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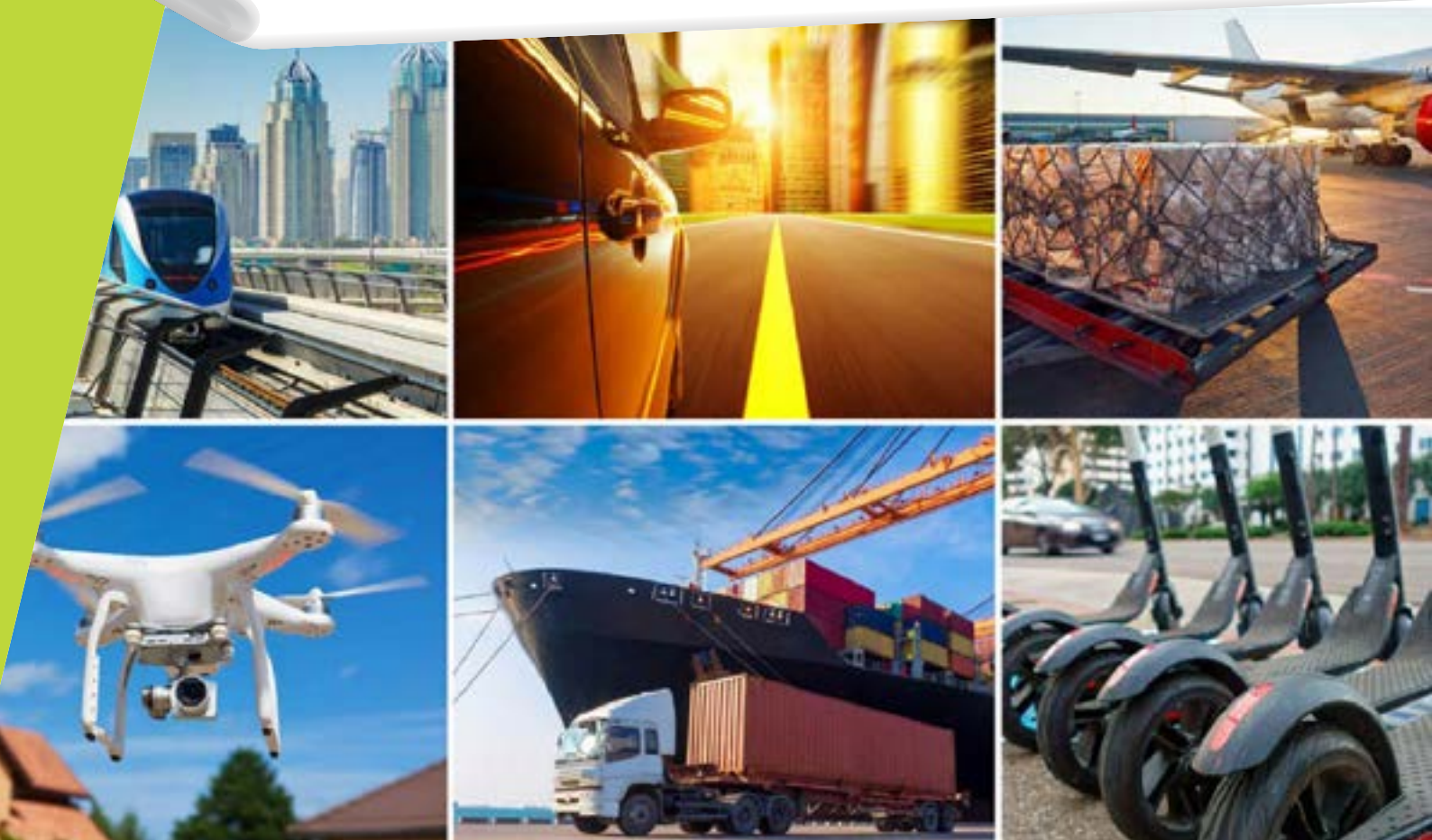
# Mobility and Transportation – Hot Topic Q&A Interviews

Volume 2






# Contents

# Stressed Companies in the Supply Chain: Restructuring and Distressed M&A

*Published 3 April 2023*

The automotive sector is undergoing a once-in-a-century transformation. The resulting stresses on the supply chain are varied, significant, and ongoing. While some companies will struggle and fail to adapt, others will identify opportunities to properly position themselves as the sector transforms.

In this hoganlovells.com interview, Lance Bultena, Global Director of Thought Leadership MOVE sectors at Hogan Lovells, discusses the current financial landscape of the automotive sector with three Business Restructuring colleagues at Hogan Lovells, partners David Simonds and Astrid Zourli, and counsel Aafke Pronk.

## *What is the current status of Business Restructuring and Distressed M&A activity in the automotive industry in the United States and Europe?*

**Lance Bultena:** A perfect storm is hitting the automotive industry and its supply chain. The first signs of distress are emerging.

The industry is evolving rapidly from the internal combustion engine to electric vehicles. Software and sensors are becoming increasingly important, as are connectivity and related interfaces. Driver assistance functions are developing quickly. This massive transformation is dramatically realigning the supply chain for this significant global industry.

On top of industry transformation, other issues have put supply chains under pressure:

- The gradual return to normalcy from the pandemic has led to the withdrawal of government aid;
- Shortages and price increases for raw materials or components like semiconductors, steel, and other metals and minerals, and energy cost increases affecting both input costs and consumer demand;
- Logistics bottlenecks and tensions;
- Effects stemming from the Russia-Ukraine conflict;
- Growing geopolitical tensions between China and the U.S.; and
- Macroeconomic factors – a one-two punch of inflation and interest rate increases, and fears of economic recession – impacting both manufacturers and their customers.

**David Simonds:** This perfect storm challenges some but potentially advantages others. Stronger industry participants should have opportunities for growth through strategic acquisitions of businesses that have useful intellectual property or other assets, but suffer from financial and/or operational challenges. These challenged businesses could face cash flow and/or credit issues that may lead to an ownership transfer (in-court or out-of-court) at depressed valuations.

With respect to insolvencies, it has been surprisingly quiet in the U.S. since just after the beginning of the COVID-19 pandemic. Although there was substantial risk of financial distress (or even crisis) for several challenged companies (including as a result of factors broadly affecting the automotive industry, unrelated to the pandemic), favorable fiscal and other government policies enabled them to refinance existing debt facilities and obtain incremental financing. No major U.S. automotive bankruptcies were filed in 2021 or 2022.

**Astrid Zourli:** The situation is similar for the European insolvency market as a result of the legal and financial aid granted by governments to European companies. Right after the first COVID-19 lockdown, the demand for financings increased and automotive industry participants, from OEMs to top-tier parts suppliers, benefited from state financial support and liberal monetary policies. As a result, there were very few major or noteworthy insolvency proceedings in Europe in 2021 or 2022.

## *What are the emerging trends in Business Restructuring and Distressed M&A in the United States and Europe? Will we see more activity in these two areas in the next 24 months?*

**Aafke Pronk:** With respect to emerging trends and activity, we expect the following:

- As the automotive industry faces headwinds, there will be an increasing divide between the "haves" and the "have-nots." The "haves" are properly capitalized and aligned with the automotive market's transformation. The "have-nots" are capital deficient given current conditions, or are being left behind by the industry's transformation. Smaller suppliers or spare-parts makers in the traditional internal combustion engine (ICE) sector are a prime example.
- Many forecasts predict sales volume decreases globally of light-duty vehicles. Fewer sales and the resulting lower revenue will stress all, but, in particular, impact the "have-nots".
- The technological transformation of the industry will continue the trend toward the formation of strategic partnerships to accelerate R&D activity and achieve scale in the electric and advanced vehicles sector. However, interested parties need to be acutely aware of the current and prospective financial condition of their would-be partners, and ensure that transactions are structured with an eye towards risk mitigation, both to ensure continued access to necessary technologies and product, and to avoid bearing unanticipated liability.

## *There are many reasons for Distressed M&A. What are the most significant for the automotive industry?*

**Simonds:** A few stand out:

- Excess leverage/debt levels that have resulted in some firms lacking the liquidity and financial strength to weather market downturns, address macroeconomic issues, or fund transition to new technology.
- Even previously healthy companies may not be well-positioned to make the technological shift to the industry's future in vehicles that are autonomous, connected, electric and shared.
- Falling demand that decreases revenue and profits, and draws down cash.
- Cost increases in the supply and production process that further depress profits and consume cash.

## *How can we help resolve the problems clients may be facing?*

**Bultena:**

- Decline of internal combustion engines: This transformation exposes several sub-sectors: foundry, forge, mechanical engineering, stamping, turning or metal processing. Strategic partnerships should be explored to better align capacity with the demands of the industry's future. We assist in creating those partnerships.
- Supply chain disruption and shortage of skilled labor: We regularly advise clients as they optimize business processes through technology acquisitions or specific deals to address supply chain issues and skilled labor shortages, or to gain access to key raw materials. Based on our market knowledge and experience, we understand the key issues and points of negotiation.

**Zourli:**

- Increased cost of energy: Volatile and high energy prices continue to disrupt the automotive industry. Clients could negotiate updated economic and other terms with their energy suppliers, amicably or with prevention tools that exist in and across various jurisdictions in which we have a strong presence and meaningful expertise (e.g., conciliation or ad hoc mandate proceedings under French law).

- Increased cost of raw materials: High raw materials prices also continue to be disruptive, and automotive suppliers are challenged to pass increases on to their customers. For example, according to global advisory firm AlixPartners, the cost for raw materials for battery electric vehicles (BEV) for light-duty vehicles in North America reached a peak of $6,860 per vehicle in March 2022, after averaging only $2,924 in 2020. Clients could negotiate having their customers take on these costs, or share costs with them, amicably or with prevention tools that exist in some jurisdictions.
- Increased leverage and debt service costs: Manufacturers and suppliers have incurred a significant amount of debt during the pandemic as a result of favorable monetary policies across the globe. While many remain flush with cash from their financings, the increased debt service costs associated with interest expense and principal payment obligations may impinge on their resources. In addition, market yields for debt have begun to increase meaningfully and suggest that access to capital (and the ability to refinance existing debt) will tighten. This dynamic, may lead to cost-cutting efforts that could negatively impact top lines, manufacturing efficiencies, and production quality. Financial distress could result for firms either operating on "the razor's edge" or as a result of significant exogenous factors beyond their control. This process will particularly impact upstream suppliers unable to exercise pricing power over their customers.

**Simonds:**

- As liquidity concerns or capital needs arise, borrowers should, with the assistance of counsel, carefully examine their loan and other credit documents to understand covenant flexibility to allow additional capital or reduce debt through "liability management" exercises that have become prevalent in the U.S. (and are beginning to emerge in Europe) due to the borrower-friendly documentation (i.e., with weaker covenant protection for lenders) that lenders, who were subject to extreme levels of deal competition, accepted during the recent credit cycle.
- Potential financial risk regarding upstream suppliers: The above factors may impact the viability of one's upstream suppliers, which could ultimately impact customers and other industry participants. This might lead to a vicious cycle of distress within the industry. Clients should ensure that their commercial agreements are structured in a fashion that best ensures a continued flow of inputs from their vendors and provides protection from their customers' inability to satisfy their financial obligations. If any such supplier or customer distress emerges, clients should take corrective action promptly by modifying their commercial agreements or enforcing their rights.

### *What opportunities might present themselves?*

**Pronk:**

- Clients that see technology as a way to be competitive will seek strategic opportunities where M&A could help add technological capacity, achieve scale, vertically integrate or share costs.
- Distressed M&A can be a real opportunity for more financially robust companies to fulfil their strategic objectives.
- Systems have already begun transitioning their manufacturing platforms from ICE to BEV, with another third expecting to do so within the next five years. This presents an opportunity for suppliers and manufacturers to fill in production capacity gaps through M&A activity, potentially with some assets purchased at "fire-sale" prices. In addition, contrarian investors and businesses, not yet convinced of steep projected increases in BEV demand, may seek to enhance their technology and production capabilities. In fact, several private equity sponsors have been pursuing acquisitions in the ICE space – these investments may be based on steady cash flow from long-term contracts and limited requirements for capital investment.

### *How are we helping clients affected by distress in the automotive sector achieve their business goals?*

**Simonds:**

- We review clients' supplier arrangements and propose modifications to potentially improve their standing in the event of supplier distress.
- We also craft accommodation agreements, customer financing agreements, and other arrangements to help mitigate operational and financial exposure regarding our clients' key suppliers, including meaningfully reducing risk associated with counterparty bankruptcies and insolvencies. These protections extend to critical IP, inventory, tooling and broader manufacturing capacity, and often involve taking legal title to certain important supplier assets, establishing processes to transfer tooling to replacement suppliers, and establishing and preserving setoff rights against counterparties.

**Pronk:**

- We help clients with their strategic plans and focus on value creation. Capital still remains available for M&A where there remain meaningful opportunities in the areas of transformative technology, renewable energy, automation, digitalization, and next-generation materials.

**Zourli:**

In addition, when our clients face financial difficulties of their own, we bring to bear our substantial experience in assisting distressed situations:

- Through "liability management" exercises (including tender offers/open market purchases, consent solicitations, loan amendments/extensions/waivers, up-tiering/dropdown transactions that inject capital/liquidity, and other use of covenant loopholes/flexibility);
- Workouts and out-of-court restructurings (including debt-for-equity exchanges, comprehensive consent solicitations, equity-level (or subordinated) capital injections);
- Distressed M&A (including asset sales (whether in-court or out-of-court), carve-outs and mergers, joint ventures, OpCo/PropCo separations and sale-leasebacks);
- Restructuring plans (including pre-packaged and traditional under U.S. law or non-U.S. law/cross-border); and
- Providing directors and officers with guidance regarding their fiduciary obligations, which can be tricky as companies approach insolvency or, in fact, have become insolvent.

### *If you could provide automotive clients one key takeaway when considering Business Restructuring and Distressed M&A for their business, what would that be?*

**Simonds:** Monitor with care the financial health of upstream suppliers, particularly ones that are single-source or limited-source suppliers of critical parts:

- Monitor for the following signs of potential financial distress: (i) supplier requests for price increases, accelerated payment terms, or customer financing support; (ii) late deliveries, changes in product quality, or product recalls; (iii) material litigation or threatened claims; (iv) resignations of members of boards and executive teams; (v) failure to effectuate cost reductions; (vi) spikes in key commodity prices; (vii) deteriorating accounts receivable and accounts payable; (viii) employment of consultants and financial advisers; (ix) announced divestitures and sale-leaseback transactions; (x) restatements or delays in issuing audited financial statements; (xi) renegotiated debt covenants,

incurrence of new debt, or fully drawn lines of credit; (xii) growing leverage multiples; (xiii) steep declines in prices of public debt or equity or debt rating downgrades; (xiv) failed refinancing efforts or debt exchange offers; and (xv) impending loan or other debt maturity dates.

- By proactively monitoring supplier health, automotive clients are better placed to protect themselves by either helping the supplier stave off bankruptcy or being protected in the event of a bankruptcy.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# Cyber security, mobility, and the cloud.

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Cyber-attacks are widely accepted as inevitable—it's not a question about "if" but "when." So how can companies protect themselves, minimize the risk and mitigate against the damage? How does storing data in the cloud increase companies' vulnerability to cyber-attacks? Or does cloud storage reduce the risk? And what does this mean for connected mobility?

In this interview, Lance Bultena, Global Director of Thought Leadership MOVE sectors at Hogan Lovells, talks with Sherry Gong, Partner at Hogan Lovells in Beijing, and Joke Bodewits, Partner, Privacy & Cybersecurity at Hogan Lovells in Amsterdam, about the cloud, litigation, privacy, national security, and how these differ in Europe and China.

## *What do we mean by 'The Cloud'?*

**Lance Bultena:** To understand the role of cyber security in mobility and transportation, we need to understand the role of the cloud. Sherry, what is the cloud, and why is it so significant to this discussion?

**Sherry Gong:** The cloud is a combination of various servers storing corporate and private data. Those servers can be based anywhere in the world, but they are generally accessible from wherever someone wants to log in to them. You might have a cloud using servers located in the US or in Asia, but an individual in Amsterdam could have full access to all the data contained in that cloud.

Data can be localised, and separated, with some stored on servers in certain parts of the world, and other data stored on servers elsewhere in the world. But ultimately it is stored somewhere, locally and securely, with data experts on site if required. From a cyber security perspective, cloud service providers need to consider not only how the cloud is accessed, but also how that access is monitored and controlled.

**Bultena:** We think of our data as being ours, and we give somebody else authority to use it because it has value to both parties. But with words like cloud, and "X to everything" connectivity, how do we protect valuable data that could be accessed from many different locations and in so many ways? Does the ultimate utility of use anywhere as needed also mean more risk?

**Gong:** That's a good observation, because the cloud involves high volumes of data and complex security measures. China is implementing the Multi-Layer Protection Scheme (MLPS) 2.0, with five levels of cyber security based on risk. Cloud service providers are usually subject to a higher security requirement. The different levels come with different security obligations, so if companies, e.g. in the transportation sector, want to engage a cloud service provider, they must ensure that this provider has an appropriate security system in place according to MLPS.

## *How do rules compare and contrast in China and Europe?*

**Bultena:** Sherry, are there any rules in China that we need to be aware of regarding data localisation?

**Gong:** The first restriction for providing a cloud service in China is that you need a telecom license, and these are not open to international investors. Companies such as Amazon, Apple, and Microsoft operate in China, but to provide cloud services, they must cooperate with a Chinese partner with a telecom license.

The second limitation is that cloud service providers in China that are classified as critical information infrastructure operators must store personal data and important data generated in China locally. If they want to transport such data outside China, they must first prove a business requirement to do so, and then seek government approval. The question of whether and how data can be legally transferred from China to abroad is currently one of the most common problems for our clients. In China, the most important regulatory entity in the cyber security space is the Cyberspace Administration of China, the CAC.

**Bultena:** Joke, what are the guidelines in Europe for companies to control access to the cloud?

**Joke Bodewits:** In Europe, there are rules which ensure that personal data is kept secure, and that there are appropriate secondary organisational measures to ensure that data isn't used unlawfully. The European Union Agency for Cybersecurity, or ENISA, issues guidance around security measures, including access limitation measures, for example. At a national level, everything relating to personal data goes to a Local Supervisory Authority, but that varies by nation state within the EU as there isn't a single European body.

These are the starting points in Europe when it comes to protecting data in the cloud, but to know what kind of mechanisms to implement, it is important to conduct a threat risk analysis before sending data to the cloud. Only with a full analysis of threats is it possible to know what to do to mitigate those threats, ensure that data is available to people on a need-to-know basis, monitor access to that cloud and rightful use of that data, and be alerted to any incidents.

## *What are the main consequences of cybercrime, and how can companies mitigate against an almost inevitable cyber-attack?*

**Bultena:** As we know, following guidelines alone cannot guarantee against hacking, so presumably companies must still prepare for a hack?

**Bodewits:** Yes, with cybercrime, it's not a matter of if, but when, because any company could be victim of a cyber-attack at any time. Companies should be able to demonstrate they took measures to be alerted to an incident, and knew what mitigation measures were available to ensure business continuity, limit data exposure, and minimise reputational risk. There is plenty a company can do in advance to prevent very negative consequences.

**Bultena:** Could you provide some examples of those negative consequences?

**Bodewits:** Nowadays we see many more ransomware attacks than we saw two or three years ago, and the kind of ransomware attack has evolved. There are different threat landscapes, and we would advise companies to perform a threat risk analysis for a complete picture of the threats they would normally face. That analysis is obviously dependent on circumstances, and depending on the threat risk analysis, companies can implement data governance strategies, technical and organisational measures, and enter into relevant agreements with third parties. And all of this can be used for accountability to regulators and the market to demonstrate they took the appropriate mitigation measures.

**Bultena:** What else can companies do internally to prepare for a possible cyber-attack?

**Bodewits:** The starting point is knowing your data flows, the value of the data and the consequences of the data being unavailable to the company. Based on this assessment there's a need for internal policies on data usage, and people's access to data. It's important to consider access limitations, log access, and implement technical security measures, such as encryption, data segregation, or enhanced securities. There's plenty to do internally, but in addition to technical measures, companies also need to ensure they comply with organisational measures, such as ensuring that people with access to data have sufficient awareness about confidentiality, and how they may or may not use that data. This can be done through training, creating a culture of awareness, and ensuring people understand the importance of notification if they become aware of an incident.

**Gong:** China's data protection regime draws heavily on European practice, such as personal data protection regulations which generally follow the European Union General Data Protection Regulation (EU GDPR), as well as its own regulations and standards. In China, there's a confusing mix of recommended industry standards and countless mandatory requirements, and companies understandably find this a challenge. China has introduced MLPS 2.0, but even though the regulations haven't been finalised, we already have the standards in place. The local public security bureaus want companies to conduct assessments, so they must hire an outside assessment firm to help them conduct a personnel audit.

This process also includes things that Joke mentioned, such as understanding your company's assets, what systems you operate in China, the threat risk analysis, and appropriate technical and management measures. China also has a data classification and grading system, where an enterprise must audit the societal impact of the data and system and then use a protection system appropriate to that impact according to a graded scale. Self-audits after a potential breach are very important. Reference to this data grading system will impact interactions with the public security authorities.

**Bultena:** So those operating in China must be vigilant in closely monitoring the regulatory landscape, because the formal regulations are still evolving and some not finalized are nevertheless being enforced—and those rules are layered with requirements from various governmental entities that are subject to evolving interpretations.

**Gong:** Yes, exactly. There are some high-level regulations under China's Cyber Security Law, but although the rules have yet to be finalised, the government has already implemented the regime. Companies are advised to begin the process of grading their cyber security systems. In China, we already have individual rights similar to those under GDPR, such as the right to ask for accessing and receiving copy of personal data, correcting inaccurate or incomplete data, deleting personal data under certain circumstances, and the need to respond within a certain period, e.g., 15 working days for Apps. At the same time, China's enforcement is not as strict as Europe's enforcement of GDPR, but the government is trying to change this. China's Personal Information Protection Law (PIPL), which took effect on 1st November 2021, came with financial penalties based on a percentage of revenue.

## *What can companies do to prepare for litigation relating to a cyber-attack?*

**Bultena:** Joke, you talked about threat risk assessment, and how litigators might view a company's cyber security preparation. Obviously the better prepared a company is, the more it can demonstrate to regulators that it did everything possible to limit the impact of a hack in a world where hacking is deemed inevitable. What about the equally inevitable lawsuits?

**Bodewits:** Threat risk analysis can be very useful preparation against regulatory enforcement actions and lawsuits. For instance, a company could triage its data, then secure more robustly the most confidential business information which is core to business continuity, or most sensitive from a GDPR or other data protection law perspective. Less security might be appropriate for operational data, such as publicly available telephone numbers. Doing this can be helpful in lawsuits involving technical and organisational measures from a GDPR perspective. Furthermore, securing key data robustly could be helpful to demonstrate that it was considered a trade secret, and that can be used as an argument in trade secret litigation. But ensuring appropriate technical and organisational measures is not something done only to satisfy a regulator or limit enforcement or litigation risk—it is something you do as a company to make sure you can build a robust data strategy and that individuals can trust you when you process their personal data.

**Bultena:** Is private litigation over cyber security breaches something to worry about in China?

**Gong:** Recently we had some significant cases around protecting facial and fingerprint information—these lawsuits were heard in court and the individuals prevailed. We see an increasing number of individuals using litigation to protect individual rights, and if there's a criminal investigation, we also see the government implementing criminal liabilities more strictly than in previous years. In fact, we've been assisting clients on how to defend criminal investigations, because we expect more lawsuits to protect personal data.



## *What happens when technological developments are seen as a national security threat?*

**Bultena:** China is the world's largest automobile market, but the country is very concerned about national security when it comes to technology, with rules on who can use certain technologies, and how. When setting up a cloud-based system, for example, how does one factor in national security concerns that might evolve in China? How can you limit access to the cloud so that it's a Chinese cloud?

**Gong:** National security is the Chinese government's first priority, so even for a cloud service provider, the government has access rights if there is an investigation on criminal or national security grounds.

**Bultena:** When it comes to cyber security and national security, what is the focus in the EU?

**Bodewits:** There is a very high expectation of privacy within Europe, with limited access to data for governments. In July 2020, the European Court of Justice argued that any party sending data outside of the European Union should ensure the data importer provides an adequate level of protection, similar to the safeguards we see in Europe.

But if you transfer data from within the EU to a cloud, that data is generally transferred outside of the EU, unless it is going to cloud storage in Europe. We can therefore expect to see a growing number of companies looking for cloud solutions based in Europe, instead of globally.

## *Clouds don't respect borders – how can digital clouds be contained within national jurisdictions?*

**Bultena:** The word "cloud" illustrates the challenge—meteorological clouds don't respect borders. The idea of the digital cloud is that data can be moved around servers very quickly. But how does one localise a server in a particular geographic area, and restrict who can access the data? Is it more about the "who" than the "where"?

**Bodewits:** Yes. It's not just about who has access to the data, but also who can influence the access to that data. Cloud services can be affected by say, a denial of service attack, with someone remotely preventing you from accessing your own data, and using the cloud to issue such an attack. And with large cloud services, corporate data is no longer stored on the company's servers, which could be an issue if others take over that account and access that data. That's why it's so important to have an up to date threat risk analysis.

**Bultena:** Sherry explained that in China, the company setting up the cloud is the key player, and that foreign companies need to partner with a Chinese license holder. Does Europe have similar rules, where the "who" matters, or is it what they "do" that matters?

**Bodewits:** In Europe, it's the "do" that matters. From a GDPR perspective, for instance, it's not so much the entity that is ultimately in charge of the cloud, but the data stored in the cloud. A US entity storing EU data will still be subject to GDPR, which is less of an issue from a European perspective. But within Europe there could be an expectation that data is stored locally because of the Schrems II judgment I referred to. The concern is that data stored outside the EU or the European Economic Area may be stored in a location which provides a weaker level of protection than we would expect in Europe.

## *Cyber is a growth market that's just getting started...*

**Bultena**: New technologies come with countless advantages and opportunities, but they also introduce new challenges. Do you expect further change as technology, risks, and government rules evolve?

**Bodewits:** Anything and everything relating to data, including compliance, commercial, and regulatory, is just getting started. There's no simple solution because the processes, technologies, and legal structures are evolving. Luckily there is a lot companies can do to benefit from the advantages and opportunities. If done correctly, these steps could also be helpful to

enhance compliance levels and stay in control over data flows.

**Bultena:** When are the lawyers brought in? At the end of the process? After a risk and threat analysis has been done? Or early on? When does it work best?

**Bodewits:** Most of my clients bring me in for incident response or regulatory enforcement actions. But it is much more beneficial for clients to bring us in when they start threat risk analysis, because that's when the legal requirements are very important, and when they can benefit from benchmark expertise and inside knowledge about regulatory expectations.

**Gong:** We suggest corporate IT security teams work with regulatory bodies to keep pace with evolving technologies. It's better for lawyers to be involved from the outset, to develop the rules and processes ready for when that inevitable problem occurs.


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# What is a trade secret, and how can you protect it?

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How do you protect the intellectual property (IP) upon which your business depends? An invention can be patented; specific text can be protected by copyright; and a brand name can be trademarked. But a process, the results of testing, the method of obtaining those results, or some other information or data that clearly sets your company apart from its competitors, is a trade secret, and needs protecting. Yet despite being as important as these three other types of IP, the trade secret is the most difficult to protect.

In this hoganlovells.com interview, Lance Bultena, Global Director of Thought Leadership MOVE sectors at Hogan Lovells, and Celine Crowson, Partner and Head of IPMT Americas at Hogan Lovells discuss the difference between trade secrets and patents; the need for companies to ensure trade secrets are not leaked to competitors; the arbitration of trade secrets and patent laws in major global markets such as the US, China, and Europe; and the complexity of protecting innovation and inventions in a new era of artificial intelligence (AI).

## *What is a trade secret, and how does it differ from a patent?*

**Crowson:** A trade secret is something, such as an algorithm, data, or information, that is valuable, and not generally known. Keeping it secret is the real challenge in trade secret protection.

In the context of mobility and the automotive sector, consider AI and machine learning. Examples of trade secrets here might be the training data for autonomous driving systems that use AI or machine learning. How does the system distinguish between a person and a pilon in the middle of the road, or between a dark tunnel and a brick wall? Systems that rely on machine learning need to be trained. How the training is conducted, and the results of that training, are examples of trade secrets. So too are the software and algorithms a vehicle uses for autonomous driving. Other examples of trade secrets include the results of tests, customer lists, and employee training. The key thing is that the information, data, algorithms, or results, need to be kept secret to be protected.

A patent is a registered government document that you need to apply for, and you can protect some software, algorithms, and processes with patents. The difference between a trade secret and a patent is that when you file a patent, your innovation is published, and someone can innocently infringe upon that patent. A trade secret infringement, on the other hand, involves theft.

**Bultena:** There's a suite of intellectual property that any company needs to manage. It sounds as though patents and trade secrets need to be in that basket. Can trade secrets be registered with a government entity?

**Crowson:** They are not registered in the way that a patent or a trademark may be. Best practice for protecting innovations and valuable data information not protected by a patent or a copyright, is to archive or list the key trade secrets, software packages, information, and AI training protocols that are important to the company's business, and then develop a plan to protect those innovations and that important intellectual property.

The challenge is to protect trade secrets when they're not registered. The kind of information that we're talking about is often widely shared within a company, but when an employee leaves that company and starts at a new company, they take this knowledge and information with them. It's easier to download and steal software, for example, than it is to take a large device out of a factory. And reverse engineering is generally permitted from a legal standpoint, unless there's a contract in place to prohibit this. Reverse engineering is free game, and that can ruin trade secret protection if others have access to innovations, or devices, or software that can be reverse engineered.

Those are some of the key challenges in protecting trade secrets, especially in such an innovative area where there are many new companies, high employee turnover, and information sharing. Companies really must get their house in order, starting first by cataloguing key trade secrets, and then taking specific steps to ensure that those trade secrets are protected.

## *How can companies ensure that intellectual property, and trade secrets, remain within a company and do not leave with employees who quit to go to a competitor?*

**Bultena:** Mobility and transportation are shifting away from mechanical, and electrical engineering, to software, batteries, and new business models. We're seeing people setting up companies, then going into a big enterprise, and then going into a different big enterprise – and that human capital walks out the door with them. This looks like an area of growth and concern, and companies big and small clearly need to focus on how to manage this, making it really clear to their employees. And, as an employee, I'd want to know what the rules are when moving on, to avoid potentially years of litigation!

**Crowson:** There are some basic things that a company can do in addition to standard practices, such as the use of non-disclosure agreements, or NDAs with respect to third parties. You should ensure that employment agreements contain confidentiality obligations, and assign intellectual property rights, including trade secrets, to the company. You should use confidential and proprietary labeling for materials, software, and other shared property. Such simple measures help you prove, when looking back several years, that a piece of information or data was a company trade secret and not something that was readily available. You should review your cybersecurity systems, and rules, and make sure that policies are up to date. And then, to the point about employees leaving, make sure they understand the rules, using severance agreements that require employees to return confidential or trade secret information and promise not to share anything. Some companies even write to the employee's new company, warning them that someone is coming with confidential information and that the new employee should be screened from related areas of development.

Those are just some of the basic things that companies can do to help protect trade secrets when they're not registered. In connection with joint ventures and partnerships, a raft of confidentiality obligations and other agreements need to be put into place to make sure that a company's trade secrets are not inadvertently transferred when establishing a joint venture, for example.

**Bultena** When we talk with innovative companies of any size, they're concerned about how to secure revenue, and how to keep up with the latest developments. It's easy for companies to forget the good housekeeping things that can be critical in the short term.

## *How does the protection of trade secrets differ in the U.S., Europe, and China?*

**Bultena:** The U.S. and China are in a phase of rather aggressive competition, and this is certainly impacting the worlds of automotive, mobility, aerospace, and logistics. Is this also impacting trade secrets?

**Crowson:** It is, and this is particularly noticeable when it comes to the contracting piece, when a U.S. company is doing business in China, say, through a partnership. Chinese companies can be more flexible than they were years ago. Previously, Chinese law always had to apply, but now it's more common to see New York arbitration rules apply. For that reason, it's important that on the contracting front, one is engaged with confident Chinese counsel to help make sure the agreements don't inadvertently transfer intellectual property. Until recently, a technology transfer was almost always required in a deal with a Chinese company, but that's no longer the case. U.S. companies now often have more leverage in China than they think.

The other area of development, with respect to trade secrets, is that certain tribunals or jurisdictions in the United States are developing a body of law regarding trade secrets. One such organization is the U.S. International Trade Commission, or ITC, which is a bipartisan, independent agency of the U.S. federal government. If there is a trade secret misappropriation in China, and products are made incorporating that misappropriated trade secret, and then there is an attempt to import those

products into the United States, the ITC believes it can take that up as a violation of U.S. intellectual property rights, and stop those products coming into the country. It's basically an exclusion order, and the administrative agencies, and the courts try to have an extra territorial reach to protect trade secrets. In some regards, that's broader than what they can do with patents. You need to have a U.S. patent for an exclusion order to apply at the ITC, for example. But with trade secrets, they're trying to get at situations where there's a trade secret misappropriation abroad, say in China, and prevent that importation of products into the U.S.

So, when planning a trade secret protection strategy, it is important to be aware of some of the remedies and jurisdictions in the U.S. that can help with trade secret violations that occur abroad.

**Bultena:** All the more reason for good housekeeping! The ITC was recently involved in a dispute between some well-known battery manufacturers in South Korea. This dispute was watched very carefully by those in the automotive world, and as a result, many more people are aware of the work of the ITC. What are the equivalent agencies in Europe and China?

**Crowson:** In Europe, the European Court of Justice is very active in intellectual property issues, especially those involving competition or antitrust laws.

In China, much of the enforcement is carried out in a system similar to our district court system. A client recently asked whether they can enforce their trade secrets and property rights in China. The response of our partner, Katie Feng, was that yes, they can, especially at the federal level, but also in the provinces—and most of that is done through a district court, effectively a court of first instance.

There's plenty of action around trade secrets, and the courts and administrative agencies are gaining considerable experience. If the trade secret has been protected in the ways that we've talked about, and kept secret, there are good avenues for enforcement. Trade secret infringement involves bad actors. You can't instantly infringe a trade secret—there's a theft, and that's something that courts and agencies are equipped to deal with.

**Bultena:** Clearly, in this area, global scale is essential. Technology goes global because of the size of the investments, so for an international market, you need to protect trade secrets on an international basis and work across jurisdictions. The potential here is exciting.

*As AI becomes ever more powerful, how do we protect trade secrets that involve AI, and how do we apply patent law to something that may have been invented by AI?*

**Bultena:** In other contexts, explainable artificial intelligence has become an issue, particularly in Europe and some other jurisdictions where we don't necessarily know how the system comes to its conclusions. At the beginning of this conversation, we talked about the need for a trade secret to have some economic value, and to be something that is not generally known. But the word "known" is interesting here. Say I have an AI system, but I don't know how it comes to its conclusions, is that a problem with regard to trade secrets? Or do you protect the trade secrets through the data input and the general software approach?

**Crowson:** How the AI comes to its conclusions could be an issue for trade secrets if it's difficult to identify what the trade secret is. Protection of trade secrets typically starts with logging or tracking the trade secret as an asset to be protected, and in AI that can be difficult. Moreover, if an artificially intelligent system is outputting data or information in a way that's perceivable by others, there may be a giveaway of trade secrets in that output.

The question you raised here also brings up issues in connection with patenting. If the AI system is coming up with things that are new, discovering new relationships, perhaps even inventing something, who owns that trade secret or invention? Courts in the U.S. and in Europe have recently ruled that an AI system cannot be the inventor, so it cannot be the owner of a trade secret or an innovation. Here, what was being tested was whether IP arguably created by the AI system makes the AI the innovator/inventor. Courts and patent offices are not going that far with machines, yet. They've decided that the developed of a trade secret or the conceiver of an invention must be human. We'll see how that develops.

**Bultena:** With the U.S. and China competing over quantum computing, this could be an exciting area, especially as this has the potential to change everything from drug testing to the design of new products and facilities. It seems that artificial intelligence will be an interesting area of practice for some time to come.


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# The Future of ACES is Living Mobility

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The future of mobility is autonomous, connected, electric and shared. But to really understand that vision of the future of mobility we need to look beyond vehicles, to individuals and society. Most importantly, what do people want? And how do they want to move – and live.

In this hoganlovells.com interview, Hogan Lovells partner Patrick Ayad, Global Leader of the firm's MOVE sectors, and Lance Bultena, Global Director of Thought Leadership MOVE sectors, discuss the future of mobility and how ACES relates to the concept of Living Mobility.

### *What's next for ACES? And what is Living Mobility?*

**Ayad:** The acronym ACES or CASE, which stands for Autonomous, Connected, Electric and Shared, is a business concept that was developed a few years ago. If we think about the future of mobility, particularly in the last couple of years, ACES is still the general direction where the industry is heading.

There are discussions about reframing the "S" in ACES. Rather than "Shared" some are starting to call it "Smart Mobility" or "System Integration." In part, that is because there are struggles with shared mobility in light of the Covid-19 global pandemic. But reframing from shared reflects a vision beyond automobiles.

In terms of innovation, we are seeing an emphasis on AI, sensors and connectivity. There is a clear trend in thinking about convergence of all transport modalities – planes, drones, trains, micro-mobility and vehicles– and how it all comes together into mobility or, more broadly, an ecosystem. That system is also about moving people and goods.

So, again, we think ACES is still the general direction for the future of the global automotive industry and more generally the future of mobility. But we thought about how we could approach this somewhat differently and adjust the perspective to see it from a customer's point of view.

The customer perspective is what we are calling Living Mobility. Living Mobility is a shift of our mindset in how we look at the future of mobility. And Living Mobility for us comes down to four descriptive elements: Objective, Inclusive, Unifying and Sustainable.

### *How did you develop the Living Mobility concept and the elements within it?*

**Bultena:** In taking the perspective of an individual consumer or customer we realized that ACES focused on the car or vehicle but customers have many more transportation options – there is the traditional public transportation system, new micro-mobility options, even a vision of drones flying people in the future. We noticed that mapping programs no longer provide merely navigational options, they provide different transportation options as well. When the way we move is changed this does not only change the car or vehicle, it changes us by shifting what we do and how we think and that in turn changes society.

We saw this shift on display when we attended CES in 2020. It was pretty fascinating how the traditional automotive players presented themselves. Many OEMs didn't have a traditional car at their booth and this at what has essentially become the dominant auto show in North America. They showed a vision not merely a product.

The breadth of that vision was maybe easiest to see in a display Toyota had about a "woven city" it was planning to build near Mount Fuji. The vision of that model city explored not mere traditional cars or vehicles but several modes of transportation. And it involved how people would live in this new "smart" or connected city and what technology they would have in their homes, including robots. Other displays throughout the show also explored this "smart" interconnected vision for how individuals would soon live with technology. We realized this vision was not just about transporting people it was about services that meant new ways of shopping and delivering goods and news ways of moving and tracking freight.

We were fascinated by the fact that automotive companies were not showing what we'd drive but how we'd live. And we strongly believe that the way we move is closely connected with how we live. "This is Living Mobility" was our conclusion. We loved the phrase but we had to define what it meant. We mapped the concepts behind the ACES acronym to more holistic terms that we felt defined the collective vision we saw. Through conversation "Autonomous" became "Objective", "Connected" became "Inclusive", "Electric" became "Sustainable" and "Shared" became "Unifying".

## Autonomous and Objective

### *How does autonomous technology relate to Objective Living Mobility?*

**Ayad:** In autonomous driving a machine using sensors and computational capacity drives rather than an individual. This process is an objective one. The machine does not drive with its emotions based on how it feels – like we do as humans. It is not distracted. Ideally, it does what it is designed to do without error. It is objective.

As sensors are increasingly embedded in almost everything and that data is analysed and utilized by artificial intelligence so many of the questions found with autonomous driving apply more generally. The most fundamental is: does it work? In other words, does the vehicle or the system reliably do what it is supposed to do in a broad range of real world conditions. This requires an objective view. Other important questions are about the appropriateness of the objective decisions made.

There are lively discussions about ethical rules for autonomous vehicles. Frankly, there are arguably more pressing questions from an engineering perspective. But from a customer perspective, this seems to be an important point. So we need to form an objective view on how we solve these potentially ethical issues that arise so people are able to trust in this technology. That will require a whole range of new government policies.

But it will also require transparency. This is an important point. We need to make the technology transparent to customers. Suppose a customer prefers dogs over cats. You may want to tell that person the car would make a decision favouring the cat and not the dog and this person would not purchase the vehicle. This may be a silly example but it shows that customer transparency is key. It's also key if you think about the data that we are collecting in these vehicles. Transparency is very important for customers to accept the technology.

## Connected and Inclusive

### *What does Inclusive mean in terms of connectivity in the transportation and mobility world?*

**Bultena:** A connected vehicle is no longer "an island", it is included in the broader world through the Internet. It communicates with surrounding vehicles and infrastructure for operational purposes, but it also enables robust interaction for passengers to meet their entertainment desires or their functional needs.

The mobility systems of the future will be inclusive in a more vivid fashion than mere connectivity to the Internet. If transportation systems are cheaper and denser this will help those with fewer financial resources. It may provide greater options for those who live in rural or more challenging environments. Drone delivery could provide not merely faster access to materials at a lower cost but bring some products and services to places not previously reachable.

This new mobility system will allow new vehicle designs and the driver assistance capacity, and ultimately the fully autonomous capacity, should provide individual transportation options to those who are aged, too young, or who have a visual impairment.

Accessibility is key to inclusiveness both in terms of physical access to the new modes of transport but also in terms of the costs. And it goes back to the point of customer acceptance. As new technologies and business models evolve they almost certainly will tie us together in new ways and create new opportunities and challenges.

## Shared and Unifying

*How do shared services relate to Unifying Living Mobility?*

**Ayad:** The launching point for our thoughts were shared vehicle services and traditional modes of public transportation. But a mobility system is really much more than not owning a vehicle or riding a train with someone else. The focus of Living Mobility is on the system and not just discrete modes of transportation.

Unifying goes hand-in-hand with Inclusive. But it also encompasses all the other categories as well. The most important thing about Unifying is that this is where all stakeholders come together. We need a holistic approach when we think about the future of mobility.

One of the interim CEOs of a car manufacturer once said "Silos are our death." If that is true for a complex design and manufacturing operation it is absolutely true for a mobility revolution taking place on a global scale. We need to break through these silos. And it's already happening. We see a lot of collaboration going on between public and private sectors – and that is hugely important for the introduction of new mobility solutions.

Where many stakeholders are involved and cooperation is needed between the public and the private sectors it is an exciting time for lawyers that explore the changes in laws and regulations rather than just assist with compliance on existing static rules for current business models.

Micro-mobility is a good example. I was totally fascinated when companies started introducing micro-mobility with e-scooters in various cities. But even in Europe there are no harmonized rules or standards for this technology. Do you need to wear a helmet? Do you drive the e-scooter on the road or on the sidewalk? It's totally confusing. For example, I was traveling to Paris, London and Berlin in the same week and used e-scooters in each city. It was really not clear to me what the rules were. And this is totally confusing for the customer. Again, customer acceptance is key.

While there is lots of discussion about standards at the local, national, regional or even global level it is clear we cannot make progress on any of those levels without clear and accurate analysis. SAE is an organization that tries to standardize rules and came up with the levels of autonomy for autonomous vehicles. Last year, SAE came up with standards for micro-mobility, too. At this stage, it's just a categorization of these different types of micro-mobility. It is an important and good start but we need to do more in this area.

The mobility revolution is really just beginning. As the technology and the business models evolve the governmental rules will have to evolve. There is a lot of work to do.

## Electric and Sustainable

*Is Sustainable Living Mobility all about electrification?*

**Bultena:** Electrification is certainly a focus for the automotive industry. Governments all over the world have been pulling the industry toward electrification for the last few years. The industry is moving quickly in that direction. There are significant hurdles ahead. For example, electrification is one important aspect of sustainability but battery technology itself will also need to be sustainable. This process will require the cooperation of industry and policymakers and ultimately the acceptance of consumers.

The vision of sustainability in Living Mobility goes well beyond electrification of a vehicle's drive-train and even beyond how that electricity is produced or whether fuel cell vehicles are an option. The idea is holistic and includes evaluating the environmental sustainability of the manufacturing process, the supply chains, the materials used, and the recycling of them once their mobility use ends.

And it's not just environmental protection. Sustainability is also about protecting economic and social development. We see more "upstream" questions about the supply chain and not just in terms of its cost or reliability. How are suppliers in other parts of the world treated? How and where are raw materials and resources obtained? Sometimes the questions look "downstream" and explore how the product might impact consumers or their community. Governments are looking into these issues and there are initiatives on these topics in supranational organizations like the United Nations and the EU. All these questions address how we behave as humans in a social context. Once again we are brought back to looking at mobility from a customer and a societal perspective rather than just looking at a set of engineering questions and regulatory standards for a specific product.

For more insights into the Living Mobility elements, read our Living Mobility Spotlight Q&A series.


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# More data, more risk: The automotive industry rethinks its privacy strategies

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As the risk of ransomware attacks and data breaches continues to escalate, it is also raising greater concerns about data privacy.
The automotive industry has been steadily increasing the amount of data it collects from car owners and drivers, prompting manufacturers to question how well their strategies and business practices can protect that information. Many companies within and outside the European Union are looking to one of the world's strictest regulatory privacy regime — the General Data Protection Regulation (GDPR) — as a template on which to build their own policies.

In this hoganlovells.com interview, Hogan Lovells partner Martin Pflueger and senior associate Charlotte Le Roux discuss data privacy restrictions and the new challenges they are creating for car and original equipment manufacturers (OEMs), as well as for the actors and stakeholders involved.

### *Cars are connected now more than ever before. They communicate with the Internet, smart phones, other cars, and networks. What data is being collected, and how is this creating new privacy and security challenges for the automotive industry?*

**Pflueger:** We are looking at a very complex ecosystem with a broad set of different types of data captured and processed, a variety of data subjects concerned and wide spectrum of players and stakeholders involved.

Vehicles are becoming increasingly connected and are collecting more and more data through various sources, such as vehicle sensors, telematic boxes, via mobile devices and infotainment systems, or via communication with other cars, infrastructure and networks. This means we are looking at a large variety of data: For instance, you have location and movement data, such as the speed or navigation of the car; status and behavioural data, such as tire pressure, fuel consumption and driving style; and your life habits data, like Internet use and infotainment systems preferences.

Then you have different categories of data subjects concerned by the processing of their data — the driver, the owner, the passenger, but also other individuals captured by your car's sensors and recordings, like pedestrians, cyclists and drivers in other cars. And you have the wide spectrum of actors and stakeholders involved — OEMs, car manufacturers, digital service providers, repair services, dealers, and telecommunication operators – all of which may have access to personal data.

This leaves companies with a very complex actual landscape that they have to consider, in addition to the very complex legal requirements they need to comply with governing the privacy and security of data processed in the context of connected vehicles.

With the GDPR, companies face a European-wide law with very high standards, strict rules and extensive accountability principles for the processing of personal data. But there are other legal regimes that come into play. For instance, you also have the e-Privacy Directive, with rules for electronic communication service providers, and the legal regime for the telecommunications sector. To give you one example, in certain cases, the authorities consider the car as "terminal equipment", like the computer or device you use to access the internet. This means that the same rules that apply to placing or reading cookies on your computer may also apply to data being stored or accessed in your car, just as if your car was a mobile device. And with new and very strict interpretations from the European data protection authorities, which put limitations on how companies can use and commercialise the data processed or collected through connected vehicles, it puts all of the responsibility on the companies to ensure compliance with this challenging legal environment.

### *How are we helping clients plan for and respond to these complexities?*

**Le Roux:** One important matter that Hogan Lovells is helping companies with is building a data governance framework.

Not only are car manufacturers making cars now, they are also making data and becoming data-centric organisations. They are collecting data from multiple sources to create value and serve different purposes, such as building customer loyalty, improving vehicle performance, and providing connectivity and mobility services.

In order to create this value, they need a strong data governance strategy. At Hogan Lovells, clients are offered assistance and advice way beyond the mere compliance with GDPR. It is well known that data is really highly regulated, whether it is personal data or not. There are various rules that can be taken into account, such as the rules concerning safety and security of the vehicles, its passengers and its data, eg event data recorders and vehicle-to-vehicle and vehicle-to-infrastructure (V2X) systems in the upcoming EU type-approval framework and the EU Co-operative Intelligent Transport System (C-ITS) framework. Other factors should also be borne in mind, like competition issues related to the use and sharing of data, commercial and contractual issues for the use of data that the OEMs "own", even though such a legal concept of data ownership gives rise to lengthy legal debates, and obviously, data privacy issues are at the top of all these strands. Therefore, the car manufacturers' data strategies must consider all these different regulations and issues, and different legal bases when it comes to personal data processing, which are then applied to different data usage scenarios.

### *Who owns the data, and who has the right to use it?*

**Pflueger:** As Charlotte said, there is no clearly defined legal concept of ownership of data; it is not an absolute right like property. Ownership is rather determined by a bundle of different rights and restrictions, based on actual access and control as well as contractual and legal rights and constraints, which define how companies can use and commercialise data.

Developing a reliable data governance and use strategy is one of the most important aspects of enabling companies to make use of the greater value of their data and to comply with legal regimes. It requires implementation of actual safeguards to protect and manage access to data, the setting up of appropriate contractual agreements, and also a strategy that reflects the different legal regimes for the protection of data, like under intellectual property laws, trade secrets and criminal law. In addition, all the regulatory constraints we have need to be managed, such as under data protection or competition law. That requires companies to develop a comprehensive data use strategy at an early enough stage enabling them to set up an appropriate framework to use and commercialise their data but also to exclude others from using it.

*Can you explain the specific challenges companies are facing in making use of data collected through vehicles?*

**Pflueger:** From a data protection law perspective, the challenges follow from the principle of purpose limitation and the requirements for the lawfulness of any secondary use of data. So imagine you have a car and you collect data from a driver for providing specific services. But you may also want to use the data for other purposes — not only to provide those specific services, but also for research and development purposes, such as to understand how your car functions, how to optomise your services, or how to train your AI systems.

The European data protection authorities stress the principles of purpose limitation and data minimisation, which set high requirements for companies that wish to process personal data for purposes other than for which the data had been originally collected. For instance, if the optical sensors of your car capture images of pedestrians walking down the street for a driver assistance system and you want to use that data for purposes beyond providing the actual functionality, the authorities may expect you to blur and anonymise the data, which is technically tricky and often reduces value, such as where the training of a system requires a clear set of validation data. Sometimes you also can't comply with blurring the information because you need clear details of individuals. For example, you may need to understand the eye movement of the driver in the car, whether the driver got sleepy in case of an accident, or the facial expressions of pedestrians to train your system to understand how they react to the car. This is where we help clients to set up a concept and implement the necessary safeguards to be able to demonstrate that they can still process the data in a personally identifiable form in compliance with laws, as necessary for their business operations.

*What are some other areas where Hogan Lovells has particular expertise with the challenges clients are facing?*

**Le Roux:** One of the most challenging hurdles clients have to deal with is the extended territorial scope of the GDPR, which poses certain difficulties. This involves personal data collected from, for example, cars in Japan, which could be in some cases subject to GDPR. This could be a real business issue, especially when local data protection rules are more flexible than the GDPR.

When it comes to these stakes, it is important to work closely with the clients in order to avoid such a situation. The question of data localisation is therefore key, and to get back to the client's data strategy, OEMs should also be taking this into account.

**Pflueger:** Yes, that is a big issue for many international companies. First of all, cars do not stop at any borders; you drive in different countries. But also the way data is collected, shared, and communicated to other cars, digital services, infrastructure, and networks might trigger the application of different legal regimes and multiple laws that you need to comply with. Therefore, as Charlotte said, the international component is an important aspect of an appropriate compliance strategy, and our team makes sure to work closely with clients early enough in their design, manufacturing, and marketing process to enable them to take into account the requirements stemming from strict European and other laws.

*And data sharing is also an important issue for the auto industry.*

**Le Roux:** Data sharing is undeniably another main challenge our team is currently working on. There is no doubt that data sharing is everywhere — it is a fact of life. Indeed, car manufacturers are sharing their data with multiple stakeholders, such as suppliers; partners; connectivity providers; infrastructure entities, such as private road managers; and public authorities, such as authorities organising services. Access to data by other entities has been overly challenging; everyone wants to have a stake at the data.

When working with clients on these matters, it is important for them to be advised on the different regulations and also on new equipment obligations that are coming into force, notably those regarding the C-ITS framework.

It is also significant that many partners are claiming a form of ownership of the data. As such, Hogan Lovells is assisting car manufacturers to develop solely contractual arrangements to protect connected data for car manufacturers, but also for other stakeholders.

Another data-sharing issue relates to older regulations which are now coming into force. For the French government, for instance, it has consisted in its ability to regulate various situations regarding data sharing. Such situations are or will be regulated at European levels, so there is a risk here that discrepancies may come up between the national and the European frameworks, which should be avoided.

**Pflueger:** Data sharing is also a special challenge where we are looking at international data transfers outside the EU/EEA where specific requirements apply that need to be overcome, and courts and authorities have set high bars for transferring data.

As another aspect, we have also recently seen is a very strict interpretation of laws by the European data protection authorities affecting the sharing of data, such as in the current guidance of the European Data Protection Board on processing personal data in the context of connected vehicles and mobility related applications. There is obviously a demand to make use of the increasing amounts of data generated by connected vehicles, not only for providing a specific functionality or service, but also for further purposes, such as product optimisation, which brings us back to the question discussed earlier in relation to secondary use.

While the GDPR allows for the use of data collected for one purpose also for compatible further purposes, provided very specific requirements are met, the situation becomes even more complex where also the rules of the e-Privacy Directive apply. The data protection authorities stress that in scenarios where the car qualifies as a "terminal equipment", falling under the scope of the e-Privacy Directive, data stored in the car may only be further processed and shared in very limited scenarios. More specifically, according to the authorities, the rules enabling further compatible use under the GDPR cannot be relied upon because their application would undermine the protection awarded by the e-Privacy Directive. That leaves companies in most cases with no other option than having to obtain consent which triggers enormous practical challenges. Applying this rather strict interpretation of the law, you significantly limit the scope of what companies can do with the data in the future.

*What aspects of cybersecurity are particularly critical for clients to understand in this context?*

**Pflueger:** As a car manufacturer, your security considerations are no longer limited to your own car. You need to consider your car's interfaces and connections with other cars, infrastructure or networks, digital service providers, and the internet. And you need to take into account that many actors involved have potential access to the data. This of course increases the number of potential vulnerabilities you have within the car. It opens possibilities for hackers and ransomware attacks, and potentially also very serious cybersecurity incidents, such as intruders taking control over driving functionalities and critical systems, which could trigger enormous road safety concerns.

That requires companies to rethink their cybersecurity and data security concept, including all players involved — the whole chain of subcontractors, suppliers and third parties. They all need to be included in a comprehensive cyber strategy to enhance the security and protection of the overall ecosystem; and this applies over the whole lifetime of the vehicle. It is not like a car manufacturer can simply stop to provide support for critical services of an older vehicle model because it has been driven already for a long time. Since cybersecurity has become an essential element of the road safety of a connected vehicle, companies need to ensure the cybersecurity of the car over the whole lifetime of the vehicle. And all these considerations need to be made against a fragmented and evolving legal landscape with different cybersecurity requirements following from various legal instruments.

**Le Roux:** There is no central cybersecurity framework or a general framework under the GDPR since the GDPR only provides for broad security obligations regarding personal data, regardless of the activity or the industry. Rather, different pieces of a cybersecurity framework come into play. One of them is the Directive on security of network and information systems (NIS Directive), which is quite key and relates to operators of essential services. Although car manufacturers are not really impacted by this regulation, they will surely and progressively become affected by this regulation when autonomous cars are operated on public roads.

It is likely that a new cybersecurity framework emerges, once it is more clear in regulators' minds what they want to have. In France, for example, the cybersecurity framework of operators of essential services could serve as a basis to be applied to automated vehicles' and automated driving systems' manufacturers. It is something that will be key to follow as well, because it will result in substantial changes with regard to the obligations that will apply to manufacturers.

**Pflueger:** That is a very good point. We see various developments at the European and international level in this area, from different regulatory and industry bodies, including the endeavors at the European Commission and also the recent United Nations ECE proposal for uniform provisions concerning the approval of vehicles with regard to cybersecurity. An interesting aspect will also be the development of standardisation and certification processes, which could provide for a more comprehensive umbrella. But it is all just starting, and we are unfortunately still not there yet.

**Le Roux:** What is also noteworthy with new services is that car manufacturers are providing connectivity to end-users, so they could be considered as telecommunication services providers. They could therefore fall under another legal category that is quite highly regulated, and such category provides for a huge number of cybersecurity obligations that may be imposed on car manufacturers.


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# To resolve international disputes, the automotive industry increasingly looks to international arbitration

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Disputes happen in any commercial relationship, and when they happen to companies based in different countries, they get complicated. Traditionally, the first choice for disputing parties in national relationships has been litigation before domestic courts. But that system is rather rigid and not intended for dealing with international issues, the proceedings can be long and expensive, and decisions are subject to appeal and can be challenging to enforce.

That is why automotive manufacturers and distributors are including arbitration clauses in their international contracts. Arbitration is international by design, provides flexible and tailor-made solutions, is often faster and less expensive and awards are difficult to reverse and easier to enforce. Arbitration thus has become the preferred method of dispute resolution for the automotive industry, worldwide.

In this hoganlovells.com interview, Hogan Lovells partners Daniel E. González (Miami) and Karl Pörnbacher (Munich) discuss automotive industry trends in international arbitration, best practices and the elements of a well-crafted dispute clause.

## *What are the trends in arbitration in the automotive industry in the United States and Europe? Are more matters going to arbitration now compared to several years ago?*

**Pörnbacher:** First, let me take a step back: Until six or seven years ago, the automotive industry was not prone to major disputes in its core business. Even in large international automotive supply contracts, the participants did not pay much attention to dispute resolution clauses because they were pretty sure that they would adequately solve any conflict commercially, without having to resort to a formal dispute resolution mechanism. That is what they were used to, after all.

But we have seen this change slowly, with an increasing number of automotive-related disputes — not only national disputes before state courts, but also, and particularly, in international arbitration.

The reason for this development is that the automotive industry is undergoing dramatic changes:

- New players have entered the automotive industry, sometimes diversifying from other industries. They are often more inclined to break out of conventional mindsets and patterns. They themselves may view their approach as innovative, others as disruptive. Be that as it may: It certainly is a challenge to the traditional, expected behavior in the industry. For example, we had a widely discussed case before German state courts where a supplier – in order to enforce its alleged rights – ceased to supply an original equipment manufacturer (OEM). This could have caused a production stop with far-reaching consequences and potentially enormous damages. Such a course of action would have been unthinkable some years ago. Even when a supplier had a serious dispute with an OEM, it would never have stopped supplying, thereby jeopardising the entire production.
- Then you have dramatic changes to the political environment with potentially new and unexpected barriers for international trade which can cause substantial strain on commercial relationships.
- And we see increasingly strict regulators causing, for example, OEMs to conduct more frequent very expensive recalls. This raises the question of who should ultimately bear the responsibility for the recall and pay for the costs. Is it the OEM, or can the OEM turn to its supplier and try to get reimbursed? And may the supplier push the dispute down the supply chain if the root cause lies further down?
- And finally, the automotive industry is facing a downturn. There is less money available for generous business solutions. Business units feel the pressure to save costs and to enforce their rights more than they did before. Insurers are not as quick to settle as they used to be. They often insist that their insured, which could be a supplier, have the dispute adjudicated.

These would be the key concerns that I see from the European perspective.

## *What about the U.S. perspective, Dan? Why are we seeing a trend toward more disputes, and why is there a greater tendency towards arbitration?*

**González:** Because the automotive market was for a long time a very closed market, it had consistent distributors and when it came time to supply, regardless of other passed disputes, you moved on and went forward, as Karl said. Now that is changing and has opened up the environment to potentially more disputes. That is Step One. These would be the key concerns that I see from the European perspective.

Step Two is that you still have the urgency that always existed, which is, these distributors and manufacturers do not want and cannot afford to be in disputes endlessly, because they are all still in a market where they need to continue to work together.

And that brings us to arbitration. When you did have a major automotive dispute, typically it would have been a purely domestic matter and you would have gone to court. But arbitration offers significant advantages for the various parties in the automotive sector.

First, comparatively speaking to a court action in the United States, arbitration can be quicker. And I am very careful about how I say that, because it is relatively speaking; arbitration by definition typically has no appeal rights, so whatever is decided by that arbitral tribunal has finality. By removing from the process the possibility of appeals you will make the dispute resolution process shorter and faster, which again is very desirable in the automotive sector.

Second, it has the advantage that arbitration is private and structured to maintain confidentiality. Therefore, the parties in this very small sector could benefit from that ability to resolve this private dispute and potentially not have it impact other distributors, relationships or contracts.

There are various elements of arbitration, such as time, the nature of the dispute and the sophistication of the decision makers that lend themselves well to the automotive industry. For example, rather than turning technical defect cases in the supply chain to a generalist judge in the United States – or even more dangerous to a jury – you can have an arbitration where you select arbitrators who have dealt with these issues worldwide, and/or who have technical, scientific, or automotive sector experience. You can hand pick your decision makers much better than you could if you were to take potluck in a court system.

The last factor – and this circles back to what Karl was saying from the European perspective – is that you have globalisation now and suppliers spread out all over the world. The idea that all your suppliers were in Detroit, or all of your products come from one domestic location and you do not need the international arbitration component, has changed. If you have suppliers coming from different parts of the world, that is another factor as to why you may want to have an arbitration clause, because you have an ability to confirm and enforce those awards around the world much better than if you were in a court in the United States.

## *How should companies plan for arbitration or dispute resolution? What best practices do you recommend?*

**González:** We regularly advise our clients in drafting appropriate dispute resolution clauses. One of the advantages of arbitration is that you have the flexibility to agree on a solution both sides can live with. One option is also to require that the parties need to attempt to settle amicably, eg by a C-level meeting, before formal proceedings may be commenced. Existing contracts should also be reviewed from time to time to see if the dispute resolution mechanism still fit the needs.

Sometimes, of course, clients come to us when the dispute has arisen, they have already decided how its resolution is going to be handled, and are prepared to move forward.

What we would say in terms of best practices is, number one, clarity, especially on how the parties agree as to how they will handle a potential dispute. It is not unique to the automotive sector that, when they are contracting, no one is thinking that we are going to have a dispute. There are many very large sectors and important contracts where the parties go into them thinking everything is going to be fine. But you still have to have some sort of dispute resolution clause.

We would tell you, from having to deal with these clauses on the back end, the more clarity there is, the better – clarity on how you intend your dispute to be handled and the key elements of a well drafted arbitration clause.

This includes specifying the venue where the arbitration will be held. And when we talk about the "venue of the arbitration", we mean the "juridical seat" because in international arbitration, it matters where the seat of the arbitration is. That is the place where you will have to rely on the local courts to enforce the arbitration clause and that is where an award has to be challenged. Also need to consider what is the substantive law of the arbitration going to be? Will the arbitration be administered or ad hoc? How will the arbitrators be selected?

What is the language of the arbitration? Can documents be submitted in a certain language, or does everything have to be translated into English? In many disputes, much time is wasted just arguing about that, because even though the contract may have been in English or another language, if the parties do not specify a language, it will be at issue in the dispute.

You also want to have the finality that we mentioned. Many times, in our industry, we talk about "pathological clauses", which goes back to not having clarity; that is, where the parties say they want arbitration but then say, we are still going to go to court, or we are still going to handle these other types of disputes in these different ways. The parties are not left with a clear understanding as to what happens once they have a dispute.

And is there finality as to the arbitration so there will not be later appeals? Again, another pathological element is when they say they are going to go to arbitration, but if one party is not happy with the results of the arbitration, they can still go to court, and that is a horrible thought – it is very expensive, lacks finality, lacks clarity and you do not want it.

We would also advise that the more you customise the clause to fit the kind of contract that you are dealing with, the better.

### *Karl, what would you add, from an automotive-specific perspective?*

**Pörnbacher:** Dan described the core issues very well. A couple of additional points: you have increasingly global sourcing agreements or global supply chains. For instance, you might have a German car supplier supplying an OEM in the United States. The parties will probably conclude a general framework agreement under which the supplier would supply the OEM in different factories in different countries all over world. This may change over time: while the supplier may have delivered a couple of years ago from a German factory to Detroit, it now runs its production lines in Romania, Mexico, or China, and supplies Romanian, Mexican, or Chinese factories of the U.S. OEM. All this would be covered by the general framework agreement, despite the various and potentially changing international entities and factories involved on both sides of the supply agreement.

The parties thus need to carefully draft conflict clauses that reflect the complexity of the actual supply relationship and allow for the flexibility required when this relationship is adjusted and production is relocated to different countries or continents. Nobody wants to renegotiate an arbitration clause or think about the contractual implications every time production is relocated. Therefore, we need to provide our clients with clauses that are flexible enough to capture such situations or which can be easily adapted.



We need to make sure that wherever and by whatever affiliate supplies are made to the OEM or any of its affiliates around the globe, the dispute resolution mechanism follows and provides for a practical solution.

This is something that only arbitration can achieve, because otherwise you would end up in jurisdictions where you do not want to be before state courts, because you do not understand the local language, you are not familiar with the substantive law they apply and they may not have the required experience for such disputes. For example: Neither the supplier nor the OEM might want to have their disputes adjudicated by Chinese state courts litigating in Chinese, by Hungarian courts in Hungarian or by German courts in German – depending on the question which affiliates have been involved in the specific supply relationship. Instead, they will prefer to have a general framework agreement, under U.S., English or German law, which would apply everywhere with proceedings being conducted in English. You want to have dispute resolutions in a language that you can follow, not in different languages and different court systems that you are not familiar with.

The second point is that in many situations the parties will need a quick resolution. For example, if a supplier threatens to cease supplying the OEM if no agreement on new delivery conditions is reached, you need a fast, final and binding decision. While some national courts systems can help in such situations, they are rarely equipped to address these situations adequately on an international level. In arbitration, by contrast, the parties can provide the tribunal with specific authority to take such decisions.

A last point: arbitration gives the parties more flexibility as to the choice of the substantive law. Arbitration allows them to pick the applicable law for the entire global relationship, and avoid the problem of adapting the agreement to each and every legal system of the countries in which the supply might take place and avoid the application of overly broad restrictions resulting from national law, such as the German law on standard terms and conditions.

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# Chain reaction: Managing financial risk and exposure in the automotive supply chain

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Heiko Tschauner (Germany), Chris Donoho (U.S.) and former partner Joe Bannister (UK) are/were part of the firm's Business Restructuring and Insolvency practice. The team has a wealth of experience acting for original equipment manufacturers (OEMs) and suppliers in some of the most complex and intractable automotive cases of the past decade. The development of new powertrain technology; challenges within established markets, such as diesel emissions issues; and falls in automotive production – production in the United Kingdom has fallen during the last 12 consecutive months – have had a significant impact on the automotive and mobility industry.

The rapid increases in demand for connected, electric, and hybrid vehicles – together with the associated infrastructure – means that effective co-operation among OEMs, suppliers, regulators and other stakeholders is now more important than ever. The cost of this new technology, aligned with shocks to production, such as the ongoing uncertainties around Brexit and China trade tariffs, means that more than ever, fortune will favour the innovative and the well prepared innovator.

## *The relationship between OEMs and their suppliers has always been highly symbiotic and capital intensive. What makes things different now?*

**Bannister:** Profit margins for the sale of new motor vehicles are now tighter than ever. That has led OEMs to refine and manage relationships with key suppliers more robustly. This tighter management is illustrated in a number of ways. First, we have seen OEMs seeking to hold suppliers to fixed prices for key components for a number of years before insisting upon phased price reductions. That in turn has often reflected the technology underlying particular models becoming more established and less cutting edge. Additionally, OEMs have carried out regular supplier culls so that wherever possible, they hold fewer relationships with individual suppliers, but those relationships extend to a greater number and range of components.

The result is to leave the supply chain increasingly vulnerable to fluctuations in demand. Additionally, the highly integrated just-in-time nature of supplies means that production of particular vehicles will almost invariably be, at best, able to carry on for a few weeks and, at worst, for a few hours in the event of any disruption. The current uncertainty as to when, and if so on what terms, the United Kingdom will leave the European Union merely serves to exacerbate those issues.

## *What are the danger signs?*

**Tschauner:** With the benefit of hindsight, what might appear at first sight to be an out-of-the-blue failure is usually anything but. Individual cases will vary, but expect first to see as danger signs some or all of requests for price increases, pleas for accelerated or increased payment terms and late or short deliveries. Other danger signs are unexplained quality problems, loss of key personnel at the supplier and restrictions or reductions in credit insurance. With listed supplier counterparties, look out for profit warnings, emergency – or under subscribed – rights issues and rumors or announcements of requests for covenant waivers.

## *What should be done from an OEM perspective?*

**Donoho:** Successful vehicle models will be in production for a decade or more and therefore the relationship between an OEM and its suppliers will invariably be long term with no easy exit. Long-term relationships call for long-term management and financial oversight. Because of this high level of scrutiny, the performance of individual suppliers should be evaluated by an experienced and dedicated team within the OEM. That team should include within it individuals well-versed in the identification and management of distressed businesses. Where appropriate, those dedicated teams should also include external financial and legal advisors with relevant experience.

**Bannister:** Wherever possible, an OEM should work with the suppliers to build up or confirm the availability of surplus components to ensure that there is a "buffer" in place to give the OEM at least some protection against any interruptions in the supply chain. Where one is dealing with a vehicle that sells very well, building up a stock of surplus components may in fact be a difficult thing to do.

The OEM should also work out how long it would take to obtain a replacement supplier for particular components should there be a disruption for financial reasons or otherwise. If necessary, a replacement/financing program should be initiated in response to the financial distress of a particular supplier. An OEM should be on top of the reporting and information provisions in individual supplier contracts. It should ensure that these provisions are adhered to. If the OEM does allow a supplier additional time to comply with these provisions, or indeed waive any other breaches, the OEM should ensure that its rights are fully reserved.

## *What should be done from a supplier perspective?*

**Tschauner:** The supplier's position is really the mirror of the OEM. In our experience, early engagement is in the mutual interest of both parties, particularly where an OEM is one of a limited number of customers. To the extent possible, suppliers should proactively manage contractual performance. Ideally, to maintain trust they should notify OEMs of potential contractual breaches before those breaches occur. Wherever possible, the supplier should agree to a mutually acceptable alternative with its OEM customer. The supplier and its advisors should, wherever possible, make the most of any interdependency between the supplier and its OEM customer. In particular, suppliers should not underestimate the ability or willingness of an OEM to provide vendor financing, early payment, or other support where the alternative is delayed production and heavy losses.

## *Funding suppliers: pre-insolvency?*

**Donoho:** Wherever possible, the OEM should not allow just-in-time to production needs to prevent it from seeking or receiving an appropriate, commercial, quid pro quo for funding that is provided. One example is for the OEM first to obtain security for any funds that it may provide. Bear in mind, however, that obtaining security is likely to require the prior agreement of other lenders to the OEM. It may also be necessary for the OEM's security to rank behind that of other lenders. That may or may not in fact protect the OEM depending on where value falls. At a minimum, however, the OEM should seek some control over the enforcement process. It should also seek the means to step in and manage the situation where the supplier has lost the ability to do so effectively.

Additionally, the OEM should insist upon tooling, finished and unfinished goods being kept separate from products destined for other clients. In doing so, the OEM will maximise its chances of recovering components or finished goods in the event of the supplier entering a formal insolvency process. Additional valuable protections against a financially weak supplier can include enhanced rights of inspection and rights of entry into the supplier's premises. Wherever possible, the OEM should seek nonexclusive licences to use or replicate any intellectual property or other design rights so as to maximise its ability of resourcing to a solvent counterparty.

**Tschauner:** The OEM should also be familiar with the particularities of the applicable insolvency regime. For example, the German insolvency code provides extensive voidability rights which can be reduced to some extent through contract management.

## *Suppose the supplier goes into bankruptcy or reorganisation proceedings. What are the OEM's options?*

**Bannister, Tschauner:** The answer will depend upon the nature and effect of the particular bankruptcy or reorganisation process. It will also depend upon the jurisdiction in which that process

takes place. To some extent, these are matters that can be planned for if either or both of the OEM and the supplier has sufficient warning. For example, some procedures – such as a U.S. chapter 11 reorganisation or an English administration – will have as their principal objective the rescue of the relevant debtor. Other procedures – such as an English liquidation – will be terminal processes, where the business in question ceases trading. The first step for the OEM and its advisors will be to determine which procedure is in play and what options it provides.

For example, there is case law in some jurisdictions that insolvent businesses are entitled – and may even be bound – to increase the prices of the components they supply to customers. This is because a financially distressed business must maximise the value of its assets to the benefit of its creditors. For the same reason, nevertheless, experience shows that it can still be possible to negotiate mutually acceptable, interim arrangements that protect the interests of both the OEM and the distressed supplier. Examples of such arrangements are the OEM providing what is in effect debtor-in-possession funding for ongoing production, with that funding being repaid in priority and as an expense of the relevant procedure. In such cases, we have successfully negotiated for OEM clients rights of inspection, options to purchase particular assets and nonexclusive licences to particular intellectual property rights.

In other instances, we have assisted OEMs in the negotiation of pre-packaged purchases of the business and undertakings of stressed suppliers. As a result we have helped save many businesses and jobs through placing those businesses on a long-term, sustainable, financial footing.

### *What makes Hogan Lovells a stand out restructuring law firm in the OEM space?*

**Donoho:** There are a number of reasons. First, the breadth of our client base sets us apart. We advise the entire range of stakeholders including debtors, management, creditor committees, suppliers, and restructuring practitioners. We have also acted for pension trustees and regulators across a whole range of industries, including the automotive sector. We possess deep practical and legal experience of the technical and commercial issues facing OEMs and their suppliers in these uncertain times. More importantly, we have that know-how in all the key automotive jurisdictions – the United States, United Kingdom, Continental Europe and China.

In addition, Hogan Lovells has one of the legal profession's largest and most experienced group of lawyers specialising in representing stakeholders in the automotive and mobility industry. More than 500 legal professionals collaborate globally in all relevant practice areas including M&A, antitrust, litigation, product liability, intellectual property, business restructuring and insolvency. We provide one-stop legal advice to clients, including the world's leading OEMs and distributors together with their suppliers, manufacturers and regulators. Members of the Hogan Lovells automotive industry group include a number of our restructuring partners and their teams. We advise clients in all 50 U.S. states as well as in Europe, Asia and the Middle East.


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# How will OEMs evolve from automotive manufacturers to sellers of new mobility to sellers of new mobility services, disrupting traditional distribution models globally?

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For decades, one business model has endured in the automotive industry: consumers buy their cars from independent dealers, not from automotive manufacturers ("OEMs"). But the automotive industry is changing. OEMs are exploring new revenue streams and distribution systems, including the sale of automotive-related mobility and connectivity services. Is the connected car or vehicle poised to disrupt traditional automotive distribution models?

Longstanding U.S. franchise and other national distribution laws across the globe, whether federal, regional or local, govern the distribution of vehicles and now also mobility services, and the aftersales services market is still largely the dealers' domain. In this hoganlovells.com interview, Patrick Ayad, a Hogan Lovells partner in Munich and Global Leader Mobility and Transportation at Hogan Lovells, and Colm Moran, a former partner in Hogan Lovells Los Angeles office, discuss to what extent OEMs will become distributors of new mobility and aftersales services, replacing or at least transforming the role traditionally played by dealers.

## *As the automotive industry changes, the way mobility services are distributed is changing, too. How are consumers influencing these changes, and how are OEMs addressing them?*

**Moran:** On the issue of mobility in the automotive industry, you have a lot of discussion about the popularity of ride-sharing programs, like Uber, Lyft and Didi, and the perspective that maybe the next generation of car owners is not going to be so interested in owning cars — they will be fine just having ride-sharing programs. The scope of this ongoing discussion includes whether an effective distribution model would be a system where the vehicles are not actually sold to consumers.

The OEM, for example, could set up a subsidiary that owns a fleet of model "A", and the customer is just sharing and paying a fee to use the vehicle on a daily, weekly or monthly basis. The vehicle would not be owned by the customer, so there is no retail sale. This is an area that OEMs are starting to take more seriously — that is, setting up entities to own fleets of vehicles that would be used for ride-sharing purposes.

**Ayad:** Yes, and that is a very significant development: the transformation from an automotive company into an automotive and mobility company, which includes the distribution of services.

Now, the rules for distribution of mobility services may be different than the rules for distribution of cars. OEMs are currently bringing in new subscription models, in the United States, Europe and globally, where you do not buy the car, you do not own it — you use it. You subscribe to the car for, let us say, one or two years. It is a sort of leasing, but different because it is not your car, in the sense of leasing it; more like a long-term rental. It is not even registered under your name, ideally. It belongs to the OEM and they may even set up a different company for that, which manages the fleet and does everything else — you do not have to worry about servicing or washing the car or anything like that.

It is really user friendly. It may be shared, or it may not, and it may be that you can change your car. Say you have your basic car, but then you can access a sports car for the weekend five times a year or so, or a convertible to use in nice weather. Such subscription models take away the ownership — it is more the usership and easy access whenever you like.

## *Would automotive dealers still have a role in this scenario?*

**Ayad:** This is a new way of distributing and also, here again, the OEMs want to do this directly. So they might not need the dealers to sell the cars, but they would still want the dealers to do the service on the cars, or the delivery of the cars, or explain the new mobility services to consumers. And here it may be more possible to do things differently than before. It may not be subject to the strict rules that we have for the distribution of vehicles, but that is a local question.

The other distribution issue would be the connectivity services, not related to driving the car, but related to the services in the car. The distribution of connectivity services will need to be addressed in consumer terms, but again, from a distribution perspective, there is a profit here. The question is to what extent the OEM will need to include the dealers in the distribution of such services?

These connectivity services, such as remote access to unlock or even start your car, would be offered by the OEMs — the dealers can hardly offer them. At the moment, these connectivity services go directly from the OEM to the consumer. In the future, OEMs may need support to further distribute such services.

## *Are OEMs focusing on any other aftersales services for distribution?*

**Ayad:** At present, about 80 percent of the aftersales market is in the independent aftersales market, so 80 percent of the market share of servicing cars is outside the OEM world. And now the key question is, do the OEMs intend to regain control here, because it may be a profitable business?

Also, in light of the fleets that they would probably own as a car manufacturer, the OEMs would then need to provide servicing of these cars that they would now own. How do they do this? Do they have their own service model? Do they use their dealers? Do they bring in alternative distribution models? So there is also a change in the distribution world when it comes to aftersales.

**Moran:** Outside of the United States, you do not always have the same type of statutory issues. But in the United States there are still a lot of commercial and business issues, and statutory issues in some jurisdictions. Patrick is exactly right that, in addition to mobility as an alternative method of distributing vehicles, you do have the issue of services on the vehicles, be it the concierge-type services or what not. In my view, this is a continuum of, what type of service are you performing?

I will give one example, where the dealer has given some pushback. Because motor vehicles now are largely so heavily dependent on and controlled by computers, a number of changes can be made just remotely, ie over the Internet. Let us use Tesla as an example. Tesla rolls out materially substantial changes to the operating features of vehicles through software. It is just downloaded in; you do not take it in to a dealer. You download it into the software package into the vehicle's hardware and update it. Changing engine performance characteristics — Tesla does it all the time, changing all types of features on their vehicles.

## *Are other OEMs now following Tesla's example?*

**Moran:** The other traditional OEMs have not gone fully into that stage yet, but they certainly have that capability. And there has been some pushback from dealers that — wait a second, at a certain point, if you are going to make an update or a change on an aspect of the vehicle, is that not a warranty?

## *What kind of legal argument do the dealers have under current laws?*

**Moran:** If it is, say, an aftermarket product, I think there is no argument that that is within the dealer's realm, that is protected by the dealer's agreement or statute for an aftermarket product. But it is an interesting question — that is why everyone says it is a spectrum of issues. What if there is a fault in the computer system on the vehicle and you can just fix it with a download over a Wi-Fi connection? And you can fix hundreds of thousands of vehicles overnight by doing that?

The dealers have expressed some pushback, saying, we should be getting a piece of that service work, as that is work coming by the warranty of the vehicle and we should be profiting on it. In other words, customers should have to come into the dealership to have the update done there.

There is a spectrum where, on one end, you have things like the aftermarket products on the vehicle. To me, I do not think there is any legitimate argument that the dealer in the United States

would have that this is covered by their agreement. Now they might make some sort of argument based on the trademark of the aftermarket product. But then you go to the other end of the spectrum, and you are fixing some problem with the vehicle software remotely, by a Wi-Fi Internet connection. Is that sort of thing on the vehicle under warranty, or does that violate the law in most states?

**Ayad:** To add, it is not that there are not any such issues outside the United States. There is a fine line between warranty and aftersales services, also as a matter of practice, as OEMs have traditionally relied on dealers to do such work. Also, going forward, OEMs will introduce further services, such as electricity services. And they will need to think about how to distribute them, with whom, and under which laws.

### *Do you think these issues will be heavily litigated?*

**Moran:** The way I would sum it up is — we have a certain system of distribution that is been in place, in the United States, for almost 100 years: the distribution of automobiles through independent dealers. There has been an entire statutory scheme that has been constructed over a century around that model. The world is changing, and now we are trying to fit new methods into this existing model. In some cases, it is almost like putting a square peg into a round hole.

If you want a fleet of mobility service vehicles and you are selling subscriptions, is that the sale of an automobile? This is a totally different model, which does not necessarily fit neatly into the existing structure. There are going to be a lot of test cases around it — where the contours are, how the law might change, or whether manufacturers can be successful setting up alternative channels of distribution outside of the existing schemes.

**Ayad:** At least in Europe, these issues are in the first instance heavily negotiated with dealer associations. But there will also be litigation. Eventually, OEMs will still need dealers, or let us call them fulfillment or service partners. There is disruption in the automotive industry everywhere, so why should traditional ways of distribution not be disrupted? In response to this, OEMs are transforming, and so will dealers need to transform — otherwise others will take over.


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