELOPMENTS AFFECTING THE AUTOMOTIVE AND MOBILITY INDUSTRY

August 4, 2021

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Morgan Lewis Automotive Hour Webinar Series

Series of automotive industry focused webinars led by members of the Morgan Lewis global automotive team. The 11-part 2021 program is designed to provide a comprehensive overview on a variety of topics related to clients in the automotive industry. Upcoming sessions:

AUGUST 11 | Power and Opportunity: EVs, Hydrogen and Other Vehicle Power

SEPTEMBER 15 | SPACs and Other Vehicles for Investment in the Automotive and Mobility Sectors

NOVEMBER 10 | New Market Entry and the Anachronistic US Distribution System: What the Future Portends

DECEMBER 8 | The IP Anatomy of the Automotive Nervous System

Today's Roadmap

- Diesel emissions and beyond:
 - Where we have been over the past 4-5 years and who are the relevant players?
 - Where we are going: How are the Biden-Harris administration's enforcement priorities are likely to impact the auto industry?
 - SPACs and the auto industry – a new frontier for parallel criminal and civil enforcement?

Recent Resolutions Involving the Auto Industry (Emissions)

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Volkswagen AG [April 2017]

About

- Automotive manufacturing company
- Based in Wolfsburg, Germany

Conduct

- Conspiracy to cheat U.S. emissions tests through false statements to the EPA and US customers about whether 335,000 VW, Audi, and Porsche diesel vehicles complied with emissions standards
- Use of cheating software; spoliation of documents; importing cars through false statements about the emissions limits
- Violation of the Clean Air Act

Resolution

- Guilty plea by VW: \$4.3 billion in criminal and civil penalties: \$2.8 billion criminal fine and \$1.5 billion in civil environmental, customs and financial violations
- 6 VW executives and employees indicted
- Monitor appointed to oversee parent company
- FBI, EPA-CID, DOJ Criminal Division Fraud Section, USAO-EDMI, ENRD (CRM/CIV), DOJ Civil Division, assistance from German authorities

Audi AG Managers [January 2019]

About

- Automotive manufacturing company
- Based in Ingolstadt, Germany

Conduct

- Alleged to have participated in a conspiracy to defraud US regulators and customers by using a software designed to cheat US emissions tests in Audi “clean diesel” vehicles

Resolution

- Four individual Audi managers criminally charged for decade-long conspiracy
- FBI, EPA-CID, DOJ Criminal Division Fraud Section, USAO-EDMI, ENRD (CRM), assistance from German authorities
- The case was transferred from EDMI to C.D. Cal. in June 2021

IAV GmbH [May 2019]

About

- Automotive engineering company
- Based in Berlin, Germany
- Volkswagen AG is a 50% shareholder of IAV GmbH

Conduct

- Played a role in the Volkswagen AG emissions fraud
- The company knew that the vehicles did not meet US emissions standards and created software to cheat the testing process. The company also knew that VW concealed material facts about cheating from regulators and customers

Resolution

- \$35 million criminal fine
- FBI, EPA-CID, DOJ Criminal Division Fraud Section, USAO-EDMI, ENRD (CRM), assistance from German authorities

Daimler AG & Mercedes-Benz USA [September 2020]

About

- Automotive manufacturing company
- Based in Stuttgart, Germany

Conduct

- Emissions cheating in Mercedes-Benz diesel vehicles
- From 2009 to 2016, Daimler manufactured, imported, and sold more than 250,000 diesel vehicles with undisclosed auxiliary emission control devices, which falsely produced compliant results during emissions testing

Resolution

- \$1.5 billion settlement with the EPA (following DOJ ENRD complaint filed) and the California Air Resources Board, including \$875 million in civil penalties, \$70.3 million in other penalties, \$436 million in the recall program, and \$110 for mitigation projects in California
- Conduct nationwide recall and repair emissions systems in Mercedes-Benz diesel vehicles sold in the US between 2009 and 2016

Toyota Motor Company [January 2021]

About

- Automotive manufacturing company
- Based in Aichi, Japan
- Subsidiaries include Toyota Motor Corporation, Toyota Motor North America Inc., Toyota Motor Sales U.S.A. Inc., and Toyota Motor Engineering & Manufacturing North America Inc. (“Toyota”)

Conduct

- Toyota violated EPA regulations and the Clean Air Act by failing to report mandatory information about potential defects in cars
- These reporting failures likely resulted in delays to emission-related recalls as well as financial benefit to the company by offsetting costs onto consumers

Resolution

- Settlement of DOJ SDNY, ENRD and EPA civil lawsuit for “systematic, longstanding violations” of the Clean Air Act
- Consent decree: Toyota to pay \$180 million civil penalty (largest civil penalty for EPA emission-reporting requirement violation) and injunction
- Consent decree subject to period of public comment and court approval

Fiat Chrysler Automobiles Italy [April 2021]

About

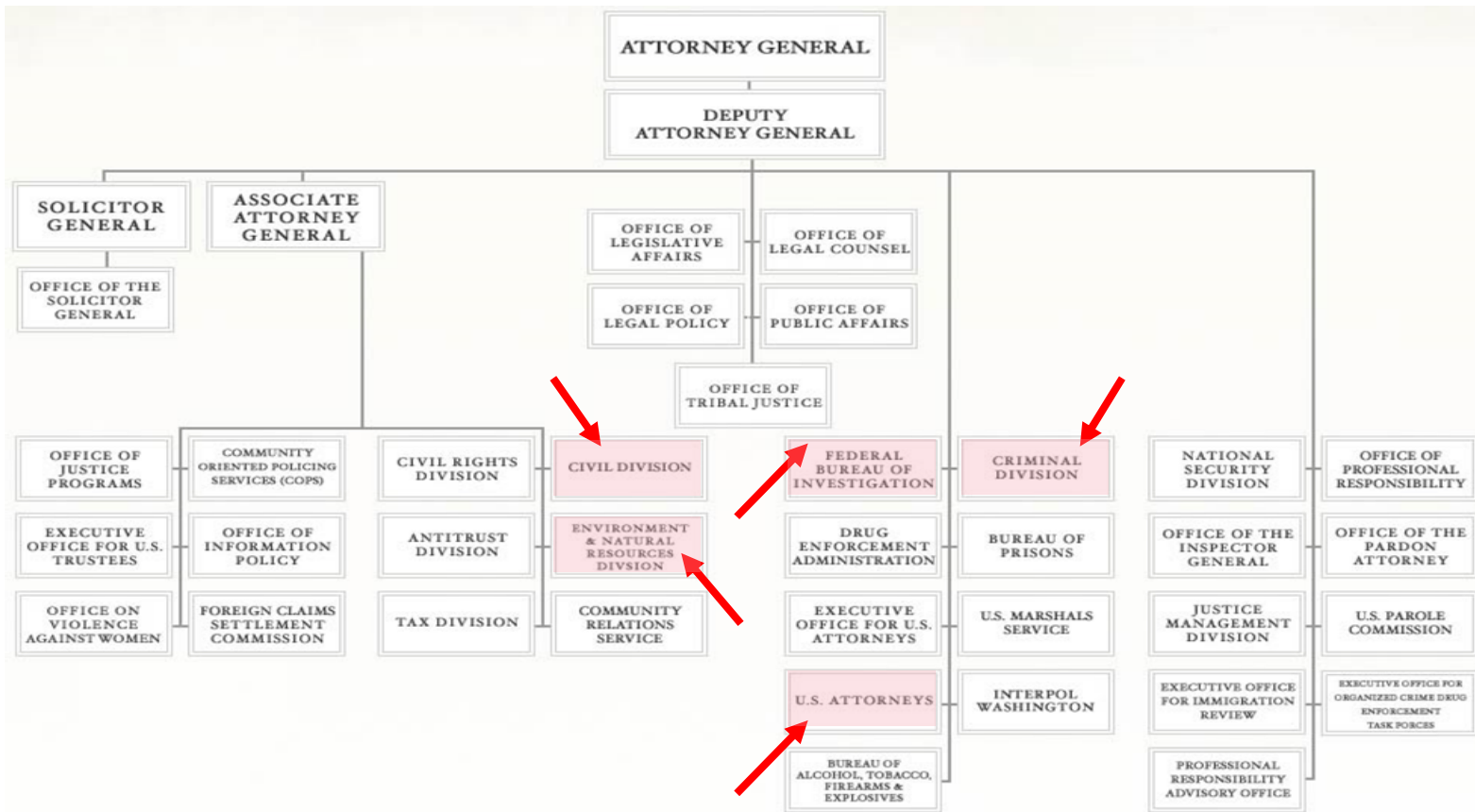
- Automotive manufacturing company
- Italian subsidiary of Stellantis, N.V.
- Based in Turin, Italy (parent company based in Amsterdam, Netherlands)

Conduct

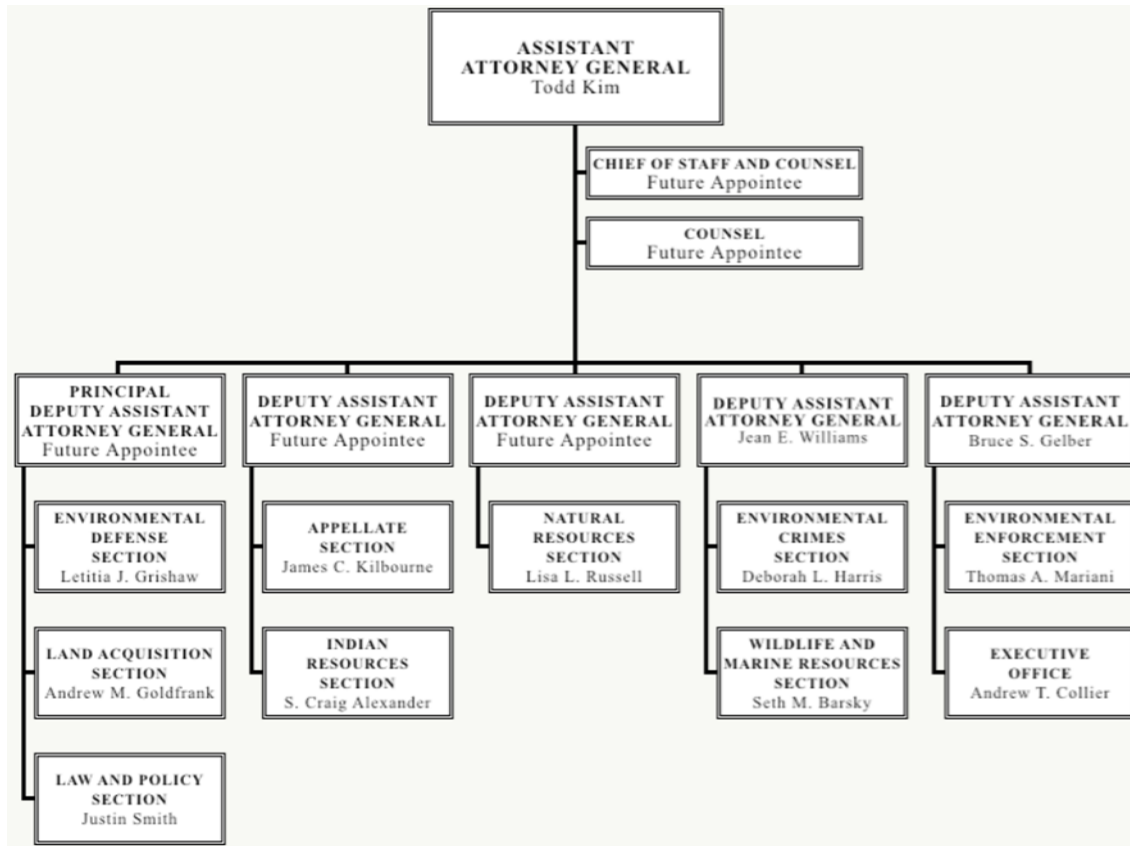
- Three senior diesel managers at FCA Italy alleged to have purposely calibrated emissions control functions to produce lower nitrogen oxide emissions to meet fuel efficiency standards set by FCA US LLC
- Allegedly used calibration to achieve best-in-class fuel efficiency to make vehicles more attractive to potential customers

Resolution

- Two Italian senior managers charged with conspiracy to cheat U.S. emissions tests, defrauding US consumers, and violation of the Clean Air Act. If convicted, each individual may face up to 5 years for conspiracy, up to 20 years for conspiracy to commit wire fraud, up to 2 years for violating the Clean Air Act, and up to 5 years for making false statements. Another senior manager was previously charged in 2019. His trial is set for October 2021
- FBI, EPA-CID, DOJ Criminal Division Fraud Section, USAO EDM, ENRD



DOJ Environment and Natural Resources Division



Recent Resolutions Involving the Auto Industry (Product Safety)

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Toyota [March 2014]

About

- Automotive manufacturing company
- Based in Aichi, Japan

Conduct

- Concealed and made misleading statements to consumers and US regulator about safety issues related that resulted in unintended acceleration in cars

Resolution

- Deferred prosecution agreement with \$1.2 billion penalty
- Independent monitor to review and assess policies, practices, and procedures
- DOJ - Securities and Commodities Fraud Task Force, USAO SDNY, DOT, NHTSA, FBI

General Motors [September 2015]

About

- Automotive manufacturing company
- Based in Detroit, Michigan

Conduct

- GM had concealed a potentially deadly safety defect with airbags from the National Highway Traffic Safety Administration (regulator) and consumers from 2012 to 2014
- By concealing this defect, GM put consumers and drivers at risk

Resolution

- Deferred prosecution agreement with \$900 million forfeiture
- DOJ - Securities and Commodities Fraud Task Force and Complex Frauds and Cybercrime Unit, USAO SDNY, DOT - OIG, NHTSA, SIGTARP, FBI

Takata Corp. [January 2017]

About

- Automotive safety-related equipment supplier
- Based in Tokyo, Japan

Conduct

- Three Takata executives, all Japanese citizens, were charged with wire fraud and conspiracy for alleged conduct related to selling defective airbag inflators
- The company repeatedly falsified safety test data regarding the safety of the airbag inflators from around 2000 to 2015

Resolution

- Guilty plea and \$1 billion in criminal penalties
- DOJ - Criminal Division Fraud Section, DOJ - Office of International Affairs, USAO EDMI, DOT - OIG, FBI

New Administration Enforcement Priorities

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New Administration's Enforcement Priorities



Stricter enforcement of environmental issues, including climate and vehicle emissions.

Antitrust enforcement, including criminal antitrust, that impact international shipping.

Early emphasis on international corruption: Foreign Corrupt Practices Act ("FCPA"), impacting both foreign and domestic auto companies.

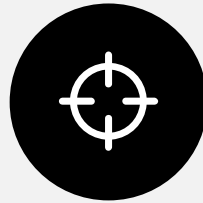
Emphasis on Climate

Climate Emphasis

The Biden-Harris administration has voiced its commitment to climate, which will impact the auto industry



Potential plan to create Environmental and Climate Justice Division within DOJ



Legislation requiring polluters to bear the full cost of their climate pollution and reinstating emission regulations



Plan for a Clean Energy Revolution and Environmental Justice



Pledge to create new jobs in clean tech and increase the presence of electric vehicles

Pro-Enforcement Antitrust Policy

Antitrust

The Biden-Harris administration has signaled its pro-enforcement stance towards antitrust



Appointment of Big Tech critic Lina Khan as the Chair of the Federal Trade Commission



Executive Order announcing initiatives to increase antitrust enforcement and to promote competition



Hiring Tim Wu as a Special Assistant to the President for Technology and Competition Policy and nominating Jonathan Kanter for the DOJ antitrust division



More aggressive merger enforcement by antitrust agencies across all sectors, including technology and transportation

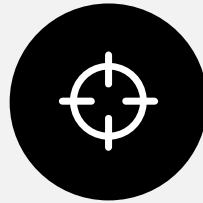
Aggressive Stance Towards Global Corruption

Corruption

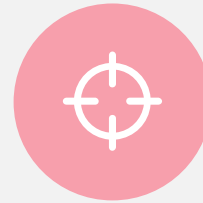
The Biden-Harris administration has announced its offensive stance on anti-corruption enforcement



Establishing anti-corruption as a core U.S. national security interest



Increase proactive methods and rely less on self-policing within DOJ FCPA investigations



More aggressive enforcement at the SEC with the appointment of Gary Gensler



Collaborate with international partners and assist foreign countries to reduce corruption abroad

Emphasis on Compliance in Enforcement

- In April 2019, the Criminal Division issued guidance that was binding on all of its prosecutors. This new guidance, titled *Evaluation of Corporate Compliance Programs*, set forth a framework for how prosecutors should evaluate corporate compliance programs, consistent with the Filip Factors.
 - The new guidance incorporated and expanded upon the sample question format from the earlier Fraud Section guidance, providing examples of how prosecutors would probe compliance program adequacy.
- In parallel with the guidance, the Criminal Division trained its prosecutors (rather than relying on a single Compliance Counsel role), bringing in outside experts to provide a range of perspectives and insights on difficult compliance topics.
 - The training involved all Criminal Division attorneys handling corporate cases, as well as 22 U.S. Attorney's Offices, the SEC, CFTC, DOJ Civil Division, and foreign prosecutors.

DOJ's Compliance Program Guidance – Recent Update

- On June 1, 2020, the DOJ Criminal Division updated its *Evaluation of Corporate Compliance Program* guidance to bring greater emphasis to:
 - The need for compliance programs to be “adequately resourced and empowered to function effectively.”
 - The evolution of compliance programs based upon lessons learned, measuring the effectiveness of training and the appreciation of risk.
 - The compliance function’s ability to access relevant sources of data to allow for timely and effective monitoring and/or testing of controls.
 - How effectively a company has integrated acquired operations into its compliance structures and controls.
 - The accessibility of policies and the tracking of hotline reporting.

Compliance Takeaways from Recent Resolutions

A problematic corporate culture can undermine otherwise reliable compliance program structures, i.e., Knowledge plus inaction paradigm (“the compliance department initially did what they were supposed to—identifying potentially suspicious orders by applying preset metrics, but the failures came later, when the corporations’ executives chose to ignore the suspicions and failed to conduct any investigation or due diligence)

Unless a compliance program and its reinforcing controls are reassessed from time to time, they may be allowing problematic transactions to slip through undetected, despite an outward appearance of effectiveness.

A corporation’s failure to sufficiently empower and support its compliance function e.g., in one instance, despite the company having \$1 billion in annual revenue it did not hire a dedicated compliance officer, but instead added the compliance function to an existing employee who already had a number of other time-consuming tasks, such as managing the warehouse and tracking inventory.

The biggest transactions deserve the same level of scrutiny and controls – if not more – than more routine transactions.

Prompt remediation matters, especially when it comes to monitoring risks.

SPACs in the Auto Industry: Focus of Parallel Government Investigations

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General Background on SPACs

Typical timeline: 18 to 24 months



Shell Formation

SPAC stands for: Special Purpose Acquisition Company

Form and publicly list a shell company

Search and Merge

Individuals or entities (e.g. hedge funds) will purchase a private company and fast forward the process to take the company public through the shell company.

Negotiations

Merge private company into shell company, rename the company and change its trading ticker symbol. PIPE (private investment in public equity) to find additional investors to raise capital.

Closing

After shareholder approval and regulatory clearance, the company becomes public and starts returning investment to shareholders

The fast-moving nature of SPACs make them targets for investigations

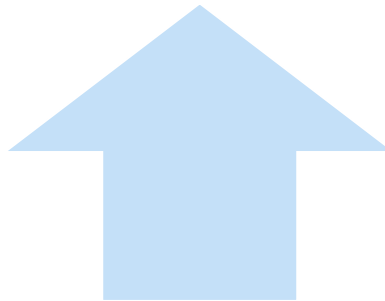


Cons:

Pressure from accelerated timeline
Complex accounting and financial reporting/registration requirements

Pros:

Access to capital
Lower transaction fees
Accelerated timeline to go public
More streamlined regulatory process than traditional IPOs



The accelerated timeline creates pressure to move at a fast pace. This, coupled with the risk of having to return the seed money to investors if the company does not become public, **may result in inadequate due diligence.** There may also be potential securities fraud charges resulting from representations made to potential or actual investors about the health of the newly-merged company.

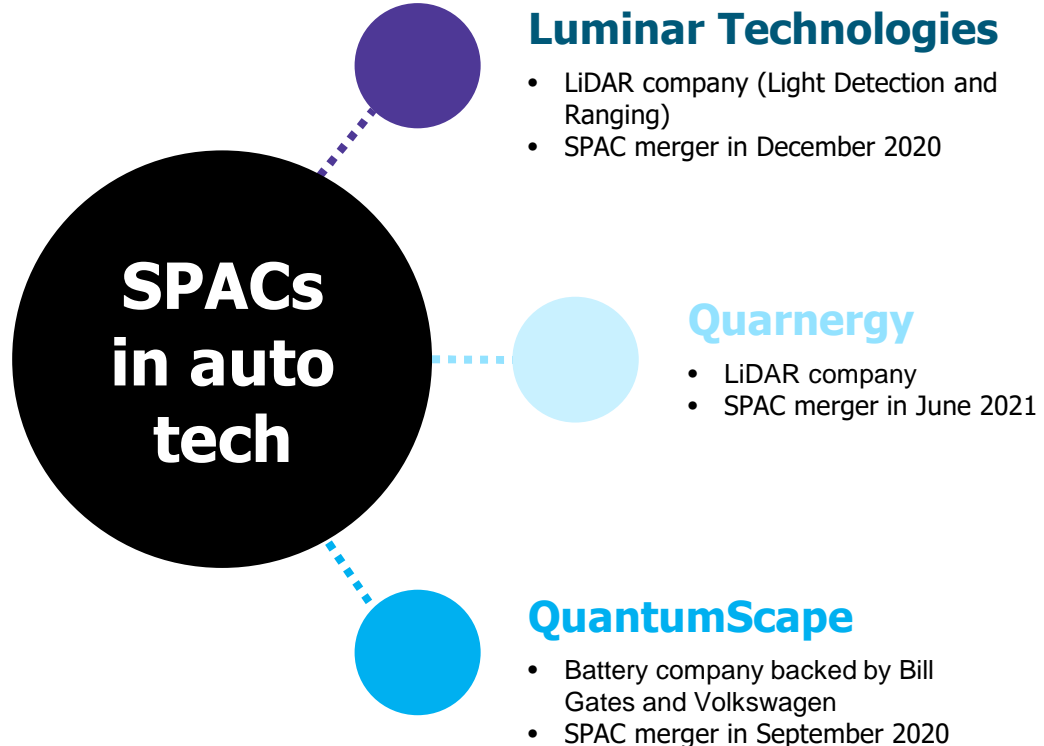
SPAC movement in the auto industry

- Increase in electric vehicle start-ups and auto tech companies going public through SPACs. The industry is particularly attractive for SPACs.
- Advantages include:
 - Quicker timeline
 - More streamlined regulatory process compared to the traditional IPO
- The marketing process for SPACs also provide an avenue to discuss projections and forward guidance. This is especially helpful in justifying future revenues because the market for electric vehicles has untapped potential.
 - Prospect of becoming “the next Tesla”
- However, SPACs in the auto industry are also particularly prone to government investigations.

SPAC movement in the auto tech industry

Increase in SPAC activity

Recent examples of auto tech companies going public via SPAC.



Nikola Corp. (DOJ & SEC)



About

- Electric truck startup with a goal of zero-emissions.
- Founded in 2014, SPAC completed in June 2020
- Based in Phoenix, Arizona
- Stock: NKLA (NASDAQ)

Conduct

- Hindenburg Research, a short seller, accused Nikola of fraud allegations regarding proprietary technology and misrepresenting the completeness of its prototype, including using parts produced by outside vendors.
- Hindenburg alleges that Nikola used false statements to mislead potential partners into signing agreements.

Current Investigations and Impact

- Nikola received subpoenas from the SEC and the DOJ in relation to Hindenburg's fraud allegations.
- Shares of Nikola fell by 20% after the announcement of the SEC and DOJ investigations.
- Founder Trevor Milton resigned shortly after, resulting in another decrease in shares of 35%
- Milton indicted by SDNY on 3 counts of criminal fraud for lying about "nearly all aspects of the business" to bolster stock sales of the electric vehicle start-up; SEC also filed civil securities fraud charges

Lordstown Motors (DOJ & SEC)



About

- Electric truck startup backed by General Motors. Its first product is an all-electric pickup truck called "Endurance"
- Founded in 2018, SPAC completed in October 2020
- Based in Lordstown, Ohio
- Stock: RIDE (NASDAQ)

Conduct

- Hindenburg Research, a short seller, accused Lordstown of fabricating orders and misleading consumers and investors about production timeline "to raise capital and confer legitimacy"
- Company CEO stated the orders were meant to gauge customer interest, not to confirm future sales, although the CEO

Current Investigations and Impact

- Lordstown subsequently received "requests for information" from the SEC
- After the announcement of the Hindenburg accusations and request for information from the SEC, Lordstown shares fell by 27%
- The DOJ is also investigating Lordstown. The stocks decreased by nearly 10% after the Wall Street Journal reported on the DOJ probe in July 2021.

Questions?

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Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

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To help keep you on top of developments as they unfold, we also have launched a resource page on our website at www.morganlewis.com/topics/coronavirus-covid-19

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple “Stay Up to Date” button.

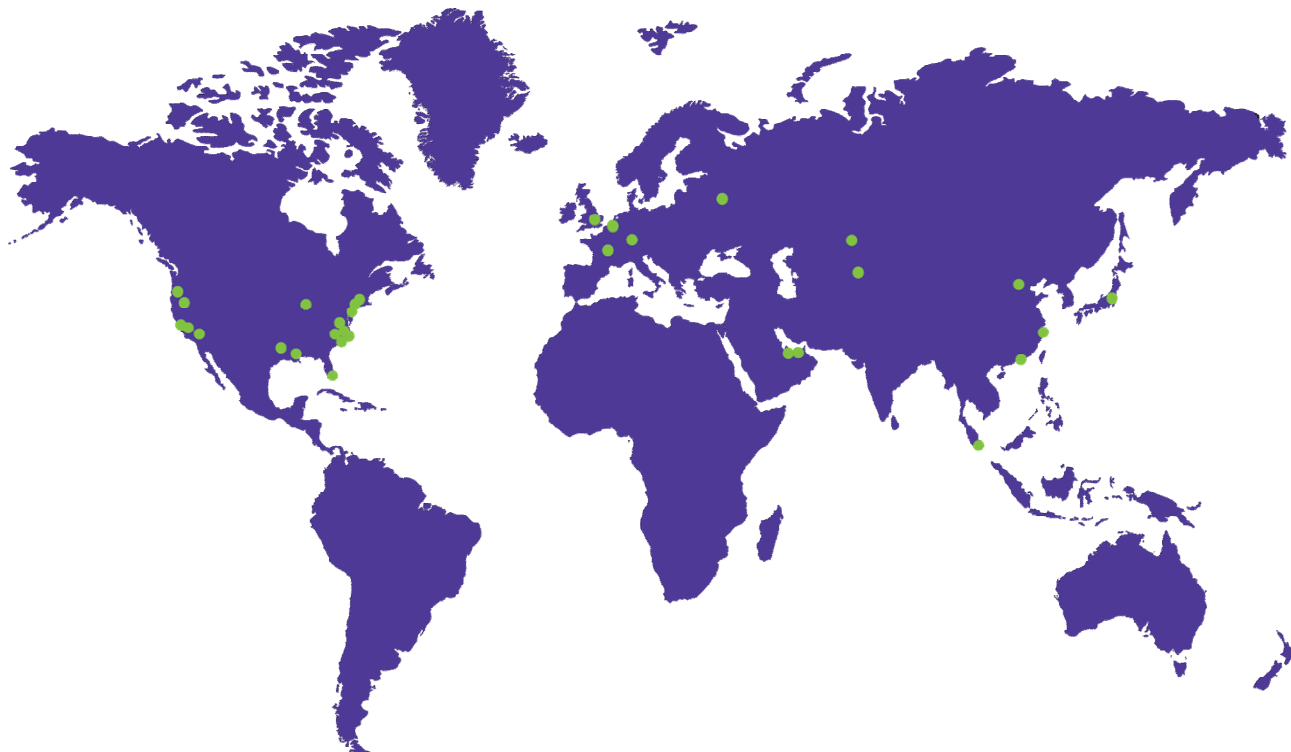


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