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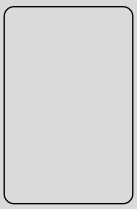
Published by
Law Business Research Ltd
Meridian House, 34-35 Farringdon Street
London, EC4A 4HL, UK

First published 2017
Sixth edition
ISBN 978-1-83862-978-6

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



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Lexology Getting the Deal Through is delighted to publish the sixth edition of *Automotive*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting the Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

Lexology Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Patrick Ayad and Lance D Bultena of Hogan Lovells, for their continued assistance with this volume.

LEXOLOGY
Getting the Deal Through

London
July 2022

Contents

Global overview

Patrick Ayad and Lance D Bultena

Hogan Lovells

Covid-19 loomed large again, similar to the past two years. While health concerns are easing in many locations, China is still experiencing pandemic-related shutdowns in major cities and critical manufacturing areas. The supply challenges initiated by the pandemic linger and are unlikely to abate in the next year.

Geopolitical issues add to those pandemic-related supply challenges. Strategic competition between the United States and China continues to accelerate. Russia's invasion of Ukraine has greatly expanded geopolitical challenges and added further issues to the supply disruptions experienced by the industry. Russia's actions have also deepened the growing competition between the US and China, given China's 'unlimited' partnership with Russia. At the time of writing, Russia's actions seem to have increased Europe's own concerns regarding China and have shifted their policy stance toward the United States. The complexity and depth of these geopolitical challenges are likely to accelerate over the next few years. The challenges for the industry extend well past supply issues to significant questions about markets, partnerships and how critical new technologies are developed and brought to market.

While the pandemic was accelerating in its early phase, we, like many, were already trying to discern the impact on the automotive industry. We concluded the original equipment manufacturers (OEMs) were better placed financially than when the 'great recession' began in 2008 so the survival of the OEMs was not an immediate concern. We, like many, were, however, worried about some of the supplier network, but major problems did not develop. We wondered about the challenges of extra debt taken on to address pandemic-related issues. We were convinced the greater focus on resilience in the supply chain would gain force and was a trend that would extend well beyond the easing of the pandemic.

The auto industry has done better through the pandemic and with the supply challenges than almost anyone predicted.

Sales declined quickly with the pandemic, but demand came back sooner than expected. Companies cut costs and focused production strategically on fewer but more popular and profitable products. Supply challenges – most profoundly in 'chips' – have caused intermittent but significant production shutdowns for nearly two years. The resulting challenges are real, but companies have managed them well. Given the huge efforts already expended and costs absorbed to address a crisis of semiconductor shortage that still rages on, it remains to be seen how this challenge will fully impact the industry. Manufacturing more 'chips' is the obvious solution but that takes time. The conversations we noted last year continue about 'vertical integration' of key components and the advantage 'in-sourcing' provides for control of critical supply. Certainly, increased control along the supply chain is an even greater priority this year, especially for battery technologies and related raw material supplies, so the vital transition to electrification is not endangered.

These production challenges have also kept vehicle supply constrained while demand is strong, so sales prices are high and so is profitability. Prices are also high in the used vehicle market. This further supports prices for new sales and helps the residual value of vehicles coming out of lease programmes, another aid to profitability. The balance sheets of OEMs are generally in good condition. Given the challenges confronted over the past two years, this result is a profound relief for many.

At the beginning of the pandemic, we also argued the technological transformation of the industry would not slow as some feared. We noted that as companies took aggressive financial actions to survive a global economic crisis, they continued to shift resources toward investing in the mobility future based on electric vehicles that deploy ever more complex arrays of advanced technologies.

We continue to believe one would be hard-pressed to find more vigorous endorsement of the future of mobility than companies investing in that vision while facing such immediate and significant challenges. We see the same dynamic in response to supply challenges, accelerating geopolitical concerns and the growing focus on environmental, social and governance (ESG) issues. The technological transformation of the industry is not merely a trend that can be dislodged, it is an enduring reality. The global nature of this transformation is reflected throughout this volume as authors of the country-specific chapters regularly note the technological development of the industry is important in their jurisdiction.

So, why do we believe the transformation of the industry to a new mobility future is no mere trend?

The technological transformation and digitalisation of the industry continue to accelerate – sometimes, as with emissions technologies, driven forward by government policy; other times, as with advanced technologies and the use of data, restrained some by government policy.

The significance of these technological shifts is hard to overstate. They are transforming the vehicle as a product, leading to the introduction of new services, and causing innovation in business and distribution models. Less well documented, but perhaps more difficult than technological invention, is the change in corporate culture. An industry that has focused vigorously throughout its history on traditional engineering excellence must shift to enterprises built around software and batteries. Companies must think as service providers that generate revenue after the initial equipment sale. The vehicle and its associated services can continue to improve after initial sale through software updates, rather than remain rigid as with a purely mechanical vehicle from the past.

Long-established companies, and their suppliers, must tackle these challenges while facing competition from powerful new entrants, either in the form of tech companies with 'deep pockets' or new companies with high valuations. The classic pairing of challenge and opportunity is vividly evident in the industry.

There are two areas where the massive impact of government policy requires discussion: emissions rules in response to global climate change and production decisions in response to economic and foreign policy concerns. The accelerating competition between the United States and China, has a global impact on the industry. While the European Union is still struggling to determine how it will navigate that

challenge, as noted above, the recent invasion of Ukraine by Russia that brought war to the European continent has pushed Europe toward the US and increased concerns about China.

First, emissions. Governments have long been pulling the industry on a global basis toward products with a lighter environmental touch. In the past couple of years, that tug has become a vigorous yank that is further fostered by the stock market success of 'pure play' electric vehicle (EV) companies. More stringent regulation of vehicle emissions is also cited regularly in this year's edition. An EV future is rapidly being forced by a synergistic dynamic of technological advances, stock market valuations, concerns about global climate change, the desire for energy security through less dependence on fossil fuels, competition between major markets over critical industries, and aggressive pledges by some traditional OEMs to convert their fleets by specific dates.

The rapid transition to the EV future confronts two daunting hurdles, however: supply and demand. Gearing up a new global supply chain very rapidly and achieving consumer acceptance at a comparable pace are real challenges. Consumer acceptance is key. EV sales are accelerating but are still a relatively small portion of the market. Rapid EV adoption therefore requires even more rapid technological advancements, price decreases and infrastructure deployment so that EVs 'sell themselves' in the mass market. Interestingly, much higher fuel prices are increasing consumers' willingness to explore EVs.

The second area where government policy cannot be ignored is in decisions on supply chains and production siting. For the past couple of decades, these issues were not top-level concerns. OEMs managed reasonably stable trade rules and optimised for low cost, with supply chains that were long, thin and opaque. The natural world gave this approach its initial nudge with the Fukushima earthquake and tsunami in 2011 and then a dramatic slam with the current pandemic. The blockage of the Suez Canal in 2021 drove the point home: one cannot assume a supply chain will function, one must build in diversity and options. Shorter, thicker and more transparent supply chains are the trend.

This trend is accelerated by the ever-growing competition between China and the United States – the two biggest auto markets. The implications for the global auto industry are staggering as these nations compete across so many parameters. Technologies designed for a global scale cannot be used in China for national security reasons. Those rules and concerns are getting tighter. The US has its own national security concerns – most evident in 5G – that restrict Chinese suppliers. The range and reasons for competition are numerous and complex. The simple truth is that each day this competition is becoming more aggressive, and that makes choices harder for global companies. Nothing has the potential to disrupt business plans more completely and durably than the type of 'big power' competition that is now so evident. The current war begun by Russia and the response by 'western' nations is rather overwhelming evidence that geopolitics is definitely pushing back globalisation.

The growing focus in financial markets on ESG issues amplifies and adds another dimension to each of the environmental, supply chain, geopolitical and policy issues discussed.

The emphasis on environmental issues – the E element of ESG – adds financial market pull to the policy impetus to limit emissions. This change is very significant. In previous decades, when emission stringency increased this posed market valuation issues for traditional OEMs. Now, when those traditional OEMs announce a move toward EVs – even though challenging and expensive – their market valuation tends to increase. Policy has found a further lever toward emissions limits as financial regulators explore rules around climate impact declarations that will impact all listed companies and force them to analyse emissions along the entirety of their supply chain (scope 1 through 3).

The social element of ESG amplifies supply chain challenges. Goods and materials from countries seen as violating ESG norms are negatively evaluated as are the companies that utilise them. These evaluations pose real challenges, as China is the origin of so many supply chains and Russia is a significant producer of energy and raw materials. As data becomes an increasingly important element of companies' services and quest for profit, privacy norms and cyber resiliency are also increasingly aspects of the S element of ESG that are explored by financial markets.

What about autonomous vehicles (AVs)? The advances in driver-assist technology continue at a solid pace. AVs will happen. Debating exactly when is no longer such a hot topic as the general press realised a sudden and swift transition to all autonomous vehicles is not upon us. The discussion now is more about where AVs will find their initial use. The assumption that robot taxis would be the first widely adopted commercial application now seems more unlikely, with more betting on applications that move freight on major road systems or deliver goods by automated small vehicles in local areas. In recent months, tentative but significant regulatory developments have occurred in Europe and the US that show the evolution of a policy framework for AVs has begun.

The march toward a mobility future continues. In other venues, we have said 'living mobility' is the best conception of our future where the focus is less on a particular vehicle and more on broader, more diverse, inclusive and sustainable mobility options that will change how we live. That is another impact of the pandemic and geopolitical challenges. Changes to how we live and work no longer seem remote or fanciful. We are living them.

Canada

David C Kruse, Jill M Lawrie, Holly Reid and Linc Rogers

Blake, Cassels & Graydon LLP

OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry is one of Canada's largest manufacturing sectors and accounts for 11 per cent of North American vehicle production (1.9 million vehicles per year). For foreign investors in this sector, Canada offers a strategic location in the heart of one of the world's largest and most lucrative automotive markets. There are 37 high-volume assembly plants within a 500km radius of the Windsor–Detroit border. These plants have produced up to 7.4 million vehicles in one year.

Canada has one of the lowest cost structures among advanced economies, with the lowest cost structure among G7 countries and an overall cost advantage of 8.2 per cent over the US in the automotive sector. According to a KPMG study, automotive parts operations based in Canada typically enjoy an 11.2 per cent labour cost advantage compared to their US-based counterparts.

2021 was a time for continued change in the industry in Canada, the most significant of which is a push to assemble electric cars in Ontario. In October 2020, Ford Motor Company of Canada (Ford) reached a transformative and industry-leading deal with the labour force and all levels of government. The province of Ontario announced that it was matching the federal government's investment of C$295-million to help retool the Ford Oakville Assembly Complex into a global hub for battery electric vehicle production. The C$1.8-billion in funds committed by Ford and various levels of government is one of the most significant investments in the sector in Ontario, preceding a series of large investments announced by other major manufacturers.

The long-term impact of the covid-19 pandemic and the effect of related work stoppages remains unclear. Prior to the outbreak of covid-19, Canada's automotive manufacturing sector directly employed over 134,000 workers, accounted for over 8 per cent of manufacturing GDP and currently generates revenues of C$103 billion according to Statistics Canada. Passenger and commercial vehicle assembly plants in Canada employ over 38,000 workers with 2.1 million units of installed capacity. Original equipment manufacturers (OEMs) such as Ford, Fiat Chrysler, General Motors, Toyota and Honda each have assembly operations in Canada employing thousands of people. Typically, about 92 per cent of the vehicles assembled in Canada are exported. The automotive supply sector in Canada consists of some 615 companies, 815 facilities, over 74,000 employees and over C$36 billion in annual shipments, 53 per cent of which is exported. The manufacturing sector is facing some headwinds owing to trade concerns and the availability of inexpensive labour in other markets. However, it is hoped that the Canada–United States–Mexico Agreement, the replacement for the North American Free Trade Agreement that came into force on 1 July 2020, will help to stabilise the market.

Most of the OEM assembly plants and parts manufacturing facilities are located in Southwestern Ontario where 92 per cent of shipments are made. Ontario is the top ranked vehicle assembly jurisdiction in North America, doubling the number of JD Power Plant Quality Awards of any other region in the past 20 years. In addition, Ontario is home to many of the world's leading parts suppliers including large Tier I manufacturers, such as Magna, Linamar, Stackpole and Martinrea.

The Ontario region also includes a growing technology hub (second only to California) in close proximity to Toronto and the University of Waterloo. The cluster of fast-growing technology companies are within easy driving distance to 37 light vehicle assembly plants producing 6.1 million vehicles on both sides of the Canada–US border. This colocation is important, as communications technology plays an increasingly key role in the development of connected and autonomous vehicles. There are 24 colleges and 11 universities in Ontario offering auto-related research initiatives and training programmes. Further, over 200 companies, including GM, Ford, Google, Uber, Apple and BlackBerry QNX, are developing connected and autonomous vehicles technologies in Ontario.

The Canadian automotive manufacturing industry has grown strongly in value and volume in recent years following decline in 2009. In past years, trucks have had the highest volume in the Canadian automotive manufacturing industry with total sales of 58 per cent of overall volume.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Federal and provincial levels of government share the responsibility for motor vehicle safety oversight. The federal government is responsible for the safety standards for new and imported vehicles of prescribed classes, tyres and equipment for use in the restraint of children and disabled persons. The provinces are responsible for driver licensing, vehicle registration and operational use.

Federal

The Minister of Transport (Transport Canada) has the responsibility for the administration and enforcement of the Motor Vehicle Safety Act (MVSA). The MVSA applies to companies that manufacture regulated vehicles or vehicle equipment in Canada, companies that distribute vehicles or equipment obtained from those manufacturers to other persons for the purpose of resale, importers of regulated vehicles or equipment into Canada for the purpose of sale, and persons who import regulated vehicles previously sold at the retail level in the United States. The MVSA also regulates the temporary importation of non-compliant vehicles and equipment.

Provincial

Each provincial government oversees various aspects of transportation in its respective province, including the establishment and maintenance of the provincial highway system, the licensing and training of vehicles and drivers and the policing of provincial roads. For example, in Ontario, the Ministry of Transportation has the responsibility for the administration and enforcement of the Highway Traffic Act (HTA), which regulates the licensing of vehicles, classification of traffic offences, administration of loads, classification of vehicles and other transport-related issues. The provinces also regulate automobile insurance.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

OEMs and supply chain

OEMs operating in Canada use terms and conditions for contracting with parts suppliers. These terms and conditions are generally based on each OEM's global standards. The OEMs resist any variance from their standard terms and conditions.

The supply chain is segregated into distinct tiers. For example, in a three-tier supply chain, the Tier I supplier sells a finished assembly product directly to an OEM. The Tier II supplier, however, sells its parts, which would reflect some value-added labour and minor sub assembly, to the Tier I supplier for use in the production of its components. The Tier III supplier will sell engineered raw materials, such as rolls of sheet steel, to the Tier II supplier. It is not uncommon for suppliers to straddle more than one tier. For example, a supplier may be a Tier I and Tier II supplier, selling some parts directly to an OEM and other parts to other Tier I suppliers.

In the Canadian automotive industry, just-in-time inventory and purchase orders containing little or no long-term purchase obligations are common.

Distribution and retail

Automotive companies typically contract with distributors and dealers to sell their vehicles, parts and accessories. The substantial majority of these distributors and dealerships are independently owned and the relationship with the distributor or dealer is governed by a written contract.

Automobiles are subject to various consumer protections. There is no 'cooling-off period' in Canada for motor vehicle contracts, so the consumer must be sure of his or her decision before signing the contract. In most cases, the contract will be binding. When a consumer buys a vehicle, the dealer must provide the most accurate information available about the vehicle's history and key features. If the dealer omits certain information, the buyer will have 90 days to cancel the contract. Additional consumer protections apply when the purchase of the vehicle is financed, which is often the case.

The Canadian Motor Vehicle Arbitration Plan (CAMVAP) is a free arbitration programme from participating manufacturers. Vehicle dealers must let the buyer know if the car being purchased qualifies for this programme. If it does, the programme can assist the consumer in dealing with disputes about manufacturing defects.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Agents and distributors

A foreign automotive company may wish to offer its products or services in Canada by means of an independent agent or distributor. An agent will usually be given limited authority to solicit orders for acceptance at the foreign head office, and will not normally take title to the goods or provide services to the customer. A distributor, on the other hand, usually takes title to the goods and offers them for resale, either directly to the customer or through dealers or retailers.

The relationship with an agent or distributor should be established by contract. Although provincial law does not generally prohibit the termination of an agent or distributor, the courts will require reasonable notice to be given, or damages in place of notice, in the absence of an agreed contractual term for the relationship. The nature of the relationship determines whether the arrangements are subject to franchise legislation.

Distribution and dealers

Distributors and dealerships, which are most often independently owned, are the most common intermediaries between automotive companies and the retail consumer and fleet markets. Dealerships primarily deal parts and accessories to retail consumers while authorised parts distributors primarily distribute parts and accessories to retailers. All provincial governments have some form of legislation regulating motor vehicle dealers. The nature of this legislation varies from province to province, as do its scope and comprehensiveness. The general aim of legislation concerning motor vehicle dealers is to regulate the trade in a valuable and dangerous commodity that is susceptible to theft and raises consumer protection issues, and to provide a compensation system in the event of a motor vehicle dealer's misconduct.

Importers

With certain exceptions, all types of vehicles that Canadians import which are designed to be driven on public roads, and those designed for off-road use, must comply with the MVSA. Once modified (other than having general repairs or routine maintenance), the vehicle no longer maintains its original factory-issued certification. This certification is required for importation into Canada. Importing an electric or hybrid vehicle is no different from importing any other type of vehicle. The MVSA does not regulate shipments of individual parts, with the exception of tyres, child car seats and booster seats.

Franchising

Franchising is not as heavily regulated in Canada as it is in a number of other jurisdictions. In Canada, franchising is a purely provincial matter. About half of the provinces currently have franchise legislation in effect. While there are slight differences in the legislation and regulatory requirements of each province, they are all derived ultimately from the US model of mandated disclosure by a franchisor to prospective franchisees, coupled with a duty of good faith and fair dealing owed by each party to the other, and a right of franchisees to associate freely among themselves.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

M&A

As in any other industry, a threshold question in any automotive acquisition is whether to purchase shares or assets. In addition to the usual considerations, a purchaser and vendor of an OEM or parts manufacturer may want to proceed by way of share purchase to avoid the right of members of the dealer network to consent to the assignment of the dealership agreements.

In the case of an acquisition of a large OEM or parts manufacturer, regulatory considerations are important, particularly potential pre-clearance under the Competition Act and the Investment Canada Act (ICA). In addition to such regulatory approvals, third-party consents from dealers, suppliers, landlords, equipment owners, creditors and shareholders are typical. Under most Canadian corporate statutes, if a sale involves the disposition of all or substantially all of a corporation's assets, shareholders must approve the transaction by special resolution.

Joint venture structuring

As is sometimes done in the Canadian automotive industry, two or more parties may engage in a joint venture or syndicate where they collaborate in a business venture. There is no specific statutory definition or regulatory scheme for joint ventures, at either the provincial or federal level, although they are not uncommon. A well-known Canadian example of a joint venture is a large OEM assembly plant, Canadian Automotive Manufacturing Inc (CAMI). CAMI is now owned by General Motors but commenced as a joint venture with Suzuki.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

Incentives for investment

Canadian automotive manufacturers are recognised for their strong capacity in launching complex and advanced automotive manufacturing projects due to their world-class plant and labour quality. Canadian assembly plants have won one-third of all JD Power plant quality awards in North America. The industry is highly concentrated in Ontario, with manufacturing centres also located in Quebec, Manitoba and British Columbia.

Foreign investors rely on strong supplier and research capabilities in lightweight metals, biomaterials and composites, advanced safety systems, software and the 'connected car,' alternative powertrains (electric vehicles, fuel cells, natural gas and biofuels), and vehicle safety and testing. Manufacturers that do research and development in Canada take advantage of Canada's Scientific Research and Experimental Development Tax Incentive Program.

The province of Ontario recently created the Ontario Vehicle Innovation Network (OVIN), which is intended to build on the already created Autonomous Vehicle Innovation Network. Ontario will mandate OVIN to accelerate the development of next-generation electric, connected, and autonomous vehicles and mobility technologies, as well as support the Province's role as the manufacturing hub of Canada. OVIN will be charged with encouraging innovation and collaboration through partnerships with small and medium-sized enterprises, academia, the automotive industry and the battery sector, with the goal of continuing to lead on electric and autonomous vehicle research and technologies.

Other programmes are in place at the retail level in some Canadian jurisdictions to incentivise the adoption of new technology.

Barriers to enter and new entrants

The ICA is a federal statute of broad application regulating investments in Canadian businesses by non-Canadians. Investments by non-Canadians to acquire control over existing Canadian businesses or to establish new ones are either reviewable or notifiable under the ICA. The rules relating to an acquisition of control and whether an investor is a 'Canadian' are complex and comprehensive.

Subject to certain exceptions, an acquisition of a Canadian business by a non-Canadian investor controlled by persons who are residents of World Trade Organization member countries (WTO investors) is reviewable where the enterprise value is C$1.141 billion or more. There are additional restrictions in place in respect of certain prescribed circumstances such as investments by non-WTO investors and by state-owned enterprises.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Product compliance and safety

The MVSA was recently amended to introduce broad powers for Transport Canada to order manufacturers to submit a notice of defect or noncompliance when Transport Canada considers it would be in the interest of safety. The Motor Vehicle Regulations Enforcement Branch conducts post-market surveillance and oversight of the regulated community through programmes of compliance inspection, testing, corporate audits, and the investigation of alleged safety-related defects and recall monitoring.

National Safety Marks (NSMs) are used to indicate the compliance of a vehicle or equipment with the MVSA and the related regulations and safety standards. Transport Canada authorises their use and any company that intends to use an NSM must apply to Transport Canada to obtain this authorisation.

The Canada Motor Vehicle Safety Standards (CMVSS) prescribe the minimum performance levels that vehicles and equipment must meet. Each CMVSS standard includes performance requirements against which regulated vehicles and equipment are measured and compliance determined. These standards may include Transport Canada approved Motor Vehicle Safety Test Methods, Technical Standards Documents or third-party published test methodologies.

The Defect Investigations Group has a mandate under the MVSA to investigate complaints relating to alleged manufacturing safety defects. At times these investigations may lead to safety recall campaigns or safety advisory publications.

Environmental regulations

Vehicular greenhouse gas emissions (GHG) in respect of light-duty vehicles are regulated under the federal Environmental Protection Act. In May 2018, the federal government introduced new regulations under that Act establishing more stringent greenhouse gas emission standards for heavy-duty vehicles and engines.

In 2017, a federal government agency, Environment and Climate Change Canada, released a regulatory framework outlining the proposed design of Canada's Clean Fuel Standard (Standard), which is aimed at assisting in meeting Canada's goal of lowering GHG to a target of 30 per cent below 2005 levels by 2030 as part of Canada's participation in the

Paris Agreement. The Standard will include reductions in the carbon footprint of transportation fuels and will require increases in renewable fuel content or the purchase of credits that can be generated through the deployment of energy sources that offset fossil fuels, such as electric vehicles.

Product liability and recall

8 | Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability

There are three key categories of claims typically made in the nature of product liability claims: claims against manufacturers alleging negligence in the design or manufacture of vehicles; claims against manufacturers and dealers alleging the breach of express or implied warranties of fitness and quality; and claims against manufacturers and dealers seeking consumer protection remedies based on unfair business practice provisions of consumer protection legislation or breach of the misleading advertising provisions in the federal Competition Act.

In negligence, a plaintiff may recover for bodily injury or property damage (and in some specific circumstances, economic loss) if the plaintiff can establish a duty of care, a breach of the applicable standard of care, and damages caused by the alleged breach. These claims typically assert negligence in design, manufacture or failure to warn potential users of the product's inherent dangers.

A party to a purchase or supply contract is entitled to sue for damages for breach of contract or breach of an express warranty, or both, if the product does not comply with express contractual or warranty terms. In some jurisdictions, legislation imposes implied warranties regarding the fitness and quality of the automotive products sold. This legislation commonly prohibits exclusion of these statutory warranties and conditions from contracts for the sale of products to consumers. In some jurisdictions, legislation implies statutory warranties in favour of consumers by manufacturers and others in the distribution chain in certain circumstances, even in the absence of contractual privity.

The federal Competition Act provides a civil right of action for damages caused by misleading advertising in specific circumstances.

Some provincial jurisdictions provide remedies to consumers against automotive dealers, manufacturers or distributors for 'unfair practices', including the making of false, misleading or deceptive representations. Provincial consumer protection legislation may provide consumers with relaxed criteria for recovery.

Class actions

It is not uncommon for a class action alleging negligence and breach of express or implied warranties to follow a product recall. Class actions seeking consumer protection remedies are also common. To date, many class actions have been certified but relatively few class actions have proceeded to trial in Canada (outside Quebec), though this number has increased in recent years. It remains to be seen whether the availability of class actions will result in larger punitive damage awards or other changes in substantive laws.

DISPUTES

Competition enforcement

9 | What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Participants in the automotive industry must ensure compliance with Canada's Competition Act, the key legislation in Canada that regulates competition. The Competition Act includes provisions that regulate civil practices (such as mergers, refusals to deal, price maintenance, exclusive dealing, tied selling, abuse of dominance, competitor collaborations and deceptive marketing practices) and those that prohibit criminal conduct (including conspiracies, bid rigging and criminal misleading advertising practices).

Over the past few years, one of the key issues for the automotive industry has been the enforcement activity of antitrust regulators in the automotive parts sector. Specifically, numerous investigations have been launched by antitrust regulators around the world concerning alleged conspiracies and bid rigging arrangements entered into among various suppliers for the sale and supply of automotive parts. These investigations have resulted in a number of convictions and fines, including in Canada. To date, the Canadian Competition Bureau's investigations have resulted in multiple guilty pleas and over C$80 million in fines imposed by Canadian courts.

The investigations in Canada, and around the world, have led to significant follow on civil litigation in Canada. Section 36 of the Competition Act provides that any person who has suffered loss or damage arising out of conduct that contravenes the criminal provisions of the Competition Act has the right to commence a private right of action to recover the damages suffered, plus legal costs. Class actions alleging conspiracies and bid rigging arrangements relating to approximately 40 different automotive parts have been launched in British Columbia, Saskatchewan, Manitoba, Ontario and Quebec. These actions seek millions of dollars in damages from the defendants (automotive parts suppliers) on behalf of both direct purchasers of the alleged cartelised products, such as original equipment manufacturers (OEMs), and indirect purchasers, such as consumers who purchased automobiles during the proposed class period.

Dispute resolution mechanisms

10 | What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Disputes in the automotive industry generally arise in three contexts: vehicle owner or lessee claims against manufacturers, distributors and dealers, claims between OEMs and their dealer networks, and claims involving OEMs and their suppliers.

Vehicle owner and lessee claims

In Canada, automotive owner or lessee claims take many forms including class action civil suits by one or more plaintiffs seeking to represent a class of owners or lessees of vehicles. These representative plaintiffs commence a civil action alleging a class-wide product defect in the manufacture or design of a vehicle model or some specific part of a vehicle or alleging breaches of consumer protection legislation provisions implying warranties or prohibiting 'false', 'misleading' or 'deceptive' practices. These claims seek compensation or other relief against manufacturers or distributors, or both, on behalf of the entire class. In Canada, product liability class actions will often be commenced in concert with similar proceedings in the US and, increasingly, recalls of vehicles in the industry will lead to class action proceedings where

a plaintiff is seeking additional economic loss damages that extend beyond the repairs called for in the recall notice.

In addition, the courts deal with many individual personal injury or property damage civil suits alleging that a product defect caused damage, usually personal injury or property damage. Another source of litigation is individual warranty claims in which vehicle owners or lessees allege defects in the manufacture of a vehicle that are not adequately repaired by a manufacturer under warranty. For these disputes, owners or lessees may seek binding arbitration under the CAMVAP, an arbitral process set up by participating Canadian manufacturers, which is available at no charge to consumers and can be accessed by consumers in all provinces and territories in Canada.

OEM/dealer claims

In provinces where franchise laws apply, duties of good faith and fair dealing are imposed by statute on the OEM and on the dealer. Some disputes between manufacturers and dealers in the automotive industry are determined in the courts, but most are not because roughly 90 per cent of Canada's automobile dealers have agreed to participate with their manufacturers in a nationwide mediation and arbitration plan called the National Automobile Dealer Arbitration Program.

OEM/supplier claims

Disputes between OEMs and their suppliers can be determined in court proceedings in Canada, but most supplier agreements will include mandatory mediation and arbitration clauses that require that disputes be determined by way of private alternative dispute mechanisms. The exception is when suppliers are added as third parties to ongoing court proceedings involving product liability and product quality claims made by consumers against OEMs. Increasingly, manufacturers are pursuing suppliers in claims for contribution and indemnity in the context of product liability and product quality class action proceedings as well as other civil product liability proceedings.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

The statute of choice for the restructuring of an insolvent company of any size or complexity is the Companies' Creditors Arrangement Act (Canada) (CCAA). The CCAA is federal legislation and the functional equivalent to Chapter 11 of the US Bankruptcy Code, although there are some important technical differences. Generally, to qualify as an applicant under the CCAA, a debtor company (or the corporate group of which it is a part) must be insolvent and have in excess of C$5 million in debt. The CCAA allows for wide judicial discretion and relief can largely be tailored to fit the specific needs of a particular case.

A supplier subject to CCAA protection can seek to either to sell its assets and business through a court-approved process or restructure its business and affairs through a plan of compromise and arrangement. If the court is satisfied that certain commercially reasonable steps have been taken to obtain the highest and best price for a supplier business and assets, the court can approve a sale free and clear of any liens and encumbrances, without any creditor vote. If the distressed wishes to pursue a plan to, for example, rationalise its balance sheet, the plan must be passed by each class of creditors to whom the plan is made, by a majority of voting creditors representing two-thirds of voting claims, in each affected class.

Generally, a Canadian court cannot order a supplier to a debtor company to advance 'further credit' following the CCAA filing. Suppliers are entitled to payment on delivery. Also, if a party is not under a continuing legal obligation to supply or provide services, it cannot be compelled to supply the debtor following the filing, even if the debtor is prepared to pay on a cash on delivery basis. Thus, in certain circumstances, the court may authorise the payment of 'prefiling debt' to critical vendors to induce them to continue the provision of goods or services to the debtor during the restructuring. One exception to this rule is if a supplier is deemed to be a critical supplier. If certain criteria are met, the court can order the critical supplier to continue to supply on credit, provided the supplier is granted a charge on the assets of the debtor company to secure payment.

In the case of an insolvency of an automotive parts supplier, a large proportion of these critical supplier payments are made to tooling vendors. The Tier I and Tier II suppliers will often act as a general contractor for building tools and outsource construction to specialised tool builders. As a result, critical supplier payments could be required to induce the contractor to finish or release the tools. This is of greater significance if the tools are needed for an upcoming product launch.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Automotive companies generally own their own licences to use numerous patents, copyrights and trademarks on a global basis. Automotive companies typically have policies to protect their competitive position by, among other methods, filing international patent applications to protect technology and improvements that the companies consider important to the development of their business, including the filing of patents under the Canadian Patent Act.

Non-practising entities, more commonly referred to as 'patent trolls,' are a large issue in Canada. This is increasingly so in the automotive industry given the proliferation of communications technology in automobiles. Patent trolls typically acquire patent rights that are perceived to be infringed by the industry at large. Since the cost of patent litigation can be in the millions of dollars, patent trolls often propose a quick settlement that is less than the potential cost of litigation. A sophisticated intellectual property strategy – namely, having strong intellectual property protections in place – can minimise the effect of patent trolls.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

With certain notable exceptions, most hourly workers in the Canadian automotive manufacturing sector are unionised. Unionised workers are covered by collective bargaining agreements, which are negotiated by the original equipment manufacturer and parts manufacturers periodically with various unions. Many automotive manufacturing workers are members of large unions such as Unifor (resulting from the 2013 merger of the Canadian Auto Workers Union and the Communications, Energy and Paperworkers Union of Canada, currently with over 300,000 members).

Collective bargaining agreements provide guaranteed wage and benefit levels and provide members with a significant level of job security. Unions have often negotiated with automotive companies in Canada for defined benefit pension plans and other benefits and perquisites that have significant employer costs. Unionisation and the terms of collective bargaining agreements may restrict the ability of automotive companies to close plants, divest businesses and outsource functions. Employment

of unionised employees generally transfers automatically on the sale of a business, as the purchaser remains bound by the terms of the collective bargaining agreement in place at the time of the sale.

Aside from unionisation of automotive workers, Canadian employment law is unique. Unlike in some other jurisdictions, there is no 'at-will' employment in Canada. Absent valid contractual provisions limiting the employee's termination entitlements to minimum statutory amounts, non-union employees are entitled to 'reasonable notice' of termination or payment in lieu of such notice. Termination entitlements for employees tend to be much higher in Canada than in other jurisdictions. Also, on an asset transaction, the employment of non-unionised employees does not transfer automatically, other than in the province of Quebec. Employees must be offered and accept employment with the purchaser. The defined benefit and defined contribution pension plans that are maintained by many Canadian employers to supplement the federal Canada Pension Plan may be subject to various federal and provincial legislation. Relevant to the acquisition of a Canadian automotive business, these rules govern such things as recognition of an employee's past service and transfers of plan assets.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

Driving and safety are regulated in Canada by the provincial governments. Automated vehicles (AVs) equipped with Society of Automotive Engineers' (SAE) international driving automation Level 3 may now be legal driven on roadways in Canada's two most populous provinces, Ontario and Quebec. In addition, both provinces have pilot projects in place to permit limited use of SAE international automation Level 4 and 5 AVs. Other provinces, such as British Columbia, Alberta, Saskatchewan, Manitoba and Nova Scotia have some legislation at the provincial or municipal level allowing for the driving of some AVs.

Ontario also has a separate pilot programme for cooperative truck platooning. A cooperative truck platoon means two or more commercial motor vehicles that use an advanced driver assistance system and vehicle-to-vehicle communication system to travel in a convoy where the vehicles steer, accelerate and brake cooperatively and synchronously.

At the federal level, Transport Canada is engaged in several initiatives relating to the safety and testing of automated and connected vehicles and published the following two documents in February 2019: Canada's Safety Framework for Automated and Connected Vehicles; and Safety Assessment for Automated Driving Systems in Canada. These new reports complement work outlined in two other recently published documents: Automated and Connected Vehicles Policy Framework for Canada (released in January 2019 by the Council of Ministers Responsible for Transportation and Highway Safety), and Testing Highly Automated Vehicles in Canada: Guidelines for Trial Organizations (released in June 2018 by Transport Canada).

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Cybersecurity protection has been a major area of concern for the automotive sector. The threat is particularly meaningful to the manufacturers of autonomous vehicles as the sensors in those vehicles collect vast amounts of sensitive data about the vehicles and the people in them. It is recommended that companies have an information technology security policy, data governance framework and cybersecurity incident response policy in place, that employees receive appropriate training and that insurance coverage is obtained.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

China is one of the world's largest automotive market and vehicle manufacturing countries. The total vehicle output and sales volume of China in 2021 respectively reached 26.08 million and 26.27 million units. The automotive industry sector, by involving over 100 sub-industry sectors, has become a pillar industry in China given its contribution to the GDP growth, and has been recognised with economic and strategic significance.

Since its accession to the World Trade Organization in 2001, China has experienced unprecedented growth in its automotive industry and market. With steady improvements in product quality, the growth of Chinese automotive brands compounded and these brands have tapped into the international market. Chinese brands have also gained an increasing edge in segmented markets such as commercial vehicles and sport utility vehicles. China has also made significant strides in the field of new-energy vehicles (NEVs) during recent years. There is little doubt that China's automotive market has matured but not necessarily levelled off. Market demand will continue to outpace other consumer markets, especially for the NEVs, given the Chinese government's policy of having 40 per cent of the vehicle growth to be powered by new energy by 2030, and taking petrol cars off the market gradually potentially starting from 2030.

The following trends have been observed based on consumer or customer behaviour and are likely to indicate the future direction of the automotive industry of China.

- It is generally believed that China will sustain a continuous economic growth in the mid-length terms. The decline in production and sales since the outbreak of covid-19 had been contained and the market rebounded with economic stimulus. For 2022, the economic growth of China is forecast at around 5 per cent despite the domestic and international uncertainties.
- Rapid urbanisation, rising family incomes, desire for vehicle ownership, consumption upgrading and increased mileage capacity and accessibility of recharging infrastructures for electric vehicles, will all contribute to the growth, and the preference, of new buyers. Chinese consumers will have a bigger appetite for luxury, roomier and greener models.
- Chinese consumers are valuing more on vehicle safety, accessories and value-added functions, and fuel economy (in the case of fossil fuel cars) or mileage capacity (in the case of NEVs). Affordability at the cost of the above will be much lower than the norm for automotive manufacturers.
- Consumption of NEVs is expected to grow more quickly than other developed markets due to various causes. Carbon emissions and the environmental crisis have been under the spotlight and the Chinese government has committed to achieve carbon neutral by 2060. China's crude oil import has also been skyrocketing for decades. In an effort to reduce carbon emissions and the dependence on fossil fuels, the Chinese government has put forward a series of stimuli to promote the production and consumption of NEVs, such as providing subsidies for NEVs manufacturers, offering tax exemptions for the purchase of NEVs by consumers (such tax exemptions are expected to expire by the end of 2022, however) and setting up 'green channels' for the application of licence plates for NEVs in certain major cities where issuance of licence plates is managed under a rigid quota system.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

China's automotive manufacturing sector is, in general, heavily regulated. Nevertheless, the Chinese government has in recent years put some efforts into streamlining its various administrative approval procedures for foreign investment in this sector. One example is that, since the promulgation by the National Development and Reform Commission of China (NDRC) of the new Provisions on Administration of Investment in Automotive Industry, which entered into force on 10 January 2019, building a new automotive manufacturing plant (including the building of a new sedan plant by a Chinese-foreign equity joint venture) no longer requires the approval of the NDRC or the State Council of China (in the case of a Chinese-foreign equity joint venture sedan plant), but only needs the record-filing with the NDRC's local or provincial counterpart. Another example is that after the Foreign Investment Law came into effect since 1 January 2020, foreign direct investments in all industry sectors (unless being a prohibited sector) no longer need to be either filed with or approved by the Ministry of Commerce of China (MOFCOM). That said, foreign direct investment in the automotive manufacturing sector no longer needs to go through any approval by MOFCOM (but still is subject to all other applicable approvals and procedures), which traditionally could add several months to the overall timeline for establishing a foreign invested automotive manufacturing business.

After the automotive manufacturing plant has been established, the manufacture and each automobile model to be manufactured are then subject to a special 'access permit for automotive manufacturers and their products', which is issued and administered by the Ministry of Industry and Information Technology of China (MIIT). To qualify for a manufacturing permit, an automotive manufacturer must meet all the requirements set out by MIIT, including obtaining the venue, capital

and personnel necessary for carrying out manufacturing operations, as well as demonstrating capabilities on product design and development, product production facility, product production consistency and quality control, and product sale and post-sale service. MIIT periodically publishes a list of the manufacturers and products for which the permits have been granted.

Each vehicle model produced by manufacturers with the above-mentioned access permit must also:

- meet the relevant standards (as set out in the Items and Underlying Standards for Compulsory Standards Inspection of Automotive Products promulgated by MIIT);
- obtain the China Compulsory Certification (CCC); and
- pass inspection performed by a qualified inspection institution.

The production of automotive parts, on the other hand, follows a different licensing regime. First of all, for many types of automotive parts, a production licence issued by the State Administration for Market Regulation (SAMR) is required. Second, the automotive parts must be manufactured in accordance with the compulsory standards, known as Guobiao or GB, formulated and kept by the Standardisation Administration of China (becoming affiliated to SAMR in 2018). In addition, certain automotive parts being subject to CCC must also undergo a specific accreditation process.

As to distribution, suppliers and distributors shall register at the national automobile distribution information management system administered and maintained by MOFCOM within 90 days of the issuance of their business licence.

Further, each vehicle to be sold must be registered in accordance with the National Environmental Protection Catalogue and, where applicable, the local Environmental Protection Catalogue, which might set a higher standard for registration. The issuance of on-road permits (vehicle registration licence) and licence plates is administered by the vehicle administration office under the local Public Security Bureau (PSB) based on the Automobile Register and CCC Certification. In addition, all vehicle owners must purchase mandatory liability insurance for automobile transportation accidents before their vehicles can be registered with the PSB and lawfully allowed on the road. The base insurance premium rate and the insurance terms are uniformly set by the China Banking and Insurance Regulatory Commission. Vehicle owners are free to decide whether to purchase additional commercial property and liability insurance.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

A foreign automotive company must establish a foreign invested enterprise (for example, in the form of a limited liability company) in China to operate its business. A foreign automotive company, in general, shall not operate in China without a permanently established business presence.

There used to be restrictions on the shareholding of a foreign investor in a Chinese automotive manufacturing enterprise, such as the shareholding threshold at 50 per cent and the prohibition of investing in more than two automotive manufacturing enterprises of the same type. These restrictions have been progressively lifted since 2018 and, according to the latest version of the Special Administrative Market-entry Measures for Foreign Investment (Negative List) issued by MOFCOM in 2021 (Negative List), from 1 January 2022 on, all such restrictions are lifted. That said, as of today, there is no restriction over foreign shareholding in automotive manufacturing companies. On the other hand, there has not been any restriction on foreign investors holding equity interests in automotive part manufacturers.

Due to the aforesaid historical restrictions on shareholding, traditionally, overseas automotive manufacturers partner with large Chinese state-owned or privately owned automotive groups and establish 'Sino-foreign joint venture' companies to manufacture automobiles. Under this model, overseas automotive manufacturers – mainly from the US, Europe, Japan and South Korea – localise their brands and share in the profits with their joint venture partners.

Foreign automotive companies also establish wholly owned subsidiaries without a Chinese partner. This model is traditionally possible only for automotive parts manufacturers and import and sales companies, but is now permitted for all types of automotive manufacturers as well. One of the advantages of setting up a wholly owned subsidiary is that the foreign automotive company has full autonomy in deciding on all strategic and operational issues in relation to the subsidiary. However, because of the lack of a Chinese partner with an inside track, this can limit the wholly owned subsidiary's ability to tap into the local market and in many cases supply to the local government, which itself is a highly sought-after customer base.

There are two sources of supplies: imported and local. In the automotive parts market, foreign companies, as well as the localised foreign-invested enterprises, are the key players in technology-heavy areas such as electronic components including power steering, electronic braking, suspension systems and engine management systems, while local suppliers have a clearer advantage in less technology-driven areas, such as vehicle windows. Branded automotive manufacturers may impose certain constraints on small-scale automotive parts suppliers. Historically, for example, they were able to require these suppliers to sell parts only to their branded vehicles. Except for several large automotive parts suppliers, quite a number of local suppliers have made and sold their products to automotive manufacturers under an exclusive OEM arrangement. However, under the Automobile Sales Administration Measures enacted by MOFCOM on 1 July 2017 (Automobile Sales Measures), this practice is no longer permitted, as the Automobile Sales Measures generally prohibit automotive manufacturers from restricting or preventing automotive parts makers and importers from supplying their products to others.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Prior to the enactment of the Automobile Sales Measures and with the exception of parallel imports, car sales in China were primarily made through a branded sales and service system under the Implementing Measures for Administration of Branded Sales of Automobiles, issued in 2005. Under such a branded sales and service system, an automotive manufacturer may itself, or may authorise a sole distributor to, establish a branded sales and service network by using a unified shop name, logo or trademark. While a domestic automotive manufacturer may sell cars by itself, an overseas automotive manufacturer must establish a local presence or authorise a domestic entity to act as its sole distributor to sell cars in China. The sole distributor may further authorise several sub-dealers to engage in automobile sales and service activities. In other words, a dealer must be authorised by either the automotive manufacturer or the sole distributor to sell cars and car parts. Under this traditional regulatory frame, automotive manufacturers and their sole distributors gained more leverage in negotiating their contractual arrangements with other distributors and dealers.

The introduction of the Automobile Sales Measures in July 2017 has reshaped the automobile sales and post-sales service market of China,

by granting the distributors more freedom, therefore more leverage, in the market. Under the Automobile Sales Measures, for the first time it is possible for dealers to distribute automobiles without pre-authorisation of the automotive manufacturers under certain circumstances. It also allows dealers to purchase cars from other authorised dealers for resale and sell imported vehicles through a parallel import scheme. In addition, the Automobile Sales Measures permit the establishment of automobile post-sales service providers without in-house sales functions, which reportedly have a higher profit margin than those with an in-house automobile sales function. It was widely expected that, alongside the traditional dominant single-brand 4S store (sales, spare parts, service and survey) networks, additional automobile distribution and post-sales service channels that are relatively independent from automotive manufacturers and their sole distributors would emerge, especially in rural areas where the profit margin is typically lower and too costly for 4S store networks to cover. Nevertheless, it seems that the traditional single-brand 4S stores still play a dominant role in automobile sales. It may take longer to see the changes brought by the Automobile Sales Measures.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Mergers, acquisitions and consolidations in the automotive industry are generally encouraged by the Chinese government, to the extent such market activities enhance the overall competitiveness of the automotive industry. As the 2021 version of the Special Administrative Market-entry Measures for Foreign Investment (Negative List) taking effect from 1 January 2022 removes the last pieces of restriction on foreign shareholding in automotive manufacturing companies, more acquisitions or restructurings have occurred for the purpose of having the foreign car manufacturers gaining more shareholdings in the Chinese companies in this industry.

Merger control (antitrust) filing might still be a major concern, since many of the players in the market are global automotive makers and might have significant market share in a specific segment. Another major issue is how to protect the foreign brand or trademark when being used in China. Licensing of such brands requires careful consideration and strategy.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

The Chinese government has been providing substantial incentives to the new-energy vehicles (NEVs) sector for the past few years, which is ranged from manufacturing and purchasing subsidies, tax breaks, to legislation and policy stimulus. For instance, if an automotive manufacturer qualifies as a High and New Technology Enterprise in China, it will be granted a preferential enterprise income tax rate of 15 per cent (reduced from the regular 25 per cent) and certain R&D expenditure may be deducted from its pre-tax revenue. Also, the Amendment to the Regulations on Management of New Energy Vehicle Production Enterprises and Product Access came into effect on 1 September 2020 further lowered the entry thresholds into the NEV market by, among others, removing the requirement for the manufacturers on the design and development capacities of NEV. Moreover, there is no longer any restriction for foreign capital investors on their shareholding in automotive manufacturers, and Tesla's wholly owned Shanghai Gigafactory completed in October 2019 is a good example. Nevertheless, pursuant to a circular issued by the Ministry of Finance, the Ministry of Industry and Information Technology of China (MIIT), the Ministry of Science and Technology and the National Development and Reform Commission of China (NDRC) on 31 December 2021, the purchase subsidies for new-energy vehicles (NEVs) have been reduced by 30 per cent in 2022, and will be completely removed from the end of 2022 – however, how this will impact on manufacture end remains to be seen.

However, there are still barriers to entry into the market. On 4 June 2017, the NDRC and MIIT jointly issued the Opinions on Accomplishing the Administration of Automotive Investment Project, which provided that as a general principle, the Chinese government will not approve the establishment of any new traditional petrol and diesel vehicle manufacturer. Also, capital requirements do apply to both foreign and domestic investors, subject to the type of automotive product manufactured. For example, the total investment amount for establishing a new commercial vehicle manufacturer must be no less than 2 billion yuan, of which 800 million yuan must come from the investor's self-possessed funds. Nevertheless, high-quality, environmentally friendly and innovative products will still find their opportunities. We have seen successful cases in non-first tier local cities in China particularly, which we understand may be associated with a greater willingness of local governments to attract foreign investment. For example, in Sichuan Province, the commercial vehicle manufacturer Sichuan Hyundai Motor Co, Ltd completed its conversion from a 50:50 Sino-foreign joint venture to a wholly owned subsidiary of Hyundai Motor in January 2020, aiming to develop the hydrogen commercial vehicle market; in Anhui Province, Volkswagen took over the majority stake (75 per cent) of its joint venture with the Chinese partner Anhui Jianghuai Automobile Co, Ltd (JAC) in December 2020, planning to establish an eMobility hub, as Anhui is known to be a hotspot of NEV manufacturing. Note that, however, the Provisions on Administration of Investment in Automobile Industry, as promulgated by NDRC and came into effect from 10 January 2019, have also set forth requirements and restrictions for the establishment of NEV manufacturers, such as the requirements on capacities of design and R&D, manufacturing, and post-sales services, as well as the restriction that a new NEV factory can only be set up in a province where all existing NEV factories in that province have commenced operations with the approved production capacity, and the overall automotive production capacity in that province must be utilised at a higher rate than other local industries during the past two years.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Automobiles and automotive-related products are among the most highly regulated in the product quality or liability regime of China. China Compulsory Certification (CCC) must be secured before whole vehicles and applicable automotive parts (either domestically manufactured or imported) can be sold in the Chinese market. Under the current version of the CCC Catalogue, promulgated by the Certification and Accreditation Administration of China (CNCA) on 22 April 2020, whole vehicles including passenger cars, trucks, trailers and motorcycles, and components including tyres, vehicle windows, rear-view mirrors, safety belts, seats and door locks, all require CCC prior to sale in China. CCC-related regulations are actively enforced by the CNCA. Manufacturers securing CCC must apply CCC marks to their products

(including applicable modifications) and are subject to routine CNCA inspections once a year.

For whole vehicles, however, CCC is only the first regulatory step before entering into the market. For consumers to be able to actually drive the cars on the road, the products must also receive emissions type approvals according to the standards set by the Ministry of Ecology and Environment (formerly known as the Ministry of Environmental Protection) (MEE) as well as its local and regional counterparts. As vehicle emissions are regarded to have a major impact to its air quality, China has recently taken action to strengthen its vehicle emissions standards. From 1 July 2021, all types of motor vehicles (including heavy-duty vehicles) imported into, distributed in and registered in China must comply with the Stage VI Motor Vehicle Emissions Standards (Stage VI), replacing the previous Stage V motor vehicle emissions standards implemented in 2018. The timeline above is the national standard, while local governments have discretion to move the date forward. Several cities, such as Shanghai, Chengdu, Guangzhou and Shenzhen already enforced Stage VI in 2019.

Apart from the above, manufacturers, sellers and other parties in the distribution chain – such as the parties that provide transportation, warehouse services, and repair and maintenance to automotive products, among others – are also subject to various post-sale product quality and safety monitoring and reporting obligations pursuant to the Product Quality Law, the Consumers' Interests and Rights Protection Law, and the Civil Code. If a product is determined to contain a defect, the laws require primarily that manufacturers, or their domestic importers if the car is foreign-made, conduct a public recall, pursuant to guidelines and procedures set up in the Regulations for the Administration of Recalls of Defective Automotive Products (the Recall Regulations) effective from 1 January 2013 and the implementing rules of the Recall Regulations effective from 1 January 2016. The Recall Regulations cover both motor vehicles and trailers and apply to automobiles produced or sold within China. The requirement to recall is triggered when automotive products are determined to contain unreasonable risks endangering personal and property safety, or when the products fail to comply with mandatory national or industrial standards that safeguard personal and property safety. Under the Recall Regulations, manufacturers are also required to promptly evaluate and investigate potential defects when they become aware of them, and the State Administration for Market Regulation (SAMR) will also notify the manufacturers about potential defects when they come to its notice through reports or its own investigation. Manufacturers or operators in the distribution chain refusing to cooperate with SAMR during the defects investigation and recall process will be subject to penalties, and automotive manufacturing permits may be revoked in serious circumstances. Moreover, the Provisions on the Administration of Motor Vehicle Emissions Recalls promulgated by SAMR and MEE, effective from 1 July 2021, have extended the product recalls from safety recalls to emissions recalls as well. Similar to the Recall Regulations, motor vehicles with substandard exhaust emissions must be recalled.

Moreover, on 15 March each year (World Consumer Rights Day), SAMR publishes a report regarding product recall for safety and environmental issues. And it appears that the safety issue for new energy vehicles (NEVs) has been a major focus of SAMR in recent years. According to the report of 2021, SAMR intends to establish a NEV defect investigation mechanism driven by big data, develop an OTA (Over-the-Air Technology) big data platform for NEVs, and implement a supervisory sandbox in due course.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

The Part III Contract and the Part VII Tort Liabilities of the Civil Code, the Product Quality Law, and the Consumers' Interests and Rights Protection Law are the primary legislation setting out the bases for product liability in civil law cases, which generally are divided into contract actions and tort actions. A potential breach of contract claim exists between a consumer and the party that directly sells the automotive product to such customer. By comparison, a cause of action under torts can be asserted by anyone who has allegedly been injured by a defective product against any party in the distribution chain that allegedly caused the damage. In extremely serious product liability cases, the government may also pursue criminal charges pursuant to the Criminal Law.

The civil procedures of China recognise a 'joint action' or 'representative action', but this is substantially different from a class action under many common law jurisdictions, such as the US. A joint action allows for more than one claimant who share the same legal relationship against the defendant or defendants. The court's decisions in such cases apply only to parties acknowledging the proceedings. Moreover, we are not aware of any large-scale joint or representative action ever being brought for consumer or product liability claims.

Apart from this, the 2013 amendments to the Civil Procedure Law also allow qualified parties, such as national or provincial-level consumer interests and rights protection organisations, to represent groups of consumers in 'public interest litigations' against defendants of product defect claims. In practice, neither joint actions nor public interest actions for automotive product defects are commonly seen. Claims involving numerous consumers are primarily settled through public recall actions under the supervision of the Chinese government, or filed against manufacturers and sellers on a case-by-case basis.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

The State Administration for Market Regulation (SAMR) is empowered to exercise the antitrust-related functions that were previously exercised by the competent divisions under the National Development and Reform Commission (NDRC), Administration for Industry and Commerce and the Ministry of Commerce of China.

In terms of enforcement efforts, according to a report published by SAMR, during the period from 2016 to 2020, SAMR imposed fines in nine cases of monopoly agreements and six cases of concentration of undertakings in the automotive industry. Notably, in mid-2019, the joint venture in China of an international automotive manufacturer was fined approximately 160 million yuan by SAMR for fixing prices among its distributors; and in late 2019, an international automotive manufacturer was fined approximately 90 million Chinese yuan by SAMR for setting a minimum sales and resales price for its cars. We anticipate the antitrust enforcement actions will continue to promote the antitrust authority's active initiative and hard stance against monopolistic practices. Also, the automotive industry is likely to remain a major target under stringent scrutiny.

In terms of legislative efforts, on 4 January 2019, SAMR promulgated Antitrust Guidelines (Guidelines) for the automotive industry, which grabbed the attention of potential investors in various aspects. For instance, it offers some illumination on the demarcation of relevant markets. Compared to the 2016 draft published by NDRC, the Guidelines provide more specific explanations on how to define a relevant market according to different components in sales and after-sale services. With respect to anticompetitive agreements, it establishes a 'prohibition plus exemption' framework, meaning agreements that substantially hinder competition would be prohibited, but exemptions would be granted if they satisfy the conditions set forth in the Antitrust Law. Moreover, it stipulates a list of common types and thresholds applicable to presumed exemptions, which could have significant implications for vertical anticompetitive agreements that have been crucial but also tricky to major economic entities across the world. It is also worth noting that the Guidelines make it clear that suppliers could be determined as being dominant in after-sale markets even if it may not be the case in sale markets, and conduct would be prohibited if they fall within the three categories provided regarding the abuse of a dominant position.

It is worth noting that China is now amending its Antitrust Law for the first time since it came into force in 2008. The draft amendment was published on 23 October 2021 seeking public comments. Among other changes to the monopoly rules, the draft amendment significantly increases the penalties for monopoly conduct by up to 10 times.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

The majority of disputes in the automotive industry arise as a result of product liability issues and other contractual issues, such as supply chain disruptions or other commercial disputes. Parties involved usually include automotive manufacturers, suppliers, dealers, service providers, consumers and any other third parties that may suffer injuries or losses. Employment issues and intellectual property issues are also commonplace.

These disputes will be resolved by litigation or arbitration. In some major cities in China, there are arbitration or mediation centres specifically chosen by state-run industry associations or quality inspection institutions to settle automotive-related disputes, such as the automotive industry consumer arbitration centres in Shanghai, Hangzhou, Wuhan, Nanjing, Harbin and Changchun. The government also provides personnel, contract templates and expert opinions to those who need help in this area.

The 2013 amendments to the Civil Procedure Law also introduced pretrial preliminary injunctions, allowing the party who claims damages to receive injunctive relief before a judgment is rendered.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

There is no settled formula for dealing with distressed suppliers in the automotive industry in China. Practically speaking, some steps can be taken are as follows:

- negotiating and documenting a security agreement with the distressed supplier; and
- negotiating new supply agreements with prospective purchasers of the troubled supplier's business.

When suppliers are likely to become bankrupt, before the court officially accepts the bankruptcy application, the manufacturer (if unsecured) can initiate an action against the supplier for debt repayment and apply for preservation measures. In practice, the court will often ask the applicant to provide security for its application for preservation measures.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Along with the rapid expansion of China's automotive industry, the number of intellectual property (IP) disputes has also been on the rise. Both domestic and international automotive companies have acted as claimants in intellectual property disputes in past years.

China has a well-established IP protection legal framework and IP rights owners should familiarise themselves as to how the system operates. IP rights owners need to identify and register registrable IP rights where they can to beef up their IP portfolios in China and ensure enforceability of such rights. The China aspect should form a part of any international filing strategy. Trade secrets are another valuable asset in the automotive industry and both contractual and physical protective measures should be adopted. Periodical training of employees and suppliers also plays a key role in pre-empting leakage of confidential information.

China has been undergoing a series of judicial reforms in the IP disputes area. In particular, China has now established specialist IP courts in Beijing, Shanghai and Guangzhou to hear technical cases, such as disputes over patent rights and trade secrets. Further, China also established the IP court of the Supreme Court. Since 1 January 2019, appeal of certain patent-related judgments made by the Higher People's Courts, the IP courts and the intermediate courts nationwide shall be subject to the jurisdiction of the IP court of the Supreme Court. In addition, while specific performance and injunctions have generally been difficult to ascertain as legal remedies in China, Chinese courts have become more willing to grant preliminary injunctions and to exercise their discretionary powers to order defendants to substantiate their denials in some cases. We expect to see the reform resulting in greater consistency and increased predictability of case outcomes, as well as improved court efficiency.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Unlike some countries, China does not recognise independently run trade unions but rather unions (including some industry specific unions, which do not cover the auto industry) formed under the auspices of the All-China Federation of Labour Unions, a central quasi-governmental body. A union formed within an enterprise or company is, therefore, part of the All-China Federation of Labour Unions. Its formation is more top-down and less grassroots. This has important implications for automotive companies operating in China and managing their relationships with the enterprise union. While the enterprise union's goal is to advance and protect the rights of employees, it can also serve as a mediator of employee disputes and act as a conduit between management and staff. They tend to be less confrontational than trade unions in the automotive industries in other jurisdictions.

It is not possible to terminate an employee at will. Employers in China may unilaterally terminate an employment contract only under certain statutory grounds. Some of these grounds allow the employer

to terminate immediately without the need to pay severance. These grounds include, but are not limited to, where the employee is in serious breach of the labour rules and regulations of the employer or the employee commits a serious dereliction in the performance of his or her duties or commits graft causing severe damages to the employer. Other grounds allow the employer to terminate upon 30 days' notice (or 30 days' pay in lieu of notice) with the obligation to pay severance. These include circumstances when the employee is unable to fulfil his or her job obligations even after receiving training or being transferred to another position or, due to non-work related illness or injury, the employee is unable to perform his or her original work or other tasks assigned by the employer after the expiry of the statutory medical treatment period.

While the law enumerates the grounds under which an employer may terminate an employee, defending such terminations before a labour arbitration tribunal can be rather challenging. This is largely because of the pro-employee environment in China.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

In the race towards innovation in automated driving, the Chinese government has invested heavily over the years in driverless car technology and developing automated driving vehicles is a key focus in the Chinese government's automotive industrial development plan. In 2015, the Chinese government inaugurated the Made in China 2025 initiative to transform the country into an innovation hub.

Under the Medium and Long-Term Development Plan for the Automotive Industry jointly issued by the Ministry of Industry and Information Technology of China (MIIT), the National Development and Reform Commission (NDRC) and the Ministry of Science and Technology of China on 6 April 2017, it is planned that by the end of 2025, at least 80 per cent of new automobiles in China will be equipped with a driver assistance system, partial driving automation system or conditional driving automation system; and vehicles equipped with high driving automation and full driving automation systems will be launched in the market. This plan is also echoed in the Strategy for Innovative Development of Smart Automobiles issued by NDRC, to join forces with other then key Chinese government agencies on 10 February 2020, which sets specific goals in smart automobile development to be achieved in 2025.

On 27 July 2021, MIIT, the Ministry of Public Security of China (MPS) and the Ministry of Transport of China (MOT) jointly issued the Intelligent Networked Vehicle Road Test and Demonstration Application Management Specification (Trial) (Road Test Specification), which came into effect from 1 September 2021, replacing an older version issued in 2018. In addition to providing the qualifications and rules for road tests and demonstration application of automated vehicles, the Road Test Specification expands the testing and demonstration area to designated public roads, which can include highways and urban roads.

Judging from the State Council's Circular on the New-Energy Vehicle Industry Development Plan for 2021–2035 (Development Plan) promulgated on 20 October 2020 and the 14th Five-Year Plan of the Chinese government promulgated on 11 March 2021, new-energy vehicle (NEV) industry is among the top of the Chinese government's agenda. In recent years, the central government has established a comprehensive policy framework to support the NEV sector, ranging from policies on research, technology innovation, finance and tax incentives to infrastructure. For instance, the Development Plan encourages an integrated intelligent transport service, tapping into cloud computing and data collection and realising highly efficient coordination between 'people, cars, roads and clouds'. According to the Development Plan, the penetration rate of NEVs in China will increase from the current 4 per cent to 20 per cent in 2025. On 27 September 2017, MIIT, the Ministry of Commerce of China (MOFCOM), the Ministry of Finance of China, General Administration of Customs of China, as well as the Administration of Quality Supervision, Inspection and Quarantine of China (AQSIQ) (now merged into SAMR) jointly issued the Measures for the Parallel Administration of the Average Fuel Consumption and New Energy Vehicle Credits of Passenger Vehicle Enterprises (Parallel Credits Measures), which came into effect on 1 April 2018, and was newly amended on 15 June 2020. Under the Parallel Credit Measures, if a passenger vehicle enterprise manufactures or imports more than 30,000 (inclusive) traditional energy powered (eg, gasoline-powered) passenger vehicles annually, it will be assigned an annual NEV credit target. This target can be met by a passenger vehicle enterprise by manufacturing NEVs to obtain NEV credits or purchasing NEV credits generated by other enterprises under a quota trading scheme. In the meantime, traditional energy powered vehicle manufacturers and large-scale importers will also be assigned an annual average fuel consumption credit target. Automotive manufacturers and importers are required to stay under that target in terms of the average volume of fuel consumption generated by the traditional energy powered vehicles they manufacture and import into China. With a view to incentivising auto makers and importers to shift their focus to NEVs, the aforesaid NEV credits obtained by them can be used to offset against actual average fuel consumption credits, so as to help the relevant enterprises to achieve their average fuel consumption credit targets. With the positive and negative incentives provided under the Parallel Credit Measures, it is predicted that the NEV industry of China will soar.

Car-sharing businesses have experienced explosive growth in China. To regulate such businesses, the MOT, MIIT, MOFCOM, the former AQSIQ, MPS the SAMR and Cyberspace Administration of China (CAC) jointly issued the Interim Measures for the Administration of Online Taxi

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Booking Business Operations and Services (Online Taxi Measures) on 27 July 2016 (amended on 28 December 2019). The Online Taxi Measures set out the licensing requirements for online taxi-booking business platforms and vehicles and drivers engaging in car-sharing businesses. The Online Taxi Measures also provide that the local transport authority in each city may impose additional criteria when issuing licences to vehicles and the drivers engaging in car-sharing businesses. While the Online Taxi Measures legitimise the car-sharing business in China, many find that the requirements under the relevant implementing rules of the Online Taxi Measures in certain cities are difficult to satisfy, suggesting that legitimacy does not necessarily mean easy entry.

Moreover, there has been progress in the field of data protection legislation in China in the past year of 2021. Along with the Data Security Law (effective from 1 September 2021) and the Personal Information Protection Law (effective from 1 November 2021), NDRC, MIIT, MPS, MOT and CAC jointly promulgated the Provisions on Automotive Data Security Management (Trail), which was the first data protection regulation targeted at the automotive industry and came into effect on 1 October 2021. The regulation was promulgated in the context of intensive regulatory and enforcement actions aimed to tighten cybersecurity and data protection in the automotive industry. It applies to an extensive variety of players in the industry and a broad scope of automotive data, and may reshape the product design as regards the underlying approach to automotive data. We expect this regulation, together with the Data Security Law and Personal Information Protection Law, will pose a compliance challenge for companies operating in the automotive and transport industries in China, especially as regards the data localisation and cross-border data transfer and sharing that the foreign car manufacturers will usually encounter and need to deal with on their day-to-day operations.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

China is amending the 14-year-old Antitrust Law for the first time since it came into force in 2008. The draft amendment has been published on 23 October 2021 seeking public comments. The draft amendment includes 70 articles, 12 more articles compared to the current Antitrust Law, covering regulations on monopoly agreements, abuse of dominant market position, merger control, administrative monopoly as well as legal liabilities. The most significant amendment lies in the monetary penalties for monopoly conduct, which have significantly increased up to tenfold, and are expanded to liabilities of individuals (such as CEOs). It is expected the new Antitrust Law may be released in 2022 and affect the commercial activities of the automotive market.

France

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

France is a major automotive market. Original equipment manufacturers (OEMs) and the entire automotive and mobility industry play a significant role in the French economy due to the impact of intermediate consumption, distribution and car-related services and production along the supply chain. Nearly 4,000 industrial companies make up the French automotive sector, with over 400,000 direct employees in France, and 2.3 million people employed in related activities. Estimates of global turnover of this sector are in the region of €155 billion.

For several years before the covid-19 breakout, French automotive manufacturers have achieved growth and a substantial increase in production volumes. Production levels in 2017 exceeded by nearly 30 per cent that of 2007. In 2019, the number of registrations of passenger vehicles rose by 1.9 per cent, reaching 2.2 million new passenger vehicles. Around 80 per cent of the production of French manufacturers is sold abroad.

The covid-19 pandemic and the invasion of Ukraine have very seriously affected the French automotive market. Sales and registrations of new vehicles in France have dropped since the beginning of 2020 (eg, a decrease of more than 25 per cent for new registrations of passenger vehicles compared to 2019). In the current context, registrations continue to decline, with an 18 per cent decrease in January 2022 compared to January 2021.

Also, nowadays, diesel vehicles face a long-lasting downward trend in France. In January 2022, the registrations of diesel vehicles represented only 18,3 per cent of newly registered passenger vehicles versus 70.8 per cent in 2010, 57 per cent in 2015 and 31 per cent in 2020. Conversely, the registration of electric passenger vehicles significantly rose in 2020, reaching 110,912 new vehicles (compared with 42,764 in 2019). Electric and hybrid passenger vehicles represented more than 21 per cent of all registrations of passenger vehicles in 2020 (compared with less than 8 per cent in 2019).

The French automotive industry is constantly making efforts to increase competitiveness, in particular through high pressure to mitigate costs at every level, as well as strong investment in research and development (with spending in excess of €5 billion on a yearly basis).

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The regulatory framework applicable in France is based on European legislation.

Approval legal and regulatory framework

Vehicle approval is regulated by Regulation (EU) 2018/858 of 30 May 2018, establishing a framework for the approval of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles, which entered into force in September 2020. The majority of the provisions of the Regulation was already implemented into French law by a Decree dated 30 April 2009, according to the Directive 2007/46/EC of 5 September 2007, which is now replaced by the Regulation (EU) 2018/858.

The Regulation contains administrative provisions and general technical requirements for the approval of all new vehicles falling under its scope and of the systems, components and separate technical units intended for those new vehicles, with a view to facilitating their registration, sale and entry into service within the European Union.

Article 13 of the Regulation provides that it is the car manufacturer's responsibility to ensure compliance with the type-approval process, as well as to ensure the conformity of production of the vehicle. This is the case whether or not the manufacturer has produced all the technical components of the vehicle. This Regulation is 'implemented' under French regulatory framework by Decree No. 2009-497 of 30 April 2009 as amended and several Ministerial Orders, in particular Ministerial Order of 18 February 2022 amending Ministerial Order of 11 January 2021 on approval of motor vehicles and their trailers and systems and equipment for these vehicles within the scope of the Regulation. Vehicles for which (1) type approval is not mandatory or harmonised under Regulation (EU) 2018/858 of 30 May 2018 Regulation (EU) 167/2013 on agricultural or forestry tractors or Regulation (EU) 168/2013 on quadricycles, or (2) do not fall into any of the internationally recognised categories, must comply with the Ministerial Order dated 19 July 1954. In any case, the scope of the French approval framework does not specifically differentiate between testing and 'normal-use' scenarios.

European Regulation (EC) 715/2007 as amended by Regulation (EU) 2018/858 and Regulation (EU) 2017/1151 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) further establish harmonised requirements for the type-approval process in terms of emissions. The Regulation also establishes rules for in-service conformity, durability of emission

control devices, onboard diagnostic systems and measurement of fuel consumption.

The manufacturer has the obligation, pursuant to article 4 of the Regulation (EC) 715/2007, to prove that all vehicles placed on the European market are type-approved in compliance with the said Regulation. Notably, car manufacturers must demonstrate that they meet all emission limits as set out in Annex I.

European Regulation (EC) 661/2009 concerning type-approval requirements for the general safety of motor vehicles, their trailers and systems, components and separate technical units intended therefor, on the other hand, aims to ensure a high level of road safety throughout the EU.

Pursuant to article 5 of the Regulation, car manufacturers have to ensure that their vehicles are manufactured 'to minimise the risk of injury to vehicle occupants and other road users'.

The above-mentioned Regulations further provide that the national authorities of EU member states can grant the EC type approval once the concerned vehicles comply with the applicable Regulations. In France, it is the Ministry of Transport, pursuant to article R 321-9 of the French Highway Code that grants type approvals to vehicles that comply with the above-mentioned European Regulations.

A new Regulation (EU) 2019/2144 complementing and amending Regulation (EU) 2018/858 will apply from 6 July 2022 and will apply to vehicles of categories M, N and O, as defined in article 4 of Regulation (EU) 2018/858, and to systems, components and separate technical units designed and constructed for such vehicles. This Regulation introduces advanced safety systems offering new possibilities to reduce casualties repealing the above-mentioned Regulation (EC) 661/2009 on road safety.

The Commission Implementing Regulation (EU) 2021/535 under the General Safety Regulation of 21 March 2021, lays down rules for the application of Regulation (EU) 2019/2144 as regards uniform procedures and technical specifications for the type-approval of vehicles, and of systems, components and separate technical units intended for such vehicles, as regards their general construction characteristics and safety. This Regulation provides for uniform procedures and technical specifications for EU type-approval of vehicles of categories M, N and O, as well as of systems, components and separate technical units in accordance with articles 4(7), 8(3), and 10(3) of Regulation (EU) 2019/2144.

Registration requirements

The registration of a vehicle is an obligation for all owners of motor vehicles pursuant to articles R 322-1 et seq of the French Highway Code.

However, pursuant to article R 321-11 of the French Highway Code, the registration of the vehicle can only succeed if the vehicle has been type-approved by the authorities.

Publicity requirement

According to the Climate and Resilience Act of 22 August 2021, manufacturers are required to include on their vehicle advertisements on the level of carbon dioxide emissions of the models promoted via a CO2 label on a gradient of seven 'classes' (ranging from A to G).

In addition, under article 75 of the Law on Orientation of Mobilities (LOM) dated December 2019, manufacturers have the obligation promote active mobility, carpooling and public transport via statements to be inserted systematically in their advertisements, defined by the Ministerial Order of 28 December 2021.

A penalty system is applicable from1 June 2022, in case of non-compliance with the above requirements.

Insurance requirements

European Directive 2009/103/EC of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability repealed and consolidated the five previous Directives on this matter: Directive 72/166/EEC, Directive 84/5/EEC, Directive 90/232/EEC, Directive 2000/26/EC and Directive 2005/14/EC.

The provisions of the consolidated Directive are essentially transposed in the French Insurance Code under article L 211-1 et seq and article R 211-2 et seq. Pursuant to these provisions, car owners have an obligation to insure their vehicles.

Insuring motor vehicles is not an obligation devolved on manufacturers but on the owners of vehicles.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Design is usually done internally, except for some niche vehicles where manufacturers use freelance designers. In some very rare cases, the development – including vehicle design, manufacture and supply – can be entirely outsourced.

Development of collaboration agreements for connected and automated vehicles is bringing new contractual structures to the market, which go beyond usual licensing and joint development agreements. Ownership of data, data-sharing agreements and value-added supervision and support agreements for these vehicles are adding a further layer of complexity to the development, manufacture and supply arrangements in this sector (for instance, for the manufacture of sensors (eg, LiDAR), deployment of AI platforms and communication systems).

As for manufacturing, 80 per cent of the vehicle value is produced by the manufacturer's subcontractors through original equipment manufacturer (OEM) partnerships. Internal manufacturer rules require the issuing of calls for tender between the manufacturer's major partners for compliance purposes and to optimise commercial deals. Specific tooling is usually provided by the manufacturer to its OEM.

Manufacturers can also share plants or in some rare cases use local plants through cost-plus agreements.

The assembly of a vehicle is usually done internally by the manufacturer or in a joint venture abroad.

Supply logistics for vehicle spare parts is usually managed by the manufacturer using carrier services. Transport of vehicles is often done by the manufacturer's internal services.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

New vehicles are distributed by dealers, dealer networks and agents under different contractual arrangements (eg, manufacturer's subsidiary or independent owner; exclusivity or non-exclusivity). Second-hand vehicle markets are generally not under manufacturers' control. In large or major cities, manufacturers sometimes provide financial support to distributors to compensate for the high costs of rent. Importers are often referred to as independent dealers abroad in countries where manufacturers have no subsidiary.

Commercial policy is under the manufacturer's control: product, price, promotion and place.

Until 2010, vehicle distribution was excluded from the general regulation on vertical restraints and solely governed by specific exemption regulations (eg, Regulation (EC) 1400/2002). Therefore, some contracts

concluded before this date still contain provisions complying with these specific regulations.

Considering that the Commission's consultation and analysis conducted in 2008 in the vehicle distribution sector did not reveal any major competition issue, the application of a distinct regime to this sector was deemed no longer justified; it was therefore decided to align, as from June 2013, rules applicable to this sector with those applicable to vertical agreements in general, which are laid down in Regulation (EU) 330/2010 (the Vertical Block Exemption Regulation or VBER).

A specific regime was, however, maintained as regards vertical agreements related to the purchase, sale, resale of spare parts and repair and maintenance services for motor vehicles, which are governed by Regulation (EU) 461/2010 applicable since 1 June 2010. Pursuant to the latter, agreements containing the following three hardcore restrictions can never benefit from the exemption:

- restrictions on the sales of spare parts for motor vehicles by members of a selective distribution system to independent repairers;
- restrictions, agreed upon between a supplier of spare parts, repair tools or diagnostic tools or other equipment and a manufacturer of motor vehicles, on the supplier's ability to sell those goods to authorised or independent distributors or to authorised or independent repairers or end users; and
- ones agreed upon between a manufacturer of motor vehicles that uses components for the initial assembly of motor vehicles and the supplier of such components, on the supplier's ability to place its trademark or logo effectively and in an easily visible manner on the components supplied or on spare parts.

This specific regulation is supplemented by Guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles (2010/C 138/05). Regulation (EU) 461/2010 is under review since December 2018; in May 2021, the European Commission released an Evaluation Report and announced the intention to adapt distribution rules to new technologies and to the role of data. It will then decide on the future exemption regime that will apply after May 2023. Likewise, VBER is currently being reviewed by the Commission, which has published a first draft in July 2021. The automotive market is also governed by non-mandatory rules implemented by manufacturer associations' codes of good practice (ACEA at the EU level and CCFA at the state level).

Agreements with distributors are usually terminated at the end of the fixed term or freely in a non-fixed-term relationship.

Regulation 1400/2002, applicable to contracts concluded between 1 June 2010 and 31 May 2013, sets out a notice period of one to two years depending on the definite or indefinite term of the contract. Codes of good practice provide for a notice period of two years.

Compliance with legal or contractual notice periods is not always sufficient to end a relationship, especially in the case of an established relationship. To estimate the length of the notice period, other criteria must be taken into account (eg, length of the relationship, percentage of turnover, retail revenue, economic dependency).

Mergers, acquisitions and joint ventures

5 | Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no particularities other than the control of the European Commission and the Competition Authority over concentrations.

Attention should be paid to the range of products sold by the target. Indeed, should some of these products have a dual use (including military vehicles) that would trigger the need for prior authorisation by the French Ministry of Economy (quite similar to the US Committee on Foreign Investment in the United States process); this approval, if required, will become a condition to closing. It generally takes between two and three months, bearing in mind that the legislation in this area has been significantly strengthened in France as from 1 April 2020 pursuant to Decree of 31 December 2019, and further enhanced controls are due to apply until 31 December 2022(in particular with respect to listed companies). In addition, should the seller want to go through a locked-box transaction, possible variation of inventories and cash between the date of the binding offer and the date of the contemplated closing should be carefully examined by the buyer, in particular in light of major variations in valuations in the context of the covid-19 pandemic and subsequent semiconductor shortages, and more recently the invasion of Ukraine. The war has caused major disruption for both carmakers and suppliers that, in recent days, were forced to adjust their activities in both Ukraine and Russia due to component shortages. Economic sanctions imposed on Russia will also impact trade. Going forward, the legal risks that come with doing business with Russia will weigh heavily on automotive companies, especially regarding the import of aluminium, palladium and steel.

If the seller or the target has benefitted from French government support to get through the health crisis, there could be important restrictions imposed on the seller or the target of the assets concerned. Close attention should be drawn to any impact on the right of the seller to transfer the target or the assets or on the way the purchaser may operate the business post-closing as a result.

Incentives and barriers to entry

6 | Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no specific tax incentives for investment in the automotive market. General tax incentives for investors may include:

- R&D tax credit (CIR), which applies to French companies incurring R&D expenses, regardless of their activity or size. This tax credit is assessed on eligible R&D expenses (including notably salaries, social security contributions, operating costs, etc). The CIR is equal to (i) 30% for the portion of R&D expenses up to €100 million and (ii) 5 per cent of R&D expenses in excess of that threshold. It can be offset against French corporate income tax due for the year during which the R&D expenses are incurred (or refunded, subject to certain requirements);
- a new tax credit mechanism for collaborative research (CICo), available since 1 January 2022, which allows companies to benefit from a tax credit on outsourced R&D expenses, equal to 40-50 per cent (depending on the size of the enterprise). The CICo is subject to the following conditions in particular: (1) the service provider must be a specific research organisation and (2) a collaboration agreement must be concluded between the two parties before the work begins;
- the innovation tax credit (CII), which applies to French small and medium-sized innovative enterprises, is assessed on certain innovation expenses (up to €400,000 per year) at a rate of 20 per cent (30 per cent as of 1 January 2023);
- the young innovative company status (JEI), which applies to R&D small and medium-sized enterprises that meet certain criteria (eg, less than 8-11 years old). JEI can notably benefit from an exemption on (1) certain social security charges on remunerations paid to R&D staff and (2) French corporate income tax (full exemption on the first profitable fiscal year and 50 per cent exemption on the second profitable fiscal year);

- companies located in certain areas and eligible for regional aid, which are usually companies carrying out new industrial, commercial activities, may be fully exempt from French corporate income tax during their first two fiscal years and then partially exempt from French corporate income tax for the next three fiscal years.

Specific 'green' automotive incentives are available to French customers:

- an 'environmental bonus' (*bonus écologique*) for any purchaser of a new passenger vehicle with an emission rate lower than 20g of CO_2/km, for an amount of up to €6,000 for individuals and €4,000 for companies, depending on the purchase price (€7,000 and €5,000 for vans, respectively). This bonus will be gradually reduced from 1 July 2022; and
- in addition, the destruction of certain old vehicles entitles the holder to a 'conversion bonus' of up to €5,000 (€9,000 for vans) for the purchase of a vehicle with an emission rate of less than 50g of CO_2/km. The amount of the bonus depends on the income of the purchaser, the vehicle to be destroyed and the new vehicle purchased. This bonus will also be gradually reduced from 1 July 2022.

Certain automotive taxes and fees that are applicable to customers (individuals or companies) may be viewed as barriers to entry into the market:

- a registration tax levied at the time the car registration certificate is issued, which notably includes:
  - a local regional tax (from which electric and hydrogen-powered vehicles are exempt);
  - an 'environmental penalty', if the CO_2 emissions exceed a certain threshold (the maximum amount will be increased to €50,000 from 2023 for vehicles over 225g of CO_2/km). The penalty is limited to 50 per cent of the vehicle acquisition price and certain exemptions may be available; and
  - an additional 'weight tax', applicable since 1 January 2022, on vehicles over 1.8 tons. Its rate is set at €10 per excess kilo. However, the sum of the environmental and weight penalties is capped at the maximum amount of the environmental penalty (€40,000 in 2022); and
- as of 1 January 2022, several existing car taxes (of which the 'tax on company vehicles' or TVS) have been repealed. Instead, three new taxes have been introduced on vehicles used for the purpose of carrying out an economic activity: (1) for passenger vehicles, two annual taxes on CO2 emissions and atmospheric pollutant emissions; and (2) for heavy vehicles, an annual 'axle tax'.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The most relevant regulations regarding product safety and environmental issues are European Regulation (EU) 2018/858, Regulation (EU) 2019/2144, Regulation (EC) 715/2007, Regulation (EU) 2017/1151 and Regulation (EC) 661/2009.

Former Directive 2007/46/EC (repealed by Regulation (EU) 2018/858) had been implemented in the French Highway Code, which still provides that:

- if the French Ministry of Transport considers that even if compliant with the type approval Regulation, a vehicle presents a serious risk to road safety or seriously harms the environment or public health, the EC type-approval may be refused (article R. 321-9 of the French Highway Code);
- if, after the French Ministry of Transport granted EC type-approval, new tests show non-compliant results, the Ministry may take all necessary actions, including withdrawal of the type approval (article R. 321-10 of the French Highway Code); and
- more generally, manufacturers must recall all vehicles already sold, registered or put into service if the model in question presents a serious risk to road safety, public health or the environment. In addition, they have to immediately inform the authority that issued the type approval thereof (article R. 321-14-1 of the French Highway Code). The General Product Safety Directive 2001/95/EC provides general guidelines through the Commission implementing decision 2019/417 that apply to recall of type-approval vehicles.

The French Ministry in charge of transport announced in June 2020 the creation of a new entity named the Vehicles and Engines Market Surveillance Service (SSMVM) whose mission is to check that vehicles and engines placed on the French market comply with the technical requirements laid down by European and national regulations on safety, health and environment.

Governmental Ordinance No. 2020-701 dated 10 June 2020, Decree No. 2020-703 dated 10 June 2020 and an Order of the same day detail the powers and missions entrusted with this new entity. The SSMVM carries out documentary checks, tests and trials on its own initiative or following complaints. SSMVM was expected to publish annual reports summarising its activities, but no such report has been issued yet.

In the event of a finding of non-conformities, the SSMVM may order administrative fines of a maximum of €1 million per product and can decide to make public the sanctions ordered against the manufacturer. The SSMV can also other administrative measures such as recalls, suspension of marketing or destruction of the products.

Criminal penalties may also be ordered in the case of non-compliance. Article L. 329-49 of the French Highway Code notably provides that if the products have created a danger to health, safety or the environment, a criminal fine may be ordered of a maximum of 10 per cent of the average annual turnover of the manufacturer.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product laws are very significant for the automotive sector: defective cars (or parts) are a source of particularly serious risks, which can potentially lead to road accidents, severe bodily injuries and significant material losses, plus the reputational loss for the car manufacturers and their brand.

Under French product liability law, claimants bear the burden of proof to assess the product defectiveness and causation with the damage. This being said, there is a trend in French (and EU) case law making the burden of proof easier to meet for claimants by making use of presumptions.

The automotive industry is one of the areas where product recalls and maintenance campaigns are very frequent. In 2021, almost 80 recalls related to motor vehicles originating from France were registered on RAPEX (ie, the European Rapid Alert System for non-food products). This includes recalls associated with defects and environmental issues.

Many questions are currently being debated concerning potential reforms of product laws. At the European level, the Commission has taken a step towards a revision of the Product Liability Directive 85/374/

EEC with an initiative entitled 'Adapting liability rules to the digital age and circular economy', which started with the issuance of an Inception Impact Assessment. The Commission also launched a large and public consultation process with key stakeholders which ended in January 2022. The Commission's two main objectives are to modernise and adapt strict liability rules to the digital age and circular economy and reduce obstacles to getting compensation in general and with respect to innovative products. The Commission targets the adoption of a draft revised Product Liability Directive for the third quarter of 2022.

Class actions are a growing risk for automotive manufacturers in France. This procedural option was introduced into French law by the Hamon Law of 17 March 2014, which came into force on 1 October 2014 and is available to consumers who are placed in a similar situation and have suffered a financial loss resulting from material damage caused by a professional. Only a limited number of registered associations can bring class actions where consumers can opt to join after a general judgment on the defendant's liability has been made. This system cannot be used to obtain compensation for bodily injuries. Since October 2014, a limited number of class actions have been launched in France. According to information publicly available, only a few of these class actions relate to the automotive sector. However, in November 2020, one of the main French consumer associations launched a class action against a major car manufacturer as a consequence of the emission issues discovered in 2015 affecting some of its vehicles. The consumer association claims that around 900,000 French consumers should be entitled to compensation in this case.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

The European Commission has fined 14 price-fixing cartels in the automotive industry for a total amount exceeding €5 billion over the past 10 years. All these cases were initiated by leniency applications filed by suppliers, which revealed the existence of the cartel and provided the supporting evidence (and which, in return, were not fined).

In 2016 and 2017, the European Commission imposed record fines of €3.7 billion on six European truck manufacturers, including a €1 billion fine, which is the highest fine ever imposed on a single company in a cartel case. Over a period of 14 years, truck manufacturers colluded on prices and on passing on the costs of compliance with stricter emission rules imposed by an EU regulation.

The European Commission punished 13 other cartels that involved car parts manufacturers for coordinating price increases to be passed on to car manufacturers, bid rigging, allocating customers and exchanging sensitive commercial information. These practices concerned 13 categories of products: wire harnesses; alternators and starters; parking heaters; automotive bearings; thermal systems; refrigerants; braking systems; spark plugs; lighting system; occupant safety systems; flexible foam used in vehicle seats; door modules and window regulators; latches and strikers.

In July 2021, the European Commission imposed a total of €875 million fines on three car manufacturers after one of them revealed that all three companies had been colluding to limit their ambitions in reducing pollution from diesel cars.

The European Commission's decisions gave rise to numerous follow-on damage actions, in particular, in the truck manufacturers' case. The implementation in March 2017 of EU Directive 2014/104 on actions for damages under antitrust issues into French law can only encourage the development of such actions in France. In the Trucks cartel case, the Court of Justice of the European Union ruled in October 2021 that victims of an antitrust violation may seek compensation from the subsidiary of the infringing parent company.

The French Competition Authority also showed interest in automotive spare parts. It issued a detailed opinion in 2012, pointing out that spare part prices were higher in France than in Germany or in the UK and making recommendations to stimulate price competition between car manufacturers and spare parts suppliers for the supply of car parts. In this respect, France adopted in August 2021 bill No. 2021-1104 opening competition for the manufacture and distribution of visible spare parts (bumpers, lights, mirrors, etc) in the automotive sector.

The French Competition Authority also (May 2019) dismissed a claim by three repair companies against a car manufacturer after the latter refused to approve them. The repair companies claimed that this denial was discriminatory and would favour the manufacturer's authorised resellers. The French Competition Authority held that the manufacturer's decisions to refuse approval have been made on objective criteria and that the repair companies had not proven that the refusal was part of a general anticompetitive scheme implemented by the manufacturer.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Apart from competition or antitrust and intellectual property issues, most disputes in the automotive industry relate to consumer matters, supply chain issues and criminal liability allegations.

There are several grounds in French consumer law enabling a consumer to sue an automotive manufacturer, such as defective product rules (article 1245 et seq of the French Civil Code), hidden defects (article 1641 et seq of the French Civil Code), non-conformity (article L. 217-3 et seq and L. 411-1 of the French Consumer Code) and general safety obligations (article L. 421-1 et seq of the French Consumer Code).

In most cases, consumer disputes are resolved in court and settlement agreements are less frequent.

In the past, commercial disputes along the supply chain remained limited. This has changed quite drastically in recent years. In a context of shrinking margins, fiercer competition, increased likelihood of defective technology and growing remediation costs, pressure is strong on all actors that result in more frequent litigation to share the costs or recover them from another party. The causes of such issues may also lie in insolvency or bankruptcy cases.

As a result, one sees more and more frequently tensions between suppliers and original equipment manufacturers (OEMs) or Tier 1 companies, even leading sometimes to threats to stop supplying car manufacturers or to terminate the business relationships at the other end. In some situations, the dependency of an OEM in a single-source situation enables suppliers to exert higher prices for the remainder of the supply cooperation.

The covid-19 pandemic has generated a surge in supply chain litigation, with some companies trying to rely on force majeure doctrine to mitigate the consequences of the pandemic.

In addition, the current shortage of components and raw materials as well as the substantial rise in energy prices have had a strong impact on commercial relations and led to ever-increasing tensions on the market. This results in particular in forced renegotiations of contractual terms and prices, often in a contentious context, as well as commercial disputes related to an injunction to supply or abrupt termination of business relationships.

Summary proceedings are available to obtain court injunctions either in cases of urgency or when the claim cannot be seriously

challenged. Interim payments can also be sought through this type of proceedings.

Both automotive companies and their legal representatives have potential criminal liability exposure in the case of bodily injuries caused by their products (on grounds of involuntary bodily harm, manslaughter or placing someone under an immediate risk of injury or death). Corporations and legal persons may be prosecuted where the company financially benefited from the offence that one of its employees or representatives. Legal representatives can be prosecuted when there is either a manifest and deliberate violation of a specific safety rule or in the case of gross negligence causing serious danger.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

Typically, distressed suppliers do their best to avoid pre-insolvency and insolvency proceedings and may seek to obtain price increases, sometimes exerting pressure by threatening to stop or actually stopping deliveries. The customer can seek court orders in summary proceedings in an attempt to force the supplier to resume the supply and comply with orders regularly placed. Courts can also acknowledge settlement agreements, where some commercial provisions may be included regarding timing and organisation of the deliveries. Such acknowledgment increases the chances of the agreement being enforced by the distressed supplier as well as facilitating the forced enforcement of the agreement in the case of failure to comply.

If the supplier is cash-flow insolvent (or anticipates difficulties it cannot overcome), it must or may (depending on the circumstances) file for insolvency proceedings with the local commercial court. An administrator is appointed by the court and typically assists the management (but does not replace them save in specific circumstances). The administrator will often ask customers to provide support by funding the insolvency period until an investor can be found or at least to give him or her a chance of finding an investor. The administrator cannot force such support but customers do not have much choice if they don't have other supply options. This financial support often takes the format of price increases, limited in time, or in raw materials pre-payment, tooling financing, etc. All customers are usually asked to participate in the effort in proportion to their share in the volumes.

Rather than filing for insolvency, distressed suppliers can seek the opening of 'preventive proceedings'. These are not insolvency proceedings with publicity but rather confidential proceedings led by a court-appointed 'mediator' who will assist the company in its discussions with its main stakeholders (in the automotive sector it is often its main customers – often the OEMs but not only (eg, shareholders, creditors) – all bound by confidentiality to try to reach a solution to avoid formal insolvency. This tool is commonly used for financial or industrial restructurings in the automotive sector.

The public authorities are often involved in distressed supplier issues through various channels. In significant cases that involve more than 400 employees, the department of the Ministry of Economy dedicated to industrial restructurings (CIRI) will oversee the negotiations and request customers (mainly French customers) to participate in the discussions. In smaller situations, which are still important locally, local representatives of the state can be involved. Dedicated funds to support distressed suppliers in the automotive sector have been created since 2008 by the French public authorities, together with French OEMs and major Tier 1 suppliers. The state-owned bank BPI is also regularly called in to support major suppliers in the automotive sector.

The process will, therefore, depend on how distressed the supplier is and how politically sensitive the issue is (ie, how many jobs are at stake).

The current crisis faced by the automotive sector that started with the technological evolution was then accelerated with the covid-19 pandemic and now the invasion of Ukraine has already generated multiple insolvency proceedings for companies at every stage of the supply chain despite the massive economy recovery plan implemented by the French government for the automotive sector in 2020.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

There is a fair number of intellectual property disputes in France. These usually do not involve car manufacturers but rather OEMs and suppliers. The intellectual property rights most commonly relied upon in the automotive industry are patents, designs and trademarks.

Intellectual property rights in France are effectively protected. French law on intellectual property rights is the result of national statutory and regulatory provisions, statutory provisions implementing international and multilateral agreements and European regulations having a direct effect in France as a member state of the European Union. The implementation of these international rules is codified with French national substantive law in the French Intellectual Property Code.

Among other things, French law includes provisions regarding patents, trademarks, designs, trade secrets, authors' rights and database producer rights. From 1 January 2023, the scope of protection of registered designs over spare parts will be significantly reduced. Pursuant to article L. 513-6-4 of the French Intellectual Property Code, 'acts intended to give their appearance to a motor vehicle and which: (1) concern parts relating to glazing; (2) or are carried out by the equipment manufacturer who produced the original part' will no longer be considered as design infringement. The duration of the protection for the rest of the spare parts will be reduced to 10 years (instead of a maximum period of 25 years currently).

Car manufacturers and OEMs have traditionally been among the top filers of patents in France, and they also extensively use registered design rights to protect vehicle body parts. As for trademarks, in the 2021 Interbrand ranking, four trademarks designating car manufacturers are ranked among the top 20 brands worldwide (all sectors combined).

Intellectual property enforcement in France is for courts to ascertain. As regards patents as well as EU trademarks and EU designs, the Paris Civil Court (where decisions are issued between 18 and 24 months) has exclusive jurisdiction. This allows for harmonisation of case law beginning at first-instance level. Cases are decided in 12 to 18 months depending on the complexity of the matter. Decisions can be appealed before the Paris Court of Appeal, and a further appeal on legal issues is possible before the Supreme Court.

Intellectual property law in France provides for a specific means of obtaining evidence, the infringement seizure. The infringement seizure is a highly effective evidence-gathering procedure whereby an intellectual property rights holder, suspecting an infringement of its rights, applies ex parte for an order of the presiding judge of the Civil Court authorising a bailiff and possibly an independent person knowledgeable in the art to enter any premises (including those of competitors or suppliers) where evidence of the infringement could be found, to seize samples of the allegedly infringing product or to describe it. Following the infringement seizure, the claimant has to follow a strict timeline (ie, 20 working days or 31 calendar days to serve the defendant with its writ of summons).

On the merits, intellectual property rights holders will mainly seek a permanent injunction and compensatory damages. Intellectual property rights holders may choose to apply for a preliminary injunction in

summary prima facie cases before or while an infringement case is pending on the merits.

Similar evidence gathering means and remedies are available for trade secrets since July 2018, when Directive (EU) 2016/943 on the protection of undisclosed know-how and business information against their unlawful acquisition, use and disclosure was implemented in France. Alternative dispute resolution is also available in intellectual property rights infringement issues. Ad hoc mediation enables the parties to reach a settlement. Additionally, French intellectual property law now clearly states that the exclusive jurisdiction of the Paris Civil Court 'does not preclude the use of arbitration'.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

There are effectively some specific employment issues or trends that the automotive industry (original equipment manufacturers (OEMs) and car manufacturers) must be aware of.

Owing to the tense and complicated employment law climate in France, cost pressures and reduction in French production, many automotive companies in France had to negotiate forced or voluntary mass redundancy plans.

This happened to most of the OEMs' French sites, which faced a significant decrease in importance in the European market over the past 10 years.

Instead of negotiating strict mass redundancy plans, the cost of which is extremely high in France and could give rise to important disputes with terminated employees, Stellantis and Renault negotiated various voluntary departure plans with unions to cut job positions and to reach agreements with unions to restore competitiveness.

Agreements on the restoration of competitiveness have also been entered into and involve significant and tough negotiations with major French unions (CFDT, FO, CGT, CFTC and CFE-CGC) and works councils to agree on:

- voluntary departures;
- salary freezes;
- increases in working time; and
- increases in working time flexibility.

Against the backdrop of increasing tensions in the automotive market (covid-19 pandemic, shortage of components and rise in raw material prices), production stoppages have become more frequent since 2020. Long-term time-off arrangements have been negotiated at the level of the industry, but also at the level of the automakers themselves (such as Stellantis and Renault, for example), in order to have more flexibility and to be able to adapt employees' activities to market constraints. This strategy has been widely endorsed by successive French governments that recognise the role of French car manufacturers in promoting the country's international development, while preserving to a certain extent local employment and using a concerted strategy with regional authorities, unions, manufacturers, suppliers, subcontractors, distributors, service providers and research centres to maintain excellence and research and development centres in France.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

The development of autonomous vehicles and mobility as a service are certainly the biggest sources of legal questioning at the moment.

Automated and autonomous driving

At the international level, during its 81st session in Geneva from 21 to 25 September 2020, the Global Forum for Road Traffic Safety (WP.1) voted an amendment to the Vienna Convention on road traffic to favour the development of automated vehicles. On 14 January 2022, 53 United Nations member states, including France, adopted an amendment to article 34, governing autonomous vehicles, as well as a new article 34 bis to the Vienna Convention paving the way to Level 3 autonomous vehicles.

At the national level, on 3 August 2016, an Ordinance was issued authorising manufacturers to conduct tests with automated vehicles on French roads. This was a first step towards the arrival of autonomous vehicles on the French market. Since then, a Decree was issued in March 2018 to set out the authorisation regime for the testing of automated driving vehicles on public roads.

The authorisation regime is made up of two levels of authorisation: one for the testing that can cover one or several vehicles involved in the testing, and a specific registration of each vehicle involved in the testing. The testing must relate to at least (1) technical tests and development, (2) evaluation of the performance in a situation for the use for which the automated vehicle is intended or (3) public demonstration, notably during events. Authorisations will be granted for a maximum of two years but can be renewed. This testing framework is not adapted to SAE Level 5 as the presence of a driver who can operate the vehicle and take control of the vehicle at any time is required. However, the driver can be outside the vehicle. The authorisation holder must provide all the information to prove that when a driver is outside the vehicle, he or she will be ready to take control over the vehicle at all times and be able to do so.

Finally, a decree modifying the testing regime of delegated driving vehicles was adopted in December 2020 to allow, as part of a testing framework, delegated vehicles platooning and the circulation of rolling machines on certain pavements for the purpose of goods delivery.

In December 2020, the French government also issued an updated strategy for the development of automated road mobility 2020–2022. Under this strategy, France plans to finalise the legislative and regulatory framework, by Q1 2022, for the operation of automated vehicles resulting from article 31 of the Law on orientation of mobilities (LOM) dated December 2019, for vehicles with a driver on board and for those (including without a driver on board) used as part of an organised transport of passengers on a predefined route or zone on the other hand.

In this respect, the French government adopted on 14 April 2021, an Ordinance setting forth the rules regarding the criminal liability in case of circulation of delegated driving vehicles and automated road transport systems. Regarding the conditions of use of automated driving systems, the Ordinance provides that such conditions of use are defined by the vehicle manufacturer and must be provided to the consumer before the purchase or lease of the vehicle. The decision to activate the automated driving system is made by the driver and when the automated driving system's conditions of use are no longer met, the automated driving system must alert the driver, perform a request to the driver to take back control and engage and perform a minimal risk manoeuvre in the case of lack of the driver taking back control or serious failure.

An implementing decree of the Ordinance was adopted on 1 July 2021. A draft of this Decree was notified to the European Commission. This Decree provides, in particular, for the definition of a delegated driving vehicle and sets out the specific features that automated driving systems may be equipped with. It also defines the interaction between the human driver and the automated driving system, as well as the manoeuvres that the system may perform automatically. It specifies the level of attention expected from the driver on his or her driving environment when an automated driving system is activated.

Focus on automated vehicle liability aspects

France has not (yet) implemented a specific civil liability regime that would be applicable to a series deployment of automated vehicles in France. As a general matter of principle, civil liability is incurred under French law if there is (1) wrongdoing or negligence (including putting on the market or selling a product deemed defective or unsafe), (2) damage and if (3) causation between the two is established.

The LOM enabled the government to adopt rules to amend French legislation (notably the French Highway Code) to take into account the circulation of automated vehicles and to define the liability regime applicable to automated driving. The Law enabled the government to regulate both 'partially or fully' automatic vehicles. This regulation was adopted on 14 April 2021. This regulation was adopted by an Ordinance on 14 April 2021, which sets new criminal liability rules for both manufacturers and drivers within the French Traffic Code.

As a general principle, these regulations provide that the driver of 'a vehicle whose driving functions are delegated to an automated driving system' should not be held criminally liable for the offences committed when the automated driving system holds the dynamic control of the vehicle at the time of the incident. This general principle suffers a few exceptions notably when the driver does not regain control of the vehicle after being requested to do so by the system, or when the driver does not comply with injunctions given by law enforcement authorities. It is also provided that the driver must constantly be in a position to respond to a request to take control of the automated driving system.

Outside these exceptions, the regulations provide for the liability of the car manufacturers in the case of manslaughter or bodily injuries when the vehicle operates according to conditions of use, provided that it is established that the manufacturer committed a criminal fault. The manufacturer will also be financially liable for petty offences resulting from breaches of driving rules.

A series of rules is set to ensure that the law enforcement authorities and the holder of the registration certificate of the vehicle access to the relevant data of the driving system in the case of traffic accident, roadside checks and petty offences to driving rules. The manufacturer must guarantee the integrity of the data.

In addition, the provisions of the French Traffic Code and the French Transport Code were amended by a Decree of 29 June 2021 to allow for the circulation on French roads of autonomous vehicles and automated road transport systems on predefined routes or zones as of September 2022. Thus, specific criminal liability rules are also provided for the deployment of automated road transport systems. These rules notably provide that the person authorised to carry out a remote intervention on a vehicle operated as part of an automated road transport system shall be liable for the offences resulting from its intervention or lack of intervention on the vehicle. These rules are an important step toward the implementation of a special liability regime applicable to autonomous driving in France even though a number of questions (notably with regard adjustments of civil liability and product liability regimes to autonomous driving) remain open even after the enactment of the above rules.

One of the outstanding questions will be whether Law No. 85-677 of 5 July 1985 improving the situation of victims of traffic accidents will need to be amended because this law imposes a specific regime of liability for drivers and vehicle custodians that is designed to ensure the compensation of victims of traffic accidents. Indeed, even if this law does not directly impact product liability, it could impact the liability of car manufacturers or software developers if they were to be considered drivers or custodians of the vehicles in an accident involving an automated vehicle. The 1985 Law notably does not precisely define who must be considered the driver of the vehicle. Also, this law imposes that any person that can be held liable for damages suffered resulting from a traffic accident must be insured accordingly. It is yet to be determined how this obligation could transpose to L4 automated vehicles.

With regard to product liability stricto sensu and putting aside the recent rules applicable to criminal liability passed so far, the main question will be to assess, in the case of an accident, in which equipment or service it originated and, therefore, which operator or person should be held liable (car manufacturer, software developer, other components suppliers, custodians or authorities who must put in place infrastructures for the automated vehicle to operate safely). In this respect, data recorders will have a significant impact to determine the origins of the accident involving automated vehicles. This question impacts all potential defendants and their potential cross-claims against each other depending on the nature of the issue.

In that respect, France also passed an ordinance on access to vehicle data providing detail on the data to be collected and the conditions of access to such data in the event of a road accident.

Connected vehicle data

One of the key principles of European and French data protection laws is transparency. Data subjects (ie, drivers) must be informed by the data controller (ie, car manufacturer) of how their personal data will be used. Therefore, the French Data Protection Authority published in October 2017 guidelines on the use of personal data collected by connected vehicles through vehicles' sensors, telematics devices or mobile applications. Such guidelines provide guidance to original equipment manufacturers on how to integrate the data protection by design and by default requirements into the production pipeline. Also, the European Data Protection Board (EDPB) adopted guidelines on processing personal data in the context of connected vehicles and mobility-related applications on 9 March 2021. The main changes between the draft guidelines (released in February 2020) and this final version are the increased requirement of consent as legal basis to process personal data from connected vehicles, the classification of speed data combined with geolocation data as potential offence-related data or further clarifications on the obligation that vehicles provide clear and easy privacy settings to allow the user to control the data collected and transmitted from the vehicle.

Finally, the Ordinance resulting from article 32 of the Mobily Law was adopted on 14 April 2021. The Ordinance sets out the legal framework on access to the data of connected or autonomous vehicles by law enforcement authorities, infrastructure managers, emergency services, transport organising authorities or insurance undertakings for various purposes such as accident prevention, knowledge of the road infrastructure and traffic conditions, or in the case of accidents, for insurance compensation or analysis of accidents. It enables vehicles manufacturers to correct by telematic means flaws and defects of vehicle systems or components affecting a series of vehicles and threatening the vital interests of individuals in a serious and imminent manner. The Ordinance finally includes new cybersecurity obligations upon vehicle manufacturer or vehicle equipment manufacturers in the case of electronic attacks.

On 23 February 2022, the European Commission presented a proposal for a regulation to frame transfers of non-personal user or business data generated by the internet of things, including connected vehicles. The objective of the Data Act is to establish a clear and

pro-competitive set of rules for services based on access to connected vehicles data. This regulation will have a direct impact on automotive suppliers with regard to access to in-vehicle data and resources, where vehicle manufacturers currently have complete control over the data flow to and from connected vehicles. The European Commission's approach is to put the user at the centre of the system, by giving them the power to decide if and how vehicle generated data is shared. However, when sharing the data with third parties, the data holder and the user may agree on measures to preserve the confidentiality of the data and trade secrets. The shared data provided may not be used to develop products that would compete with the product the data originates from, but allows third parties to use the data to provide competing services.

Shared and transportation services

The LOM and the EU Regulation 2017/1926 impose on 'on-demand transport service providers' and 'sharing service providers' a series of obligations relating to data sharing. Also, a National Access Point for Transportation Data was created by the LOM with the aim of gathering data on the entire mobility system on a national basis.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Since the beginning of 2020, because of the covid-19 pandemic and the invasion of Ukraine, the automotive sector in France has faced one of the worst crises in history: registrations of passenger vehicles decreased by 18 per cent in 2021 compared to the previous year, and by more than 35 per cent compared to 2019.

Similarly to other countries, one growing concern in the past year is the supply problems (shortage of semiconductors, plastic and steel) that directly impact OEMs and car manufacturers in France as a consequence of the covid-19 pandemic and the conflict in Ukraine. Eighty-four per cent of the French automotive equipment manufacturers would be impacted by these shortages and some plants of French car manufacturers had to stop due to these supply problems.

In May 2020, the French President presented a massive recovery plan for the automotive sector, valued at nearly €8 billion. The French president notably announced that grants for the purchase of vehicles will be raised with a view to promoting greener vehicles, as well as the creation of an investment fund of €1 billion to help companies in the sector with the aim of modernising and digitising production chains, and fostering the environmentally friendly transformation of the automotive industry.

The Climate and Resilience Act, adopted on 21 August 2021, provides for new measures to support the ecological transition in the transport industry.

The text amends article 73 of the Law on Orientation of Mobilities (LOM), which introduced the objective of ending the sale of new passenger vehicles and light commercial vehicles using fossil fuels by 2040, by adding two additional objectives. It first sets the end of the sale of new passenger vehicles emitting more than 95 gCO2/km on 1 January 2030, with the exception of certain special purpose vehicles (off-road vehicles for professional use or in mountain areas, for example) without these derogations being allowed to exceed 5 per cent of total annual sales of new passenger vehicles. The second objective introduced is the end of the sale of new heavy-duty vehicles used to transport people or goods and using mostly fossil fuels, by 2040.

These developments come along with support for the acquisition of greener vehicles as well as a funding of the conversion of thermal-engined vehicles into electric motors or the installation of technical equipment to improve safety. For example, Implementing Decree of 29 December 2021 strengthened the green bonus and conversion premium to support the development of very low-emission light commercial vehicles.

Lastly, the Decree amending the French Environmental Code regarding the greening of vehicles used by delivery platforms was published on 5 April 2022. Introduced by article 114 of the Climate and Resilience Law, the decree requires delivery platforms with more than 50 workers to respect a minimum share, increasing over time, of very low emission vehicles and bicycles for the delivery.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

If you click on 'About us' on the website of the German Association of the Automotive Industry (VDA), the first sentence on this web page reads as follows: 'Germany is where the automobile was invented.'

Despite all the disruptions of the past few years, the automotive industry in Germany is obviously one of the most important drivers of the German economy in general. Of all the industrial sectors, it is by far the strongest in terms of turnover, research, and exports, generating prosperity, growth, and employment in numerous other sectors as well. Automotive manufacturers such as Audi, BMW, Daimler, Porsche and Volkswagen, as well as the world's largest and leading automotive suppliers such as Bosch, Continental and ZF, are headquartered in Germany with global operations and among the leading automotive companies worldwide. Also, some foreign automotive companies such as Ford, Hyundai, Kia and Opel have their European headquarters in Germany.

It is expected that the German automotive industry will continue to be one of the most important automotive drivers globally, even as disruptions continue to take place, such as supply bottlenecks caused by covid-19 or the war in Ukraine, and new entrants become part of 'the future of mobility'. This is mainly for two reasons. First, by redefining their strategies, German automotive companies are relentlessly trying to adapt and transform to the radically changing new automotive world. This includes developments in the four main areas called ACES: autonomous, connected, electric and shared vehicles. Second, Germany has a strong technology focus, which should allow Germany to play a substantial role and maybe also lead the development of such vehicles. The automotive industry is by far the most research-intensive sector in Germany.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Type approval

Type approval is a prerequisite for the registration, sale and entry into service of vehicles and vehicle parts in Germany. Type approval is granted and monitored by the German Federal Motor Transport Authority (KBA) and can be generally obtained under three different regulatory frameworks: the United Nations Economic Commission for Europe (UNECE), the EU and the German type approval framework.

The UNECE framework is based on an international agreement dated 20 March 1958 (1958 Agreement) concerning the adoption of uniform technical prescriptions for wheeled vehicles, equipment and parts that can be fitted or used on wheeled vehicles and the conditions for reciprocal recognition of approvals granted on the basis of these prescriptions. This agreement currently comprises 163 technical regulations on safety and environmental subjects (UN Regulations), but not all signatory states apply all technical regulations. Therefore, the applicability of UN Regulations has to be determined on a case-by-case basis. The objective is to harmonise the UNECE type approval framework and the EU type approval framework. This process is still ongoing and not yet completed.

Within the EU, type approval regulations are harmonised and mutually recognised under the EU type approval framework. The German type approval framework is therefore only applicable if no EU harmonisation is in place. Thus, in practice, the most relevant regulatory framework in Germany is the EU type approval framework.

Under the EU type approval framework, Regulation (EU) 2018/858, which repealed Directive 2007/46/EC and has been directly applicable in all member states since 1 September 2020, establishes a framework for the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles. Regulation (EU) 2018/858 provides for administrative provisions and general technical requirements for the type approval of vehicles and their parts, with a view to facilitating their registration, sale and entry into service within the EU.

Several separate EU Directives and Regulations lay down more specific technical requirements concerning the construction and functioning of vehicles and their parts. Annex II to Regulation (EU) 2018/858 provides for an exhaustive list of all regulatory acts applicable to type approval. Examples of these regulatory acts are Regulation (EC) No. 715/2007 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) and Regulation (EC) No. 661/2009 concerning type approval requirements for the general safety of motor vehicles, their trailers and systems, components and separate technical units intended therefor. On 6 July 2022, Regulation (EC) No. 661/2009 was repealed and replaced by Regulation (EU) 2019/2144 (new General Safety Regulation), which aims to further improve the safety performance of vehicles, in particular by introducing new advanced vehicle safety systems (eg, warning of driver drowsiness and distraction, intelligent speed assistance, data recorder) as standard vehicle equipment and establishing, for the first time, mandatory EU wide cybersecurity requirements for vehicles. The new General Safety Regulation establishes final phase-in dates for new type approvals that range from 6 July 2022 to 7 January 2026.

Also, applicable regulatory acts may include specific requirements for electric vehicles.

Manufacturers are generally responsible for ensuring compliance with the type approval process and conformity of production of vehicles and their parts, whether or not the manufacturer is directly involved in all stages of construction. In addition, manufacturer's representatives, importers and distributors also have certain responsibilities under Regulation (EU) 2018/858.

Regulation (EU) 2018/858 also contains provisions on market surveillance of vehicles and their parts already placed on the market and specifies, among other, the rights and obligations of the national market surveillance authorities or the European Commission as well as the responsibilities of the economic operators in the supply chain.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The automotive companies' supply is usually organised in the form of a purchase order business with a contract structure that is typically implemented by automotive original equipment manufacturers (OEMs) and similarly flows down the supply chain (ie, by Tier 1 suppliers to Tier 2 suppliers and so on). This contract structure is characterised by a stepwise increase and concretisation of supply obligations. There are generally only limited purchase obligations as the automotive business is traditionally very much a customer demand-driven business, though this eventually depends on the contractual arrangements. For example, obligations to purchase a certain share of demand, which is typically forecast, are quite common. However, recent developments resulting in increasing pressure on supply chains have significantly strengthened the negotiation power of suppliers of critical raw materials and components. In certain areas, automotive customers have thus been more and more forced to commit to mid- or long-term purchase obligations (eg, 'take or pay') and other supplier-dictated terms that would not have been accepted in past times.

The traditional stepwise structure may typically begin with a non-binding tender or offer, followed by a formal or informal supplier validation and nomination with respect to certain components for specified vehicle platforms or ranges. The nomination or admission letter may include an initial development phase for the supplier to adapt to the customer's requirements and specifications and ultimately aims to establish a supply relationship that lasts until the end of the series production of the relevant vehicle range. Within the framework of the nomination more specific purchase agreements are then concluded, which set out prices as well as volumes linked to demand – the latter usually being specified as the supplier's expected percentage share in the customer's overall demand within a given production period (eg, annually). Finally, the actual delivery of definite volumes is based on forecasts and short-range purchase orders that often provide for just-in-time delivery.

Usually, no comprehensive written framework agreements with negotiated legal terms are in place, but rather the supply relationships are largely based on the application of the OEM's or higher-tier supplier's general purchasing terms. These terms, especially those of German OEMs, are to a large extent (ie, with only minor deviations) based on the general purchasing terms of the VDA. OEMs usually also have rather extensive additional standardised contractual documents in place, such as a warranty, quality assurance, logistics and other side agreements. More detailed individual agreements are concluded, though, where the supply relationship includes joint development efforts or otherwise is of particular strategic importance (eg, joint ventures, cooperations, in particular with respect to strategically important technologies such as autonomous, connected, electric and shared vehicles).

With new entrants such as technology companies coming into the automotive market, concluding strategic cooperations is a particular trend in the automotive industry. Also, traditional automotive rules are currently being challenged and redefined. For example, an obligation to supply spare parts for 15 years is something that technology companies can hardly accept.

Recent developments such as the covid-19 pandemic and international political instabilities have significantly increased the pressure on global supply chains and raised sensitivities about security of supply regarding critical raw materials and components, most notably in the automotive industry relating to semiconductors and scarce raw materials required for high-voltage batteries for electric vehicles. Particularly, the covid-19 pandemic and related lockdown and ramp-up issues as well as the recent semiconductor shortage crisis resulted in automotive production downtimes and major disruptions of supply chains also in Germany, as well as – at least temporarily – decline in vehicle sales. This immediately raised contractual issues for OEMs and suppliers, in particular regarding the extent of binding purchase and supply obligations under existing contracts as well as questions of force majeure and hardship. The experience of recent disruptions are driving OEMs to strategically adjust their supply chain arrangements, with a tendency to increase their direct arrangements with suppliers further down the supply chain (Tier 2, Tier 3, etc) to be able to better control and manage security of supply issues. As such new structures may interfere with the traditional concept of flowing down rights and obligations along the supply chain, the implementation regularly triggers new contractual and commercial aspects.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

The marketing of new vehicles usually takes place through a two-level distribution system. On the first level the OEM (or its national importer) has established a network of authorised dealers that – on the second level – market and sell the vehicles in their own name and for their own account to end customers. Alternatively, some OEMs have set up a three-level structure with an additional intermediary acting on the third level towards end customers, usually in the form of an agency model. The contractual arrangements within the distribution chain vary (eg, regarding exclusivity, non-compete obligations, marketing obligations and branding requirements) and to that effect also the degree of integration of the intermediaries in the OEM's distribution system vary.

Alternatively, or in addition to the above, some OEMs maintain a network of own-retail branches that sell directly to end customers without involving any third-party distribution intermediary. In other cases, it is common for OEMs to reserve the right to make direct sales to high-volume or special customers, such as fleet customers. As a general trend, direct end customer relationships are becoming increasingly important for OEMs, in particular regarding the provision of connectivity and mobility services to end customers as well as offering vehicles via direct online sales. Simultaneously with focusing on direct online sales, some OEMs are developing new 'showroom' concepts to offer point-of-sale customer experience (with showrooms either operated by the OEMs themselves or by third-party operators). Several OEMs have increasingly also started trialing or rolling out new innovative subscription models that aim to respond to evolving customer demands in terms of flexible and hassle-free full-service mobility offers. As a basic concept of such models the customer pays a flat rate subscription fee and is provided with a car, similar to a longer-term rental contract,

but in addition is offered a range of car-related services as well as the option to change car models at frequent intervals or on demand.

Under German contract and distribution law, some special rules and principles may apply to distribution relationships, with certain particularities in the automotive industry. Some of these rules are mandatory (ie, they cannot be deviated from by contractual arrangement). The rules and principles are largely based on case law, and there are many court decisions that deal with and specifically take into account the customary distribution structures and other particularities in the automotive industry. The most important examples of special rules under German contract and distribution law are as follows.

- Mandatory minimum notice periods usually apply where the principal intends to terminate a distributorship. The length of the notice period depends on the circumstances of the specific case, taking into account, among others, the distributor's economic dependency on the terminated business, the duration of the distribution agreement, the extent of exclusivity, the extent of investments made by the distributor and the existence of non-competition obligations. Minimum notice periods in the range of six to 12 months are not uncommon in this regard – for automotive distribution relationships the courts have even applied minimum notice periods of up to two years.
- The distributor can usually claim an indemnity 'for loss of clientele' upon termination of the distribution relationship. The exact calculation of the indemnity is rather complex and requires a detailed analysis of various criteria. As a matter of principle, the indemnity amounts to the value of the benefits that the principal after the termination continues to derive from the business developed by the distributor. The maximum indemnity is the amount calculated from the distributor's average annual net margin with the relevant products over the past five years.
- Standard contract terms (such as model distribution agreements of OEMs) that are not individually negotiated by the parties are subject to judicial control according to the German law rules on standard terms (AGB-Recht). Under these rules standard contract terms are unenforceable if they are considered to result in an unreasonable disadvantage to the other party. The requirements to meet this reasonableness test have been specified by case law for different types of contract clauses. Rather strict requirements apply, for example, for limitation of liability and warranty clauses.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Overall, there are no major differences between automotive M&A transactions in Germany and elsewhere in Europe.

There are, however, key features that warrant attention during the due diligence process and the negotiation of the transaction documents. Depending on the relevant business, areas that should be carefully reviewed, in particular in light of global supply bottlenecks due to the covid pandemic and the situation in the Ukraine, include alternative sourcing and the reliability of customer and supplier relations, environmental issues, product liability (including insurance coverage), intellectual property rights and compliance or regulatory (including compliance with emission standards). Purchasers will regularly seek protection against risks in these sensitive areas through adequate representations and warranties and indemnities. Warranty and indemnity insurance is becoming increasingly popular in Germany and is often taken out when the sellers are private equity firms.

Furthermore, under German foreign direct investment law, the competent ministry may object – even after closing – to an acquisition of 25 per cent or more of a German entity by a non-EU/EFTA acquirer if the public order or security is likely to be impaired by the transaction – depending on the business of the target this may already be triggered by the acquisition of 10 per cent or more of the German target. Even stricter rules may apply where the products sold by the target company are also used in more sensitive industries such as defence.

While there used to be an assumption that this only applies to key industries (eg, infrastructure, energy and defence, certain IT security functions) and this objection right was rarely exercised, the German government tends to take a broader view these days – in particular, in the case of Chinese or Russian acquirers. It is possible to apply for a non-objection certificate, which is deemed to be granted if no official investigation is initiated within two months of receipt of the application. The receipt of the certificate is regularly included as a closing condition in the sale and purchase agreement in 'critical' transactions.

Furthermore, the competitive environment for OEMs and suppliers has changed substantially. Nowadays, internet, IT and other major technology providers increasingly qualify as competitors. This is particularly relevant in the context of non-compete clauses or permissible purchasers in the event a joint venture partner intends to exit the venture. In practice, this is often addressed by an enumeration of entities that qualify as competitors in addition to or instead of a generic definition

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no special incentives for investment in the automotive market in Germany. There are rather indirect general incentives for investment, in particular in the e-mobility sector. To reach the self-set target of 15 million electric vehicles on the road by 2030, Germany incentivises the purchase and use of electric vehicles particularly through the payment of individual purchase premiums (referred to as an environmental bonus, the federal share of which was doubled as part of the economic recovery programme due to the covid-19 crisis), the granting of individual tax advantages under the German Motor Vehicle Tax Act and the offer of free parking and special parking zones in many municipalities. In addition, specific measures have been adopted to promote the expansion of charging infrastructure in Germany. In particular, there are various funding programmes for the procurement and installation of publicly accessible charge points. In addition, a revision of the 38. Ordinance on the implementation of the Federal Immission Control Act (38. BImSchV) has opened up a new revenue stream for operators of public charge points to make the operation of public charge points more lucrative: Since 1 January 2022, charge point operators can sell the greenhouse gas reduction quota (GHG quota) (ie, the CO_2 savings associated to the supply of electricity from their charge points), to fuel suppliers, who in turn can fulfil their stringent greenhouse gas emission reduction obligations with the GHG quotas.

Likewise, there are no special barriers to entry into the automotive market in Germany. Instead, there are established rules such as special terms and conditions and certain common practices developed by traditional automotive players, which generally apply to the automotive market when companies that are new to the industry enter the automotive market and deal with automotive companies in Germany.

At the same time, new entrants into the automotive market challenge established rules and common practices by applying new or at least redefined rules and practices in a situation where mostly technology-driven disruptions take place in a rapidly changing automotive world.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Product compliance safety

Under German law, general product safety aspects are primarily governed by the recently revised German Product Safety Act (ProdSG) and the newly passed German Systems Subject to Monitoring Act (ÜAnlG). The ProdSG implements the EU's General Product Safety Directive 2001/95/EC (GPSD). However, while the GPSD only applies to consumer products (eg, to passenger cars, but generally not to B2B supply parts exclusively intended for the production of passenger cars by professional car manufacturers), the ProdSG generally applies to both consumer and non-consumer products.

Environmental aspects are primarily in the line with EU type approval requirements. As of 1 September 2020, the (previous) Type-Approval Framework Directive 2007/46/EC was replaced by the (new) Type-Approval Framework Regulation (EU) 2018/858. Besides, there are several special type-approval exhaust emissions provisions such as Regulation (EC) 715/2007 and Regulation (EC) 661/2009. In Germany, type-approval requirements are particularly codified in the EG-FGV.

Besides, there are additional market surveillance provisions codified in the (new) Market Surveillance Regulation (EU) 2019/1020.

Regarding enforcement in Germany, the competent market surveillance and product safety authority for motor vehicles and motor vehicle parts (including B2B supply parts) is the German Federal Motor Transport Authority (KBA). In addition, the KBA is the competent type approval authority. The KBA's headquarters is based in Flensburg. It is a federal authority that is generally controlled by the German Federal Ministry for Digital and Transport. The KBA is structured into several departments with individual subject groups. Regarding product safety, subject group number 512 'Product Safety' in department number 5 'Market Surveillance' is generally in charge. As the competent enforcement authority in Germany, the KBA has also issued an official codex regarding the implementation and interpretation of the ProdSG as well as certain corrective actions aspects (the KBA Codex). In doing so, the KBA's initial Codex of November 2011 was replaced in September 2019 and in June 2020 by an updated version. With its Codex, the KBA's intention is to provide car manufacturers and suppliers with additional guidance on certain product safety aspects, particularly on the KBA's expectations towards automotive companies. Moreover, the KBA Codex outlines the KBA's approach towards certain product safety issues including best practices and internal procedures.

Regarding the enforcement of the EU's Rapid Exchange System for unsafe products (RAPEX), the competent German RAPEX contact point authority is the German Federal Institute for Occupational Safety and Health (BAuA). The BAuA's headquarters is based in Dortmund, with branches in Berlin, Dresden and Chemnitz. It is a federal governmental research institution generally controlled by the German Federal Ministry of Labour and Social Affairs.

One of the most important features is the implementation and enforcement of the notification obligation. In Germany, product safety notification aspects are generally in line with EU requirements, particularly with the GPSD. Section 6 paragraph 4 ProdSG implements the European authority notification obligation of article 5 paragraph 3 GPSD into German law. In doing so, the producer of a consumer product 'shall immediately inform' the KBA if it 'knows or ought to know' that the consumer product 'poses risks to the consumer that are incompatible with the general safety requirement'. Besides, article 14 of the (new) Type-Approval Framework Regulation (EU) 2018/858 also requires certain product safety and/or product conformity/compliance authority notification obligation. In particular, pursuant to article 14 (1), a manufacturer 'shall immediately inform the approval authority that granted the type-approval in detail of the non-conformity and of any measures taken'. Pursuant to article 14 (2), where 'the vehicle, system, component, separate technical unit, part or equipment presents a serious risk, the manufacturer shall immediately provide to the approval authorities and market surveillance authorities detailed information on the risk and on any measures taken in relation thereto'.

The KBA generally decides on a case-by-case basis whether and what kinds of notifications or corrective actions are necessary and reasonable. In doing so, the KBA generally drafts a product safety risk assessment, often pursuant to the RAPEX risk assessment guidelines in Commission Implementing Decision (EU) 2019/417 (repealing Commission Decision 2010/15/EU), to assess potential product safety risks.

If deemed necessary due to the result of the risk assessment, the KBA generally has the power to order a corrective action (eg, a withdrawal or a recall as well as certain publications). However, depending on the respective case, the KBA often trusts the car manufacturer or supplier to voluntarily carry out a suitable corrective action. In doing so, the KBA often refrains from issuing a formal order but closely monitors the case, particularly by asking for update reports. However, there is a recent trend that indicates that the KBA is now taking a stricter view (ie, that the KBA is increasingly relying on formal recall orders instead of a company's voluntary actions). This trend significantly increases a company's legal risks in the event of a product crisis.

As a general rule, companies should consider a proactive and cooperative approach when it comes to the German authorities. Proactively approaching and properly cooperating with the authorities is often crucial to solve a product crisis as well as to reduce potential legal risks.

Environmental regulations

Many environmental regulations are harmonised at EU level, but enforcement of such EU environmental regulations is generally done on a national level. As a general rule, non-compliance with environmental regulations in Germany will mainly entail withdrawal of relevant licences, mandatory corrective measures and administrative fines, though there may be specific, and even criminal, sanctions depending on the subject matter.

See the following examples for important automotive-related environmental regulations and, if applicable, their German implementation.

Emissions

Regulation (EC) No. 715/2007 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) and its implementing Regulation (EU) 2017/1151 establish common technical requirements for the type approval of light passenger and commercial vehicles with regard to their emissions and set out specific emissions limits. Potential sanctions for non-compliance in Germany include, for example, administrative fines, withdrawal of type approval, prohibitions on putting the relevant vehicles on the market, and ordering of other appropriate measures (such as recalls). Since 1 September 2020, Regulation (EU) 2018/858 also entitles the European Commission under certain circumstances to initiate EU-wide enforcement and remedial actions in addition to the foreseen competences of the enforcement authorities of the member states.

The European Commission is currently working on a proposal for a regulation establishing stricter emissions standards (Euro 7) for all petrol and diesel cars, vans, lorries and buses, which is expected to also include particulate matter in its remit.

Carbon dioxide

Regulation (EU) 2019/631 setting carbon dioxide emission performance standards for new passenger cars and for new light commercial vehicles and repealing Regulations (EC) No. 443/2009 and (EU) No. 510/2011 as part of the EU's integrated approach to reduce carbon dioxide emissions establishes mandatory carbon dioxide emissions targets for new vehicles. These targets do not apply to individual vehicle models or manufacturers but relate to the entire European fleet average. It is not necessary for each individual manufacturer to comply with the European fleet value. However, each individual manufacturer is allocated a manufacturer-specific value depending on the products it sells. If a manufacturer's average emissions levels are above this value, the manufacturer will have to pay an excess emissions premium. The penalty is €95 for each g/km of exceedance. Starting with new registrations in 2021, manufacturers also need to report to the Commission real-world carbon dioxide emissions and fuel or energy consumption of passenger cars, collected by on-board fuel and/or energy consumption monitoring devices.

On 8 June 2022, the European Parliament adopted an amendment to Regulation (EU) 2019/631 based on a proposal from the European Commission. According to the amendment, from 1 January 2035, a new EU fleet-wide carbon dioxide emissions target for new passenger cars and light commercial vehicles equal to a 100 per cent reduction of the target in 2021 will apply.

Waste

Directive 2000/53/EC on end-of-life vehicles, which is implemented into German law by the German Regulation on End-of-Life Vehicles, lays down measures that aim, as a first priority, to prevent waste from vehicles. In addition, they aim at promoting the reuse, recycling and other forms of recovery of end-of-life vehicles and their components to reduce the disposal of waste, as well as at the improvement in the environmental performance of all economic operators involved in the life cycle of vehicles and especially the operators directly involved in the treatment of end-of-life vehicles. The German Regulation on End-of-Life Vehicles provides for administrative fines in the event of non-compliance with certain obligations.

The European Commission is currently working on a proposal for a revision of Directive 2000/53/EC.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Under German law, there are numerous provisions that generally allow product liability claims, particularly claims under contract or warranty, general tort law as well as strict product liability law.

In doing so, most consumer claims in the automotive industry are brought under the strict liability regime of the German Product Liability Act (ProdHaftG), implementing the European Product Liability Directive 85/374/EEC. In doing so, a 'producer shall be liable for damages caused by a defect in his product'. A product is generally defective 'when it does not provide the safety that a person is entitled to expect'. This test generally takes into account 'all circumstances', particularly 'the presentation of the product, the use to which it could reasonably be expected that the product would be put and the time when the product was put into circulation'. Potential defects can particularly be linked to design, production and instruction aspects as well as certain product monitoring shortcomings. However, the burden of proof for the (alleged) defect, the damage and the causal relationship between defect and damage is generally upon the claimant. Besides, a producer's liability is generally limited to €85 million per case (pursuant to section 10 ProdHaftG).

There is a great deal of automotive product liability case law in Germany. Many courts, including the German Federal Court of Justice, have ruled on alleged vehicle defects. In doing so, German courts in particular decide cases by appointing independent technical court experts to assess whether a vehicle – design, production and instruction alike – had a defect. The courts typically ask the technical expert to apply a state-of-the-art test (ie, taking into account the respective date when the vehicle was placed on the market).

Particularly in the event of a recall, there can be substantial follow-on litigation. To mitigate risks, it is crucial to take effective and sophisticated measures to prevent unnecessary risks (eg, by avoiding unnecessary acknowledgement or by creating an incorrect impression as to the scope and meaning of a recall).

Under German law, there is generally no class action system regarding consumer litigation in automotive product liability cases. Hence, lawsuits generally have to be brought individually before the respective courts.

However, in 2018, a collective redress system – called Verbandsklage – was established to strengthen consumer protection rights. This collective redress system generally allows certain consumer protection associations to file collective redress lawsuits against automakers, suppliers or dealers, etc. As a result, individual consumers will generally be able to approach automotive companies based on the outcome of the collective redress lawsuit. Therefore, automotive companies should consider implementing proper defence mechanisms.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Notably, in the past few years the European Commission has investigated a number of car parts cartels and heavily fined original equipment manufacturers (OEM) suppliers located all over the world for anticompetitive practices, such as price fixing, bid rigging and the exchange of competitively sensitive information. These illegal practices concerned very different components such as alternators and starters, wire harnesses, parking heaters and automotive bearings. In addition, in July 2016, the Commission imposed fines of €2.93 billion on five European truck manufacturers for coordinating prices. This is the highest cartel fine the Commission has imposed so far. According to the findings of the Commission, the truck cartel existed for 14 years and was partly organised through the truck manufacturers' German subsidiaries.

In 2018, the Commission opened an investigation to assess whether German car manufacturers agreed not to compete against each other on the development and roll-out of technology to clean the emissions of petrol and diesel passenger cars. This case was concluded in 2021 with a decision in which the Commission found that the German OEM breached EU antitrust rules by colluding on technical development in the area of nitrogen oxide cleaning. The Commission has imposed a total fine for the five OEM of €875 million.

In parallel to the EU Commission cases, the Federal Cartel Office (FCO) has conducted several investigations in the automotive sector over the past few years. For example, in June and December 2015, the FCO sanctioned six automotive part manufacturers for agreeing to fix prices in relation to acoustically effective components (textiles such as flooring, car mats, etc). The manufacturers were fined a total of €90 million.

In 2015, the FCO also initiated proceedings against three car manufacturers for restricting cooperation between brand retailers and independent online agencies. The manufacturers had implemented 'internet standards' for the introduction of end customers to brand retailers via internet-based new car portals. The FCO found that such standards reduced cooperation between retailers and car portals and therefore restricted competition by reducing market transparency. The proceedings of the FCO were discontinued in December 2015 after the car manufacturers revised their clauses.

In November 2019, the FCO imposed fines totalling around €100 million on German car manufacturers for exchanging information with steel manufacturers, forging companies and Tier 1 suppliers on surcharges for the purchase of long steel products.

The cartel decisions of the European Commission and the FCO have led to several follow-on damages actions before the German courts. Germany is generally regarded as one of the major forums within the EU for competition law damages claims. Implementation of the EU Cartel Damages Directive 2014/104 through an amendment of the German Act against Restraints on Competition (ARC) in June 2017 further boosted private enforcement, for example, through collective claims brought against cartelists in Germany. The recent cartel damage claims against truck manufacturers are mainly carried on by professional claim funding companies and US class action law firms (which have established offices in Germany).

In January 2021, the last amendment of the ARC entered into force. Implementing the ECN Plus Directive 2019/1, the German legislator enshrined an antitrust compliance defence in German law, making effective compliance efforts both before and after the infringement relevant for the assessment of a cartel fine from now on. Companies with effective antitrust compliance systems for the prevention and detection of cartel infringements as well as those that contribute to the detection of a cartel infringement as leniency applicants can in the future be rewarded to a greater extent when fines are imposed, while companies that do not (immediately) opt for such contribution can now be forced to cooperate in the investigations. When reviewing their dawn raid procedures and antitrust compliance systems, companies should therefore pay increased attention to ensuring that these comply with the new investigative powers and the new requirements for appropriate and effective compliance precautions.

Dispute resolution mechanisms

10 | What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Apart from disputes concerning antitrust, insolvency and intellectual property matters, disputes in the automotive industry arise regularly along the supply chain.

The most frequent disputes between customers and the supplier include the following.

- Claims for damages based on defects of the product developed and delivered by the supplier (section 434 et seq of the German Civil Code): these also include product liability claims when defects of the product affect the safe usage of the delivered product. These disputes are either settled at an early stage with a view to the strength of the business relationship or, failing that, are brought to court, less often to arbitration. As they are often decided by technical questions, some cases are settled by the parties based on the result of an independent expert opinion or an independent procedure of taking evidence performed by the court.
- Supply chain disruption cases where a supplier threatens to or actually implements a supply stop: these kinds of disputes have become more frequent in German courts in recent years. In times of complex supply chains, just-in-time or just-in-sequence production and single sourcing, customers in the automotive industry are highly dependent on on-time-delivery of parts. Even a short period of disruption of the supply chain can cause severe damage. While formerly an exception, German courts increasingly accept the need to act quickly in order to prevent significant damage that otherwise could often not be reclaimed by suppliers. Thus, in urgent cases it is possible to file for interim injunctions requesting continuation of the supply under the contractual terms. Straightforward cases are sometimes decided by the courts ex parte in a matter of days after the filing. In more complex cases a hearing of the defendant is sometimes necessary, and a decision can take up to a few weeks. In this context, the impact of covid-19 on the automotive industry and the supply chains in particular is relevant where judges will have their own views on the relevance of the pandemic under force majeure or frustration aspects. However, the majority of cases have so far been handled through out-of-court solutions. We will see how that develops further.
- Disputes in connection with the termination of the supply contract: disputes often arise in scenarios where a customer wants to discontinue the business relationship with its supplier and switch production to a new supplier. These disputes centre on the term of the contract, termination rights, IP rights and duties to compensate the supplier for frustrated investments. In this context, the customer sometimes switches to a new source for the supply of the product. The 'old' source sometimes regards its IP rights or trade secrets violated by the production or development of the alternate product. The Trade Secrets Directive of the EU, which was implemented into German statutory law in April 2019, provides for some guidance in this context. Other disputes relate to the transfer of tools from the former to the new supplier. The punctual transfer of tools to a new supplier is often crucial for a smooth transition. Delays can cause severe damage for the customer. In urgent cases, these disputes can also be resolved in interim proceedings seeking repossession of tooling.
- A current issue for OEMs and suppliers is the effect of a squeeze on semiconductor supplies in 2021. Anticipating the uptake of OEM production in 2021, the VDA has issued a best practice guideline to provide for guidance on allocation of limited supplies amongst customer demands. Such guideline is a recommendation and can be deviated from. In particular, it is no binding law and does not specifically say which circumstances it applies for. Therefore, parties argue their cases on the basis of the terms of their individual agreements with regard to force majeure, inability to supply and default. It will have to be seen whether any of these cases go to court.

Distressed suppliers

11 | What is the process for dealing with distressed suppliers in the automotive industry?

From a customer's point of view, there may be early warning signs of the distress of a supplier, such as the supplier's request to shorten the term of payment or to increase the prices or from case to case, or a deterioration of the quality standard. If it is not possible to transfer the supply relationship to a second source, the customer of a distressed supplier may effectively be forced to renegotiate the relevant supply contracts in order (at least temporarily) to ensure continuous supply. In this case, the customer should ask for a guarantee or comfort letter issued by the supplier's parent company to limit the risk of non-performance. It should be kept in mind that actions of the distressed contracting party (ie, renegotiating existing supply contracts or the performance of contractual duties under the supply contract) could be subject to

claw-back in a subsequent insolvency. The customer should seek legal advice in order to mitigate these risks.

If the supplier is no longer able to pay its debts as they fall due or if the entity is over-indebted in the terms of the German Insolvency Code the company's management must file for the opening of insolvency proceedings without undue delay (if promising restructuring attempts are undertaken by the management the latest within three weeks in the case of illiquidity or within six weeks in the case of over-indebtedness). The local insolvency court will then institute preliminary insolvency proceedings and usually appoint a preliminary insolvency administrator. During the preliminary insolvency proceedings, which last for about three months, the company's business operations typically are continued. To facilitate that, the employees' wages are paid by the employment agency (insolvency pay). During the preliminary proceedings any business correspondence should be addressed to both the company's management and the preliminary insolvency administrator. It should be carefully reviewed whether payments must be made to an escrow account set up by the preliminary insolvency administrator and whether the court has ordered additional measures aimed at the protection of the insolvency estate. As regards existing contractual relationships the preliminary insolvency administrator may ask customers for payments in advance or other (financial) support in order to fund the business continuation. In this case, it will be crucial to find a way to safeguard such payments.

After the preliminary insolvency proceedings, the court will open (final) insolvency proceedings and appoint a (final) insolvency administrator. At this point in time the power of disposal transfers from the company's management to the insolvency administrator, whose administration must always focus on what is best for the company's creditors. Generally speaking, the insolvency administrator has the possibility to continue the company's business and (later) restructure it by way of an insolvency plan or sell it to an investor (by way of an asset deal) or liquidate the company. If the company is liquidated the customer will have to transfer its business to a second source or – if that is not possible – think about acquiring the debtor's business itself. If selling the debtor's business to an investor is the most promising option from the insolvency administrator's point of view the insolvency administrator will usually start a formal bidding process. Potential investors may then place offers for the assets they are interested in. The debtor's business or a part thereof is transferred by way of an asset deal, according to German employment law the relevant employees (including the existing employment contracts) will be transferred to the investor too. However, the insolvency administrator has (limited) possibilities to influence how many and which employees will be transferred to the investor. In the case of a sale of the debtor's business to an investor via asset deal, existing supply agreements do not automatically transfer to the investor. That means that suppliers and the investor need to agree on the transfer of the existing supply agreement to the investor or negotiate a new supply agreement.

The company's management may also apply for debtor-in-possession proceedings. In that case, a (preliminary) supervising trustee will be appointed by the court instead of the (preliminary) insolvency administrator. The main difference between regular insolvency proceedings and debtor-in-possession proceedings is that the power of disposal remains with the company's management after the opening of insolvency proceedings. Debtor-in-possession proceedings also aim at the best possible satisfaction of the company's creditors, thus the management is also bound by this maxim.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

For most car manufacturers and auto suppliers, Germany is the venue of choice to enforce their intellectual property (IP) rights against any type of infringement. The experience, reliability and efficiency of German IP courts are among the main reasons for this preference. Another reason is the rather broad scope of protection that German IP courts attach to all relevant IP rights at stake, be it patents, trademarks or designs. As a result, the amount of case law is high and constantly growing.

In the field of patents, plaintiffs appreciate that German patent judges are happy to handle difficult technical subject matter without needing a court expert. Plaintiffs like that infringement proceedings are fast (eg, six months from service to oral hearing in the Mannheim court) and relatively inexpensive owing to procedural efficiency and that the German courts grant comparatively high damages. Two sorts of disputes are particularly common. First, many automotive suppliers take cases against their competitors to the German courts. This way, the German courts have recently dealt with cases regarding a large variety of components, including, for example, crankshaft bearings, turbo chargers, brake systems, brake pads, airbags, tyre repair kits, structural reinforcement, electrical connectors, ventilation, seats, air filters, side-impact protection, fuel feed valves, windshield wipers, engine immobilisers, driver assistance systems and mudguards. Second, there are an increasing number of attacks by non-practising entities against the car industry. The majority of these cases relate to the communication technology in the car.

So far, automotive-related litigation has been particularly agile in the area of design law where German courts used to take a very favourable view towards design owners, including designs for car parts. It remains to be seen whether that will remain the case after the full harmonization of design law in the European Union has now been completed – now excluding design protection for repair parts under certain circumstances in all EU countries.

In the field of trademark law, many cases deal with the misuse of car brands for maintenance services offered by third parties. German IP courts have forced unauthorised service providers to limit the use of the brand to a significant degree. Such service providers must not use the manufacturer's logo to advertise their offer. Rather, they are typically limited to the use of the car's word mark. This makes advertising for unauthorised maintenance service much harder.

Another area of significant trademark litigation refers to accessory products and merchandising articles – such as keyrings, mugs, shirts and many other items. German IP courts try to close possible gaps of trademark registrations for such unrelated goods.

One area where German IP courts are hesitant to protect design or trademark rights against unauthorised forms of use relates to scale model replicas of original cars. In this area, German IP courts have developed a long-standing exception to the successful enforcement of car brands and designs for the benefit of all those who like to collect cars – but cannot afford the original.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

In all industries, the major sources of German employment law are federal laws, collective bargaining agreements, works council agreements and case law, the latter playing a key role. There is not one consolidated Labour Code; instead, minimum labour standards are laid down in separate laws on various labour-related issues. The legislation of the European Union as well as the jurisdiction of the European Court of Justice have increasingly affected German employment law in recent decades and will continue to do so.

Key provisions of German employment law that apply across all industries include the following.

- The statute provides for minimum standards regarding, inter alia, sick pay, annual leave and notice periods.
- The German social security system provides mandatory insurance for employees in five areas: health, nursing care, unemployment, accidents at work and pensions. With the exception of company pension schemes, the provision of further social security benefits is unusual.

Employees working in operations with regularly more than 10 employees are protected against unfair dismissal after completion of a six-months period of employment. There is no statutory claim for severance pay for loss of employment; the amount of severance, if any, is subject to negotiation between the employer and the employee or, in the event of mass dismissals or similarly far-reaching operational changes, subject to a social plan concluded between the employer and the relevant works council (where applicable).

The current national minimum wage amounts to €9.82 gross per hour and will increase to €10.45 gross as of 1 July 2022. The new German government plans to further increase the minimum wage to €12 gross per hour as of 1 October 2022.

Given the need for flexibility and just-in-time production on the one hand and the strictness of German employment laws, on the other hand, the automotive industry often seeks to work with freelancers, companies providing work and services and external staff provided by temporary work agencies. By law, the hiring period for agency temps is restricted to a maximum of 18 months in principle. Collective bargaining agreements can provide for more flexibility in this regard, and the metal and electrical industry has made use of this option by extending the maximum hiring period to 48 months. Hiring companies that are not bound by collective bargaining agreements can, in principle, adopt these collective bargaining rules by means of works council agreements. The collective bargaining agreements of the metal and electrical industry also provide for premiums that automotive companies need to pay to agency temps to comply with equal pay legislation.

Although precise figures are not available, the collective bargaining agreements of the metal and electrical industry are relevant for many employees in the automotive industry. Compared to other German industries, the level of unionisation in the automotive industry is still fairly high. However, at large supplier companies and original equipment manufacturers (OEMs), the level of unionisation tends to be significantly higher than in small and medium-sized supplier companies where the relevant trade union of the metal and electrical industry (IG Metall) hardly plays a role. By law, the application of collective bargaining agreements usually requires that both parties to an employment contract are also members of the parties that concluded the collective bargaining agreements. However, even employees who are not members of IG Metall often benefit from their employer's membership in the employers' association of the metal and electrical industry. This is due to the fact that such companies often apply the industry's collective bargaining agreements regardless of the individual employee's trade union membership, namely by a contractual commitment to apply these agreements.

In the western states of Germany, the collective bargaining agreements of the industry provide for a regular weekly working time of 35 hours. Since 2018, employers can benefit from enhanced options to agree a weekly working time of 40 hours with individual employees. Conversely, full-time employees may reduce their weekly working time from the current 35 hours down to 28 hours for between six months and 24 months under certain conditions. Moreover, employees in particularly stressful private situations (eg, with family members in need of care) can opt for a release from work of up to two years by converting their tariff supplement into free time.

Several of the industry's regional collective bargaining agreements provide for special protection against dismissal for older employees. In the southwest, for example, employees who are 53 or older can only be dismissed for good cause provided that they have been employed by the company for at least three years. Further specifics and exceptions from this special protection against dismissal differ from tariff district to tariff district.

With the collective bargaining agreement reached in March 2021, IG Metall pushed through the 'transformation payment', a collectively agreed annual special payment. In 2022, this one-off payment amounted to 18.4 per cent of the employees' regular individual monthly pay. It was recently due for payment with the February payroll for the first time. From 2023, the transformation payment will amount to 27.6 per cent of regular monthly pay.

In the eastern states of Germany, the sectoral collective bargaining agreements still provide for the 38-hours working week to be the rule. As a result of last year's tariff negotiations, however, a new opening clause has made it possible for the employer and the works council to negotiate at company level a gradual reduction of the working hours to 35 hours per week from 2022 onwards.

When it comes to employee representation at operational level, there is no legal obligation in Germany to establish a works council – even after the operation has reached a certain size. Rather, employees are entitled to establish a works council (provided that the operation has a minimum size of at least five employees over 18 years of age) but they may also choose not to. It is fair to say, though, that most companies in the industry, in particular OEMs and larger suppliers, do have works councils.

Where established, works councils have substantial co-determination rights regarding personnel, social and economic matters. In many instances, this means that the employer cannot introduce policies or implement material changes relevant to the workforce without the works council's prior consent or without having gone through litigation or arbitration procedures. In view of the continued growth of digitalisation and automation of the industry, the co-determination right concerning the introduction and application of technical equipment suitable to monitor employees' conduct and performance will become even more important than it is today. This topic is particularly susceptible to disputes, too, given the works councils' growing awareness for employee monitoring and privacy issues, especially after the entry into force of the General Data Protection Regulation.

Works council agreements providing for protection against dismissal are also quite common, in particular at large OEMs. Such agreements, which may, inter alia, provide for a commitment not to close certain production sites or not to implement forced redundancies for a certain period of time, can significantly limit a company's ability to react to changing market conditions.

The covid-19 related obligation to work from home (where possible) expired on 19 March 2022. A general right to work from home has not been introduced by the German legislator yet. Even though the coalition treaty of the new German government addresses this issue no draft bill containing more details has been produced yet. The new government has also committed itself to strengthening collective bargaining autonomy, collective bargaining partners and collective bargaining coverage. It remains to be seen whether further industry-relevant changes will be initiated.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

The most important legal developments relating to automotive technological and mobility advances continue to evolve around autonomous driving, electric vehicles and connected and shared mobility solutions.

In the field of autonomous driving, technological advances and the industry landscape are rapidly evolving. This goes hand in hand with regulatory developments addressing the question of legality of operating autonomous vehicles (AV(s)) on public roads and setting out the appropriate technical requirements for AV technology. This challenge is currently being faced by legislators around the globe to ensure the safe (commercial) deployment of (SAE/ISO Level 4) AVs. We monitor a wide variety of legislative developments and initiatives currently taking place at the international, EU and the domestic German level.

The Vienna Convention on Road Traffic of 1968 (the Vienna Convention), to which Germany is a signatory party, may authorise the use of AV technology, but may still require the presence of a human 'driver' who can take control of the vehicle at any time. In September 2020, the Global Forum for Road Traffic Safety (WP.1) voted for an amendment to the Vienna Convention which shall facilitate the responsible use of automated driving systems (ADS). A new article 34b provides that the driver requirement 'is deemed to be satisfied' while the vehicle is using an ADS that complies with domestic technical regulations (type approval requirements) and domestic legislation on operation. The amendment is expected to enter into force soon. After that, signatory parties to the Vienna Convention may incorporate the amendment into their domestic legal road traffic framework. Since signatory parties are able to impose additional hurdles for the vehicles equipped with such ADS, the respective national approach to (the waiving the requirement of a) driver may vary.

At the level of technical vehicle regulations, there are further ongoing work-streams within the UNECE World Forum for Harmonization of Vehicle Regulations (WP.29) focusing on adapting existing UN Regulations (eg, amending Regulation No. 157 on Automated Lane Keeping Systems (ALKS – defining the conditions allowing for the approval of higher maximal technical speed and lane change functions), No. 116 in the context of digital keys or No. 131 on Advanced Emergency Braking Systems (upgrade for AEBS for heavy vehicles, and providing requirements for Data Storage Systems (DSSAD) and Event Data Recorder (EDR)) as well as on defining work priorities for WP.29 and indicating deliverables (eg, setting out the functional requirements), timelines and working arrangements for the safety and security of automated/autonomous vehicles.

While the UNECE regulator is still in the process of developing an approach to regulations for higher automation, the EU Commission is currently finalising a new EU Implementing Regulation (EU ADS Regulation) laying down rules for the application of Regulation (EU) 2019/2144 (new General Safety Regulation) as regards uniform procedures and technical specifications for the type approval of motor vehicles with regard to their automated driving system (ADS). The EU ADS Regulation will cover 'fully automated vehicles' (SAE/ISO Level 4) and is expected to be adopted soon. For the time being, the whole-vehicle type approval of ADS-equipped vehicles will be limited to small series type approval and certain use cases until the necessary requirements for unlimited series type approval are established (current target date: July 2024). In connection with this, the current developments of the EU on the regulation of artificial intelligence as well as the recast of the Machinery Directive should be observed; the relationship between these regulations is likely to raise some questions, especially in the area of automated and connected vehicles.

To cover the time period until a sufficient international and EU framework is in place and to secure Germany a certain pioneering role, a new Act on autonomous driving has been adopted in July 2021 amending the legal road traffic framework. Before this amendment, statutory provisions in Germany only allowed for regular operation by a driver up to SAE Level 3. The new Act now no longer requires a driver and intends to allow 'autonomous driving functions' at SAE Level 4 to be used in regular operation in defined operating areas. Instead of a driver, a new role of a 'technical supervisor', a natural person responsible to ensure compliance with road traffic law has been introduced by the new law. For this purpose, the technical supervisor has a variety of obligations, such as being able to activate alternative driving manoeuvres or switch off the ADS and communicate with the passengers. Typical use cases under the new Act may include robot shuttles and people movers. The overall goal is to bring vehicles with 'autonomous driving functions' into regular operation as soon as possible. To enable this, the Ordinance supplementing the Act on autonomous driving and setting out the necessary requirements and approval procedures (AFGBV) has recently been adopted and entered into force. This means that in Germany, regular operation of SAE Level 4 vehicles is now possible in certain specified operating areas. We expect that the interrelation between German domestic laws and the EU type approval requirements, once in force, will raise further legal questions. In December 2021, Germany was the first country to grant a type-approval under UN Regulation No. 157 for an ALKS (Mercedes-Benz Drive Pilot). As for testing of automated driving functions and the overall concept of automated road traffic, several German statutory provisions already provide a legal basis for German authorities to grant specific exceptional permissions. On this basis, numerous tests and pilot projects (eg, including regular passenger service with 'autonomous' shuttles) have been conducted on German roads in public traffic (eg, by Volkswagen, Audi, BMW, Daimler, Bosch, Continental, Delphi and ZF) as well as by a number of research institutes and organisations for several years. Such permissions for public road traffic currently usually require the existence of a human supervisor present in the vehicle who can intervene at any time. The new Act on autonomous driving expands these existing testing options and, most importantly, aims to harmonise and centralise the procedure on a national level.

At the same time, increased connectivity of vehicles has enabled the development and growth of new mobility solutions, particularly in the area of digital intermediation of rides and ridesharing services.

Recognising the increasing public demand for such services and their potential to contribute to a reduction of greenhouse gas emissions in the traffic sector, the German legislator is encouraging their adoption and integration in daily traffic. For instance, with the revision of the German Passenger Transport Act, which was adopted in March 2021, ride pooling services are getting a specific legal basis for an authorisation and can thus become a central component of the future passenger transport in Germany.

However, the increased automation and connectivity of vehicles has also led to new challenges. A major concern in this regard are the increased cyber threats to vehicles (eg, in the form of unauthorised

remote access to in-vehicle data and the illegal modification of vehicle software over the air). Also, regular software updates to fix bugs, improve vehicle performance, add new features and protect against recently discovered vulnerabilities are becoming increasingly important in automated and connected vehicles. To address these challenges, two landmark UN Regulations entered into force in January 2021:

- UN Regulation No. 155 on Cyber Security and Cyber Security Management Systems (CSMS), which requires OEMS, in particular, to establish and maintain a CSMS including processes to identify and manage cybersecurity risks, including supplier-related risks, during the whole vehicle life cycle (ie, development, production and post-production); and
- UN Regulation No. 156 on Software Updates and Software Updates Management Systems (SUMS) which requires OEMS, in particular, to establish and maintain a SUMS including processes that ensure that software updates are executed safely, securely and verifiably during the whole vehicle lifecycle (ie, development, production and post-production).

The two regulations are implemented in the EU type approval regime in two steps.

- since 6 July 2022, compliance with UN Regulation No. 155 and 156 is mandatory to obtain EU type approval; and
- as from 7 July 2024, compliance with UN Regulation Nos. 155 and 156 will also be mandatory for the registration of vehicles and, according to the wording, the placing on the market and entry into service of components and separate technical units.

Finally, as more and more data is collected by vehicles, questions of data ownership, the legality of data collection and processing and the accessibility of vehicle data (eg, by actors in the supply chain and aftermarket, authorities and mobility service providers) are becoming increasingly important. In addition to data protection, competition and contract law aspects, particularly also regulatory requirements have to be observed in this regard. For instance, in Germany, the Act on autonomous driving has introduced certain data processing requirements for vehicles with automated driving functions.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Also in 2021 and 2022, emissions of motor vehicles remain in the focus of authorities and courts at a national and European level. The ruling of the European Court of Justice (ECJ) of December 2020, which provided for the first time an interpretation of relevant provisions regarding the (in-) admissibility of defeat devices, is still of utmost importance. In its decision, the ECJ applied a rather broad interpretation of the term 'defeat device' and defined the scope of the exemptions to the general prohibition of defeat devices rather narrowly. On 14 July 2022, the ECJ has now rendered judgments on further questions of interpretation concerning, in particular, the legality of 'thermal windows'. In this respect, the ECJ ruled, in essence, that a thermal window may generally only be justified under two strict conditions. First, it seems that both requirements under article 5(2)(a) of Regulation (EC) No. 715/2007 must be fulfilled (ie, the thermal window must be required for the protection of the engine (against sudden and irreparable damage) and for the safe operation of the vehicle). In this respect, the ECJ reiterated that the (mere) clogging up and ageing of the engine are generally not sufficient. Second, the thermal window may not reduce the effectiveness of the emission control system for means of engine protection and the safe operation of the vehicle during most of the year based on its specific parameters. However, open questions still remain, particularly what 'during most of the year' means. It thus remains to be seen how EU authorities and courts will react to these new rulings by the ECJ. Also, other important requests for preliminary rulings are still pending before the ECJ. Among other things, they concern the question whether the emission requirements under Regulation (EC) No. 715/ 2007, such as the prohibition of defeat devices under article 5(1) and (2), at least also protect the interests of an individual purchaser of a vehicle. Due to their potential impact on emission litigation, the developments in these proceedings should be closely monitored.

Going forward, the automotive industry will also be particularly impacted by the stepwise implementation of the goals of the European Green Deal, as part of which the European Commission has, among others, already presented a strategy for sustainable and smart mobility together with an action plan containing 82 initiatives.

Several legislative initiatives with relevance for the automotive industry stemming from these roadmaps are expected to progress further in 2022 after they have been delayed in the past year. They are, for example:

- the proposal of a new Battery Regulation that, among other, foresees sustainable production, deployment and waste management requirements for electric vehicle batteries (repealing Directive 2006/66/EC);
- the planned revision of Regulation (EU) 2019/631 on CO_2 emission performance standards for new passenger cars and for new light commercial vehicles;

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- a proposal for a regulation establishing stricter emissions standards (Euro 7) for all petrol and diesel cars, vans, lorries and buses; or
- the planned revision of Directive 2000/53/EC on end-of-life vehicles.

Moreover, automotive supply chains will be subject to increasing scrutiny due to evolving due diligence and ESG requirements, such as the German Supply Chain Act, which was passed last year and will affect companies from 2023. Similarly, a proposal for a Directive on corporate sustainability due diligence is currently being discussed at the European level.

Despite these constantly evolving regulatory requirements and the challenges they pose, the German and global automotive industry has set itself the goal of redefining the mobility of the future. In addition to the development and commercialisation of electric vehicles as well as the introduction of new concepts for shared mobility and connected vehicles, the automotive industry is, in particular, continuously advancing the degree of automation of vehicles on the path to autonomous driving. In doing so, the automotive industry, subject to further technical, political and public challenges, still seems some steps ahead of the legislation. But the legislator may be catching up, particularly on an EU and a German national level. Thus, it remains to be seen how the German and global automotive industry will manage to mitigate these legal risks associated with the constantly changing regulatory landscape and the introduction of innovative technologies and business models to the German and international markets.

Hungary

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry has been the main engine of Hungarian industrial production (ahead of the manufacturing of computers, electronic or optical products) and economy. Since the end of the Soviet regime in 1989, Hungary became a target of global automotive investments, as the expertise of Hungarian engineers had a strong reputation worldwide and the labour force was relatively cheap. The significance and the size of the market has expanded rapidly ever since, mainly due to persistent export demand. Companies in the industry have significantly increased their production almost every year, except for the years following the economic crisis of 2008.

The Hungarian automotive industry is defined by four major car and motor factories and the foreign and domestic-owned supplier companies. Opel and Suzuki started car manufacturing in Hungary in 1992 and soon after Audi set up a factory in Győr in 1994. In 2012, Mercedes-Benz opened its car manufacturing plant in Kecskemét, and in 2018 the construction of a new BMW automobile factory in Debrecen was announced.

With more than 700 companies involved in the automotive industry, the sector employed the most people (176,000) in Hungary in 2019 generating 5 per cent of the Hungarian GDP and a manufacturing output of 9,541 trillion forint. Although this branch of the manufacturing industry provides 21 per cent of national exports, it also gives employment opportunities for countless small and medium-sized enterprises and suppliers. Fifty-one of the world's 100 largest automotive suppliers are present in Hungary, including Bosch, Continental, Knorr-Bremse and ZF.

After a period of extensive development and growth, the financial crisis caused by the covid-19 pandemic hit the automotive industry hard in 2020, making it one of the most impacted industries in Hungary. While the automotive industry somewhat stabilised In the second half of 2020, the global chip shortage that has been ongoing since 2020, has seriously affected the Hungarian automotive industry, including causing temporary shutdowns in manufacturing plants. While the chip shortage is still an issue in the Hungarian automotive industry, it has been overshadowed by the war in Ukraine, which further deepens the disruptions. Since the Ukrainian industry is the main supplier of certain parts and other parts are primarily sourced from Russia, Hungarian car manufacturers still expect issues ahead.

However, in parallel with the above, certain developments were also announced during 2021 in connection with e-mobility, eg, Robert Bosch, and EcoPro BM from South Korea. Continental has also announced plans to increase R+D activity in Hungary and the Japanese Toray Industries completed its new plant in Hungary that will manufacture components for lithium-ion batteries.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Since 1 September 2020, Regulation (EU) 2018/858 of the European Parliament and of the Council of 30 May 2018 provides for the administrative provisions and, by reference, the technical requirements for the type-approval and placing on the market of all new motor vehicles (categories M and N and their trailers of category O), that are intended to be used on public roads, including those designed and constructed in one or more stages, as well as systems, components and separate technical units, and for individual vehicle approvals. The Regulation also lays down provisions for the placing on the market and the entry into service of parts and equipment that may pose a serious risk to the correct functioning of the essential systems of the above vehicles. Furthermore, the Regulation sets out the requirements for the market surveillance related to the above. As of the above date, the Directive 2007/46/EC of the European Parliament and of the Council of 5 September 2007 was repealed. The Regulation is directly applicable across the EU.

The Regulation aims to raise the quality level and independence of vehicle type approval and testing, increase checks of vehicles that are already on the EU market and strengthen the overall system with EU oversight, including the Commission's right to order EU-wide recalls and to impose sanctions on the manufacturers of up to €30,000 per car in cases where manufacturers are in breach of type-approval legislation. The Regulation itself does not modify the technical requirements that vehicles are required to be approved to. Such technical standards are laid down in the regulatory acts listed in the relevant Annex of the Regulation.

Based on the Regulation, there are two kinds of type approvals: the 'national type-approval', the procedure whereby the relevant approval authority certifies that a type of vehicle, system, component or separate technical unit satisfies the relevant administrative provisions and technical requirements laid down by the law of a given member state, the validity of such approval being restricted to the territory of that member state, and the 'EC type-approval' whereby a member state certifies that the same satisfies the relevant administrative provisions and technical requirements of the Regulation. As a general rule, manufacturers shall ensure that the vehicles, systems, components and separate technical units that they have manufactured and that are placed on the market have been manufactured and approved in accordance with the relevant requirements, and shall be responsible to the approval authority for all aspects of the approval procedure and for ensuring conformity of production. Vehicles for which whole-vehicle type-approval is mandatory (or for which the manufacturer has obtained that type-approval)

shall only be made available on the market, registered or enter into service if they are accompanied by a valid certificate of conformity. Components and separate technical units, including those intended for the aftermarket, may only be made available on the market or entered into service if they comply with the requirements of the relevant regulatory acts listed in the relevant Annex of the Regulation and are marked in accordance with the respective provisions.

On a national level, the regulatory framework for the approval of automobiles and automobile parts is currently set forth by Decree No. 5/1990 (IV.12.). The Decree has a wider scope than that of the Regulation. The Decree itself – similarly to the Regulation – mainly covers the administrative procedure, while the technical requirements of automobiles and automobile parts are included in the relevant EU regulations, Decree No. 6/1990 (IV.12.) of the Minister for Transportation, Communication and Construction, which transposes the relevant EU Directives and implements EU regulations, and also the applicable UNECE regulations. The competent department of the Ministry for Innovation and Technology is responsible for granting type approvals for vehicles.

As a general rule, a vehicle may only be operated on public roads if the vehicle is officially put into traffic. Putting into traffic is carried out by registering the vehicle, issuing the relevant registration certificate and the registration plate. The competent government offices are responsible for putting a vehicle on the road. Based on Act LXII of 2009, all operators of motor vehicles registered in the territory of Hungary are required to have an insurance policy covering any injury arising from the use of motor vehicles, and to pay the relevant premium charged. As a rule, this obligation applies from the time when the vehicle is registered until it is deregistered (not including any period of discontinuance).

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

To date, several OEMs have chosen Hungary for manufacturing, as well as for engineering and services activities. In addition, more than 700 suppliers and several hundred other market players are active in the territory of Hungary. Regarding ownership structure, companies with a foreign majority owner are dominant in Hungary.

In terms of development, manufacture and supply, the dominant model in Hungary basically follows the model established by major players in western European countries. More specifically, Hungary tends towards the German model, where a significant part of the supply is provided by means of purchase orders placed by the OEM based on its actual needs with limited obligation on its part to purchase. The supply chain is split into distinct tiers; Tier I suppliers – being the first level suppliers – supply directly to manufacturing plants, Tier II suppliers produce parts based on designs provided by major Tier I suppliers and OEMs, while Tier III suppliers are mostly responsible for basic products, such as engineered raw materials.

The contractual framework is basically determined by the OEM or the major Tier I suppliers, usually applying their own general terms and conditions with only limited possibility for lower tier suppliers to negotiate. Such contractual terms then go down the supply chain. It is also common for OEMs and Tier I suppliers to apply further standardised contractual documents relating to the implementation of the contracts covering, in particular, issues of purchasing, production process and quality assurance, logistics, sustainability and environmental protection.

However, in line with the direction of global trends, in certain cases a stronger relationship may also exist between OEMs and especially major Tier I suppliers, including long-term development agreements to ensure full use of potential synergies in highly resource-intensive areas, such as the development of automated, driverless systems.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

There are no specific regulatory requirements in Hungary for importers, distributors, dealers or dealer networks for new vehicles.

The Hungarian new vehicle distribution sector is basically characterised by mixed type selective distribution systems. Accordingly, one or more car brands are usually promoted by a domestic undertaking acting as the importer. Very often the importer is a subsidiary or branch office of the manufacturer. Based on the selective distribution system, similarly to several other member states of the EU, only authorised dealers may market and sell new vehicles in Hungary if they have entered into a distribution agreement with the manufacturer or its importer. It is a fundamental characteristic of the selective distribution system that the manufacturer undertakes not to supply new vehicles to unauthorised dealers for the purpose of reselling. There are certain limitations applicable to such vertical distribution agreements under the EU and the Hungarian competition law as set out in Commission Regulation (EU) No. 330/2010, Commission Regulation (EU) No. 461/2010 (expiring on 31 May 2022), Government Decree No. 204/2011 (X.7) and Government Decree No. 205/2011.

There are no specific compulsory rules under Hungarian law relating to restructuring or termination issues with the distribution partners in the case of distribution agreements. Such issues are usually regulated by the manufacturer or importer and the authorised dealer within the framework of the distribution agreement, where it is not uncommon that the parties agree on a notice period exceeding 12 months. However, if the marketing and selling of the vehicles is carried out through a commercial agent within the framework of an agency agreement, which is also one possible way to organise distribution of vehicles, concluded for an indefinite term, this may be terminated by complying with certain statutory minimum notice periods. The Hungarian Civil Code sets out a minimum notice period of one month during the first contractual year, a minimum notice period of two months during the second contractual year and a minimum notice period of three months during the third and following contractual years, none of which may be validly shortened. Moreover, termination of the agency agreement may trigger the commercial agent's entitlement to financial compensation in the form of an indemnification claim, pursuant to the provisions set out in the Hungarian Civil Code. In such a case, the amount of the indemnity may not exceed the commercial agent's average annual remuneration over the preceding five years or the average annual remuneration during the actual term if it is less than five years. Any agreement of the parties prior to the termination of the agency agreement that derogates from the provisions of the Civil Code relating to such indemnification to the detriment of the agent shall be null and void.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no specific or sectoral rules on M&A or JV transactions relating exclusively to the automotive industry in Hungary; however, the general legal regulations regarding concentrations still needs to be observed. Based on Act LVII of 1996, as a general rule, a concentration shall be notified to the Hungarian Competition Authority if the combined net turnover of the relevant undertakings of the previous financial year exceeded 15 billion forints, and there are at least two groups

involved with net turnover of at least 1 billion forints. Furthermore, a soft threshold may also apply to the notification of concentrations, with a reduced turnover value of 5 billion forint if it is not obvious that the contemplated transaction would not significantly decrease competition in the relevant market. The government may – in the public interest, in particular, to preserve jobs and for the security of supplies – declare a merger of strategic importance at the national level. Such concentrations do not need to be notified to the Hungarian Competition Authority.

If the product range of the target company includes certain specific products (for example, military products) pursuant to Act LVII of 2018, a prior approval of the Minister of Interior is needed should a foreign investor directly or indirectly or together with other foreign investors acquire an interest exceeding 25 per cent (in the case of a publicly listed company an interest exceeding 10 per cent) or resulting a dominant influence in an existing or yet to be established company with a registered seat in Hungary. In addition, to protect the Hungarian economy with respect to the covid-19 pandemic, the Hungarian government introduced a foreign investment screening mechanism in respect of strategic industries including, among others, the automotive industry. The relevant regulation is set forth by the Act LVIII of 2020.

From a transactional point of view, thorough due diligence is always recommended for M&A transactions in the automotive industry. The most important areas that should be covered from a Hungarian legal perspective include the environmental and safety issues, the contractual relationships with distributors, dealers and suppliers, employment issues and intellectual property rights.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

Although there are no special incentives for investment in the automotive industry, general incentives for investment, such as subsidies granted upon individual decisions for large-scale investments as well as normative incentives, for instance, tax allowances may apply. In this regard, the automotive industry is one of the key sectors specified in Government Decree No. 210/2014 (VIII.27) regulating the use of the Hungarian investment incentive earmarked scheme. Being the national investment promotion organisation of Hungary governed by the Ministry of Foreign Affairs and Trade, the Hungarian Investment Promotion Agency (HIPA) is responsible for government incentives for investment and is also the managing body of the 'VIP' cash subsidy system based on individual government decisions. 'VIP' cash subsidy is a non-refundable, post-financed regional investment aid. The amount of the subsidy, as well as the maximum aid intensity, may be influenced by several factors, in particular the location of the project and the development of the region where the project is planned to be implemented, as further regulated under Government Decree No. 210/2014 (VIII.27).

In addition to the above, various local business tax and corporate income tax incentives are available in Hungary covering investments and R&D activities also. While the fundamental rules of corporate income tax incentives are set forth by Act LXXXI of 1996 on Corporate Tax and Dividend Tax, the specific details are set out in further legislation, such as Government Decree No. 165/2014 (VII.17) on the development tax incentive, providing, among others, the relevant rules on aid intensity.

Moreover, pursuant to Act LIII of 2006 on the acceleration and simplification of the implementation of investments of strategic importance at the national level, the government, by its individual decision enacted in government Decrees, may provide a simplified procedural framework and grant legislative exemptions to support and promote investments. To date, several individual decisions favouring market players of the automotive industry have been adopted pursuant to Act LIII of 2006, proving the potential of the legislation.

Collaboration between universities and automotive market players is also supported in Hungary. One good example of this is the cooperation agreement that was concluded by Hungarian universities and joined by several major players, including Audi Hungaria Motor Kft, Continental Hungaria Kft, General Motors Powertrain-Magyarország Autóipari Kft, Knorr-Bremse Fékrendszerek Kft and Mercedes-Benz Manufacturing Hungary Kft.

There are no specific barriers to entry into the automotive market in Hungary. However, depending on the actual circumstances, the provisions of the Act LVII of 2018 and the Act LVIII of 2020 need to be taken into account.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Hungary, being a member state of the European Union, is subject to the directly applicable regulations of the European Union in the context of product compliance safety and environmental matters, and the relevant Directives of the European Union, including Directive 2001/95/EC on general product safety, have been implemented into Hungarian law. The basic rules of product safety under Hungarian law are set out in the Hungarian Market Surveillance Act, while detailed procedural rules on automotive-related products safety matters are laid down in ministerial decrees.

General rules on product safety include the manufacturer's obligation to design and manufacture its product in accordance with the applicable laws of the European Union and other laws applicable to the relevant product, to prepare the relevant technical documentation and to carry out the necessary conformity assessment procedures, to provide compliance throughout serial production.

The manufacturer is also bound to supervise its product if it finds such supervision necessary and to take the necessary measures, including the recall of its product, if any non-compliance is revealed. The manufacturer is also obliged to notify the competent supervisory authority of any such measures. The importer and the distributor are subject to similar obligations.

In terms of automotive specific regulations in the context of safety and environmental matters, local Hungarian legislation includes rules on periodic tests of vehicle safety, roadworthiness aspects and emissions and rules on end-of-life vehicles in accordance with Directive 2000/53/EC.

The supervisory authority in automotive matters is the National Transport Authority, which enforces automotive-related regulations in Hungary. Product recalls and other safety measures affecting motor vehicles must be notified to the National Transport Authority. In accordance with the harmonised rules on motor vehicle recalls, Hungarian law provides that product recalls must be notified to the authority that issued the type approval. The authority will issue recommendations on the appropriate measures and will notify the responsible authorities in the other member states of the EU. If the measures of the manufacturer are insufficient or are delayed, the issuer of the EC type approval is notified that this may result in the withdrawal of the EC type approval. The National Transport Authority publishes all relevant information in relation to motor vehicles that are hazardous to the health and safety of consumers or that otherwise do not comply with the applicable safety provisions.

With respect to the entry into effect on 16 July 2021 of Regulation (EU) 2019/1020 on market surveillance and compliance of products, the Hungarian Market Surveillance Act was amended with effect from such date. As a result of the amendment, the Hungarian authorities are now in a position to take enforcement measures against fulfilment service providers as well as importers and distributors, if the relevant conditions apply. In addition, the amendment also introduced regulations in relation to liaison offices between the member states of the European Union and the requirement for the National Transport Authority to use the information and communication system for market surveillance (ICSMS) to exchange information considered helpful for other market surveillance authorities.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

The rules of product liability under Hungarian law are set out in the Civil Code of Hungary based on EU Directive 85/374/EEC and apply to damages caused by a defect in a manufacturer's product. Product liability typically applies in the absence of a contractual relationship as the liable party is the manufacturer or the importer of the motor vehicle and motor vehicles are typically sold through distributors and dealers. In addition, product liability only applies to consequential damages (ie, damages causing death or personal injuries, health damages and damage to, or destruction of, any item of property other than the defective motor vehicle itself), with a lower threshold of the Hungarian forint equivalent of €500. In addition, product liability may only be relied on in the case of private use, thus, product liability can be typically applied to consumers.

Consequently, product liability may not replace warranty claims, whether statutory or contractual, and is not applicable to business use, which narrow down the applicability of product liability provisions. In addition, motor vehicle owners frequently rely on their insurance and do not pursue claims against the manufacturers. As a result, notwithstanding the manufacturer's and the importer's objective liability and a fairly long limitation period of 10 years, product liability law cannot be considered as significant in Hungary in the automotive industry.

In the absence of a significant presence of product liability cases in the automotive industry, there are no class actions or other significant published consumer litigation in product liability cases. As class actions are only recognised since 2018 under Hungarian civil procedural rules, there are no notable examples of class actions in general under Hungarian law either.

In terms of the significance of product recalls in the automotive industry, there are only 16 alerts concerning Hungary and only four alerts made by Hungarian authorities over the past 10 years in the Rapid Alert System of the EU (RAPEX) in relation to motor vehicles, which is rather insignificant compared to other member states of the EU and the overall number of notifications.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Competition and antitrust issues are not uncommon in the Hungarian automotive industry. The Hungarian Competition Authority, being the competent regulatory authority for competition matters, initiates investigations to determine, among other things, if there is an agreement in place between market players that may distort competition or if there is a violation to the consumer protection acts. In these matters, there have been numerous automotive industry-related examinations in the past two decades.

The most frequent proceedings, however, are the examinations concerning the concentration of companies. There were several cases in the past, and the subject of these investigations were mainly Hungarian suppliers. From the annual report issued by the Hungarian Competition Authority to the Hungarian parliament, it is apparent that in 2019, the automotive and automobile component manufacturing industry was the fifth most investigated industry in Hungary.

The recent European truck cartel case has also had its effects in Hungary. Hungarian carriers are joining the ongoing lawsuits against European truck manufacturers in Munich, and lawsuits have also already been started before several Hungarian courts. According to the latest procedural developments, the European Court of Justice established in an interim decision that damages may be claimed before local Hungarian courts, even against a cartel member with whom the injured party had not established direct contractual relationship.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

In recent years, there has been a growing tendency in the European automotive industry, including Hungary, to insert detailed dispute resolution clauses into contracts and agreement, often selecting the applicability of laws other than the Hungarian as well as various arbitration forums. As a result of the above, similarly to intellectual property disputes, cases are, on many occasions, settled before reputable international judicial forums, outside Hungary.

Owing to the growing number of suppliers present on the Hungarian automotive market as well as the growing complexity of the solutions offered and used in the industry, such as various software development tasks, one of the current issues in relation to Hungarian liability disputes is to determine the ultimately liable party, especially if there are more than two tiers of suppliers.

Beside the above-mentioned liability disputes, cases connected to intellectual property rights, development, tools and supply agreements as well as distribution agreements, defects and product recalls are also likely to affect companies involved in the Hungarian automotive industry. Unfortunately, there are no official statistics or data available on the number and the subject of those disputes.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

In Hungary, similarly to most countries, the reasons of distress of a supplier, the type of risks causing the distress and the process of dealing with them are dependent on numerous aspects, such as the size of the company, whether the given company is new to the market or it is a company with relevant experience.

As a general experience in Hungary on the suppliers' side, the most relevant risk factor is the potential insolvency of the buyer company. Such assessment is especially applicable these days, as the covid-19 pandemic, the rise of energy prices, the shortages of components and the temporary shutdowns of automotive manufacturing plants severely impacted the Hungarian automotive suppliers, of which a number are considered close to bankruptcy, according to the view of professional

market analysts. In cases of insolvency, the loss is not merely the consideration for the goods or services ordered, but also the additional costs, such as temporary storage and the auxiliary tasks performed regarding the goods or services concerned.

While it is not possible to prepare for every scenario caused by a distressed supplier or supply chain, certain preliminary measures may be taken by the market players of the automotive industry to mitigate the impact of such events, if it becomes necessary. The buyer company may re-source the production of the part to a new, healthy alternative supplier. Alternatively, the buyer can help the supplier by improving its operations and finding a suitable third party to buy the supplier. If neither of the above-mentioned options are applicable and the component is critical the company may consider acquiring the troubled supplier.

In terms of precautionary measures, it is not unusual that principals implement a protocol dealing with distressed suppliers to identify and address such unwanted situations in the most effective way possible. For this purpose, companies in the automotive industry continuously gather data on their suppliers regarding their financial status, including turnover and solvency data, credit reports, number of employees, cash flow and also whether any court proceedings were initiated against a given supplier. The continuous monitoring of these data, which are publicly available in official Hungarian databases, gives the automotive companies the opportunity to find the signs of upcoming or potential distress of a supplier. Scenario simulations are also prepared on the basis of the information gathered.

The Act on Business Restructuring will enter into force in July 2022, implementing the directive of the European Union on business restructuring. The main goal of the European and the national legislator is to combat the above-mentioned issues regarding insolvency.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Intellectual property plays a significant part in the automotive industry in both the fields of aesthetics and technical designs. Intellectual property law offers many indirect and direct ways to protect the design of automobiles, among others patent, trademark, copyright and design. Disputes easily arise in all the mentioned cases such as infringement of a patent or breach of copyrights.

However, the main players of the Hungarian automotive industry are car plants where the manufacturing of different components or the assembly of the automobiles takes place, not the actual designing. Accordingly, it is, therefore, atypical that the participants of the automotive industry initiate legal proceedings before Hungarian courts regarding intellectual property or to register a Hungarian national design or trademark for that matter. Legal disputes that may arise with the involvement of the automotive parent companies, the disputes are usually dealt with at the national courts of the countries where these companies have their registered seats or before the arbitration courts of their choice. This is also the case if the dispute concerns an alleged infringement of a European patent, since there is currently no common European patent court.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Labour relations in the automotive sector in Hungary have been recently discussed mostly in the context of working time arrangements and employers' ability to designate working time, work schedules and shift patterns in a flexible manner.

Under Hungarian law, employers are entitled to designate and amend work schedules unilaterally subject to protective mandatory provisions regulating, for example, working time and rest time. Employers are entitled to designate regular working hours unevenly within a certain period; thus, through planning, employers may significantly reduce the number of paid overtime hours compared to a regular work schedule. A longer working time cycle thus serves the interests of those employers whose business can be scheduled further ahead.

In the automotive industry, the maximum working time cycle is typically six months (or 26 weeks) without a collective bargaining agreement, while if justified by objective, technical or work organisation reasons, a collective bargaining agreement may set out a maximum 36 months' working time cycle. In practice, most employers have been unable to justify having a working time cycle longer than one year, and most trade unions have been reluctant to agree to such a working time cycle. Between 11 April 2020 and 17 June 2020, it was possible for employers to introduce a 24-month working time cycle so as to designate shorter working hours for a longer period to be compensated with longer working hours at a later stage due to the covid-19 pandemic. Such 24-month working time cycles may no longer be introduced, although the ones introduced when the applicable regulation was in effect have been continued unaffected by the regulations introduced later.

Since, as noted above, the agreement of trade unions is required for a number of working time arrangements, compared to other industries where unionisation is not widespread in Hungary, collective bargaining agreements are fairly common in the manufacturing industry, and particularly in the automotive sector. In the absence of an industry-wide collective bargaining agreement in the automotive sector, trade unions have more room to bargain for better working conditions and higher remuneration locally.

In addition, where an employer is not subject to a collective bargaining agreement and there is no trade union represented that could conclude a collective bargaining agreement, works councils are entitled to settle in a works council agreement all matters except remuneration that could be settled in a collective bargaining agreement. This gives works councils wider negotiating opportunities in addition to their traditional participation rights, albeit with a weaker bargaining power and, potentially, a stronger dependence on the employer compared to trade unions.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

In the past few years, one of the most important legal developments relating to automotive technological and mobility advances was the implementation of certain new provisions on the testing of self-driving motor vehicles. The Hungarian government considers the testing of autonomous driving as a priority area of development that has resulted in various investments in Hungary recently.

The legal framework for the testing of autonomous motor vehicles was first implemented in 2017 through the amendment of the relevant ministerial decrees that regulated the entire testing process. Based on these provisions, developers are entitled to perform tests on both closed test tracks and in road traffic. The relevant regulations adhere to international standards, such as the definition of the automation level definitions adopted by the Society of Automotive Engineers, and take into consideration foreign codes of practices.

The first set of rules was followed by an amendment that entered into effect in December 2018. As a result of the amendment, various registration and notification obligations in relation to the testing process of autonomous motor vehicles were simplified, including the abolition of the requirement to register Level 2 (hands off) car tests on closed test tracks, the elimination of an itemised notification requirement in relation to self-driving motor vehicles placed on the road (the notification of an approximate number is sufficient) or the extension of acceptable standards beyond ISO 26262. Certain recording obligations have also been simplified. For instance, in the context of the recording of test periods, a daily recording is sufficient compared to the previous requirement to record tests down to the minute. In addition, the recording time of accidents in the black box has decreased from 24 hours before and one hour after the accident to one hour before and one minute after the accident.

The above amendment indicates efficient communication between developers and government officials and the government's aim to create a proper legal environment to new developments in Hungary.

However, some of the most significant legal challenges have yet to be resolved, including the investigation of liability matters and the implementation of a special liability regime that will most probably be necessary to provide an appropriate response to the dilemmas that have already been heavily discussed in the context of damage caused by self-driving cars. In addition, the legal framework of telecommunication law (which is fairly rigid in Hungary compared to the continuously evolving technical and technological solutions in the industry) will also need to be adapted to autonomous vehicles, as legal issues (including regulatory and privacy matters) that are currently in the background will most likely be of high priority in the context of connected vehicles and connectivity services.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

As a step to promote the spread of electric motor vehicles and electromobility, as of 2022, as part of the construction of newly built buildings or major refurbishment of the electric infrastructure or parking spaces of buildings with more than 10 indoor or adjoining outdoor parking spaces, the installation of charging stations and other relevant charging infrastructure for the charging of electric motor vehicles is required. Similar requirements apply in this context to both residential and non-residential buildings. Non-residential buildings with more than 20 parking spaces will be subject to a general requirement to install charging stations as of 2025.

* *This chapter was co-authored by Andras Multas, who has since left the firm.*

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The Indian automotive market is currently the fourth largest in the world and is one of the most dynamic sectors of the Indian economy, with most of the global automotive giants already present in the market and contributing to its growth.

Over the years, India has established itself as a strong base for automotive manufacturing and is now the seventh-largest manufacturer of commercial vehicles. Maruti Udyog, which started as an Indian government initiative, was the only major player for a decade until the floodgates for foreign investment into India were opened in 1991. Both primary and secondary automobile markets in India have developed to witness the most reputable international automotive manufacturing companies competing for market share. Although customers have a wide array of automobile brands available in India, Maruti Suzuki India, owned by Japan-based Suzuki Motor Corporation continues to be the leader, with approximately 50 per cent of the market share in the passenger vehicle segment, followed by Hyundai Motor India and Tata Motors Limited.

In terms of foreign direct investment in the automotive industry, there has been a growth of almost 62 per cent during the first four months of financial year 2022. Factors such as directives for easing business in India and economic reforms have contributed to growth in this sector and the government of India has driven, and continues to drive the implementation of a fully liberalised foreign direct investment policy and a host of incentives ranging from tax and customs benefits to concessions for producing electric vehicles. India is expected to attract approximately US$100 billion of foreign direct investment during the financial year 2022–23.

The industry had suffered a certain amount of de-growth in the financial years 2020–2021 and 2021–2022 primarily on account of the unprecedented circumstances created by the covid-19 pandemic. The two-wheeler segment, which accounted for 81 per cent of the market, faced a decline of 27.25 per cent in its sales whereas the sale of passenger vehicles was overall down by 6.53 per cent in sales. The three-wheelers also faced a decline of over 2.2 per cent.

Though the Indian market faced setbacks owing to challenges posed due to the covid-19 pandemic, including supply-side issues, but the relaxations offered by the government encouraged to create more domestic demand and also promoted export, which has paved way to normalcy. Also, commercial vehicle sales, which were down by almost 20 per cent in 2021, have now increased by 7.41 per cent in 2022. The Indian automotive market is expected to receive a significant boost in its automotive retail sales in 2022–2023. In fact, it has been able to bounce back and recover significantly in March 2021 and 2022. According to the Society of Indian Automobile Manufacturers (SIAM), the market trend in March 2021 showed a 76.75 per cent growth rate in sales in comparison with March 2020 sale figures. It even crossed the sale figures of the first quarter of 2019 (pre-pandemic era). As of 2021, the four-wheeler sales grew by 115.2 per cent and the two-wheeler sales were 72.67 per cent higher.

India is also a prominent automobile exporter with overall automotive exports of 17–20 per cent of its automobile production sent to Africa, Latin America, Asia and the Middle East as its main export destinations. The initial stages of the national lockdown imposed in India in 2020 due to the pandemic, strongly affected the production of vehicles and consequently caused a disturbance in the economies of several countries importing vehicles from India. This led to considerable reduction in the exports 2019–20 to 2020–21. However, as the lockdown was lifted and manufacturing activities resumed to the pre-covid-19 levels, the exports have seen a surge from 2021 to 2022, with Maruti Suzuki India leading the way with highest-ever exports in February 2022.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The Motor Vehicles Act 1988 (MVA) read with the Central Motor Vehicles Rules 1989 (the CMV Rules) framed thereunder by the central government constitutes the principal regulatory framework for manufacture, registration and insurance of automobiles and automobile parts. The MVA vests authority with the central and state governments to make and implement rules regulating the construction, equipment and maintenance of automobiles with respect to several aspects including dimensions, emission norms, automobile parts such as brakes, steering gears, safety devices and warranty after-sales. The central government primarily administers and regulates the industry through its apex wing, the Ministry of Road Transport and Highways.

The manufacturing and maintenance of an automobile must comply with the parameters and standards as prescribed under the CMV Rules and those notified by the central government from time to time. The checks and controls are formulated at the stages of (1) proposal to manufacture or import a new automobile; (2) during the manufacturing process; (3) sale and use of an automobile; and (4) recalling of automobiles in the case of defects in the vehicles sold.

A manufacturer or importer that proposes to manufacture or import a new automobile is required to obtain approval of the prototype of such automobile from the designated testing agencies. The procedure for type approval and certification of automobiles for compliance with the MVA and CMV Rules should accord with the Automobile

Industry Standards as prescribed and notified by the central government. While the production of automobiles is ongoing, the CMV Rules require conformity of production tests to be conducted periodically on automobiles drawn from the production line to verify that they conform to the approval certification. Upon manufacturing being completed and sale of an automobile, the manufacturer has to issue a certificate of roadworthiness and quality to the owner, and thereafter, for in-use vehicles, owners are required to obtain a 'pollution under control' certificate a year after the date of its registration from the agency authorised by the relevant state government.

As in most other jurisdictions, every vehicle is required to be registered by the owner with the concerned registering authority and cannot be driven on public roads prior to registration. The vehicle is to be registered with the registering authority in a jurisdiction where either the individual resides or his or her place of business exists. An automobile's registration certificate is valid for a period of 15 years for petrol automobiles and 10 years for diesel automobiles from the date of issue of the registration certificate, and the same can be renewed thereafter for five years subject to inspection and the roadworthiness of the automobile. The registration of a vehicle is deemed complete only on the issue of a certificate of fitness by an authorised testing station after it has carried prescribed tests and such certificate is valid up to two years. The certificate is required to be valid at all times during the use of the vehicle. The renewal of the certificate of fitness for transport vehicles (that is, a public service vehicle, a goods carriage, an educational institution bus or a private service vehicle) up to eight years old is granted for up to two years, but for those older than eight years, the renewal is only for up to one year.

Insurance of an automobile is compulsory before the automobile can be driven in a public place. Insurance of an automobile is provided by an authorised insurer, which issues a certificate to the policyholder. An insurance policy is usually valid for a period of one year and is required to be renewed before the due date. The MVA mandatorily requires the insurance policy to cover third-party risks.

An important development in the regulatory regime of the sector has been the implementation of certain crucial and much-awaited amendments to the MVA, which had been introduced in the Motor Vehicles (Amendment) Act 2019 (MV Amendment Act) in a staggered manner vide notifications dated 28 August 2019 and 25 September 2020. One of the most important of these is the mandatory recall mechanism, which includes prescribed grounds and obligations for conducting a recall, notification requirements, assignment of responsibility, destruction of defective parts, record-keeping, auditing and penalties. The CMV Rules prescribe hefty fines to be imposed on the manufacturers, importers or retrofitters of motor vehicles on the basis of the number of motor vehicles recalled, starting from 1 million rupees up to a maximum fine of 10 million rupees.

The MV Amendment Act also provides for a penalty, including criminal liability of manufacturers, importers and dealers of motor vehicles that fail to comply with the provisions of Chapter VII under MVA and CMV Rules, which relate to construction, maintenance, sale and alteration of motor vehicles and components. The penalty includes mandatory recalls, with imprisonment for a term that may extend up to a period of one year or with a fine that may extend to 100,000 rupees in usual cases up to a maximum of 1 billion rupees in matters involving contravention of provisions regarding construction, maintenance, sale and alteration of motor vehicles and components, and other rules made thereunder by central or state government.

A significant recent development in the regulatory structure is the introduction of the Motor Vehicles (Registration and Functions of Vehicle Scrapping Facility) Rules 2021 (Vehicle Scrapping Rules) effective as of 25 September 2021. The said Vehicle Scrapping Rules have been discussed below.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Although foreign direct investment in the automotive sector is permitted up to 100 per cent without conditions, most foreign automobile companies have been carrying out manufacturing and distribution business in India by setting up joint ventures with Indian counterparts. Automotive parts manufacturers have also followed this commercial setup.

In a typical joint venture arrangement in the automotive sector, the Indian party is responsible for obtaining all local licences and approvals required for manufacturing operations. On the other hand, the foreign investor, besides bringing in capital contribution, is primarily the source of technology, technical assistance and R&D. Support, technology and technical assistance are usually licensed by the foreign partner to the joint venture subject to certain standard conditions (such as limited use by the joint venture for the purposes of manufacturing specified products). The foreign partner often negotiates a royalty (usually based on the total sales made by the joint venture company) as a consideration for licensing the technology to the joint venture.

Most of the leading auto parts and component manufacturers and suppliers, including Bosch, Lucas TVS, Delphi, Visteon, Autoliv, Wabco, BorgWarner, Denso and Nippon Seiki, have followed the multinational automotive companies in setting up their plants and shops in India. These suppliers have entered into supply arrangements with the automotive manufacturing companies.

The automotive manufacturing companies distribute and sell their products to retail customers through an authorised dealership network. The automotive manufacturers enter into contractual arrangements with the dealers for distribution to retail customers. Certain standard conditions for eligibility and continuity of dealership include adequate infrastructure, personnel, investments and working capital. The dealership agreements usually prohibit the dealer from engaging in distribution of automobiles manufactured by competing brands.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Distribution

As a general commercial practice, vehicles are distributed on the basis of contractual arrangements between manufacturers and authorised dealers.

There are no specific pieces of legislation regulating the business of distribution or dealership of automobiles. All commercial terms including provisions relating to termination and restructuring are agreed between the manufacturer and the distributors or dealers under private contracts. Usually, contracts do allow parties to terminate the contract with a reasonable notice period. On a related note, given that automobile distribution agreements have come under the scrutiny of the Competition Commission of India for alleged malpractices, such as resale price maintenance, exclusive distribution agreements and tie-in agreements, caution must be exercised to ensure that such distribution agreements are not anticompetitive in nature thereby attracting the provisions of the Competition Act, 2002.

Typically, the dealers have been family-owned concerns or businesses. Recently, we have witnessed several automobile manufacturers operating in India concentrating more on the management structure of family-owned and run dealerships. In fact, some automotive

manufacturers have been contemplating amendments to the dealership contracts to ensure that the dealer entities are organised or re-organised with consolidated management control vested in the family leader or the key person in control, rather than shareholding of the dealer companies being spread and fragmented across numerous family members.

Imports

The conditions and specifications in relation to the import of new and second-hand automobiles into India are specified in the Foreign Trade Policy (FTP) and regulated by the Director General of Foreign Trade. The FTP prescribes certain requirements with regard to the import of automobiles such as:

- new automobiles can be imported into India through the Indian customs ports such as seaports in Mumbai, Cochin (Kerala), Vishakhapatnam, Chennai and Kolkata, while second-hand automobiles can be imported only through the Indian customs port in Mumbai;
- only certain identified categories of second-hand automobiles can be imported into India;
- imported automobiles are required to conform to the MVA and CMV Rules; and
- the importer is required to submit a certificate from a notified testing agency at the time of importation that certifies that the automobile conforms with the MVA and CMV Rules.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no specific particularities for M&A or JV transactions for the automotive industry as such. However, generally due to the size of the automotive industry, due diligence is considered desirable in relation to real estate, waste management processes, environmental approvals and compliance with employment-related laws. With rapidly changing technology becoming a critical part of the automotive industry, considerable focus and attention are also required on ownership and protection of intellectual property rights.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

The government of India has played a major role in promoting investment in the Indian automotive sector. The central government primarily extends support and incentives to the automotive industry by way of tax exemptions and reductions such as customs duty charged on imports of automotive components when imported in completely knocked down kits (meaning units that contain a pre-assembled engine or gearbox or transmission mechanism or a chassis where such parts or sub-assemblies are installed).

The recently introduced Vehicle Scrapping Rules will also boost the motor vehicle sales by reducing the number of unfit vehicles on the road and encouraging the purchase of new vehicles equipped with better technology.

The central government has also endeavoured to extend tax-related reductions to exporters of auto components under the Merchandise Exports from India Scheme, notified in the FTP of 2015–2020 applicable until 30 September 2022.

During the past couple of years, the government of India has launched a number of schemes to encourage the growth of the automotive sector, such as:

- the Automotive Mission Plan 2016–26, which aims to increase the domestic production of automobiles, increase automotive exports and address environmental and safety challenges;
- the National Automotive Testing and R&D Infrastructure Project, which has been set up to enable the industry to adopt and implement global performance standards by establishing nationwide automobile testing agencies;
- the Faster Adoption and Manufacturing of (Hybrid) and Electric Vehicles in India scheme (FAME-India Scheme), which provides monetary incentives to producers and purchasers of eco-friendly vehicles in the country. The government of India approved the second phase of the scheme in February 2019 for a period of five years with a budget of around 10,000 crore rupees, which will be implemented until FY 2023–2024. Phase-II of the FAME-India Scheme is implemented through demand incentives, the establishment of a network of charging stations and administration of the scheme through publicity and other activities; and
- to promote the use of electric or hybrid vehicles, the government has introduced various schemes and incentives:
  - the National Electric Mobility Mission Plan 2020, to provide incentives to manufacturers of electric cars;
  - in 2021, the Indian government approved a production-linked incentive scheme for manufacturing advanced chemistry cells in India to facilitate a reduction in the price of batteries, which would further lead to reduction in price of electric vehicles. A similar scheme for the automotive sector was also approved by the Indian government, namely, the Production Linked Incentive Scheme for the automobile and auto component industry. It enhances India's manufacturing capabilities for advanced automotive products. This scheme provides incentives for determined sales of advanced automotive technology products (vehicles and components) manufactured in India from 1 April 2022 for a period of five consecutive years. The Production Linked Incentive scheme consists of two components, the Champion OEM Incentive Scheme (it is a sales value linked scheme, applicable to battery electric vehicles and hydrogen fuel cell vehicles of all segments) and Component Champion Incentive Scheme (a sales value-linked scheme, applicable to advanced automotive technology components of vehicles, completely knocked down or semi-knocked down kits, vehicle aggregates of two-wheelers, three-wheelers, passenger vehicles, commercial vehicles and tractors). Applications of major automotive manufacturers in the Indian market, such as Ashok Leyland Limited, Ford India Pvt Ltd, Kia India Pvt Ltd and Tata Motors Limited, have been accepted for the Champion OEM incentive;
  - battery-operated vehicles are given green number plates and are exempt from permit requirements and payment of fees for the purpose of issue or renewal of registration certificate and assignment of new registration mark. The government has also provided a 2 per cent concession on tax for electric vehicles in respect of the BH - series non-transport vehicles at the time of registration; and
  - the goods and service tax on electric vehicles has been reduced from 12 per cent to 5 per cent and goods and service tax on chargers or charging stations for electric vehicles has been reduced from 18 per cent to 5 per cent. Tax deductions up to 1,50,000 rupees are available for electric vehicles under the Income Tax Act 1961.

Additionally, to avoid shortages and delay in providing essentials during the covid-19 pandemic, the government permitted vehicles exclusively carrying oxygen to operate without any specific approval. The

state governments have been actively involved in offering incentives to the automotive sector, especially to attract foreign automobile manufacturers to set up in their states. The incentive offers usually involve lease and sale of land at concessional rates, reductions in land-related levies or duties and power tariffs, concessional rates of interest on loans and investment subsidies. Very often, the state governments also offer special incentive packages for mega projects. State governments are also providing incentives and subsidies on the purchase of electric vehicles that are separate from those granted under FAME-India Scheme, Phase II. The states such as Rajasthan, Karnataka, Tamil Nadu, Uttarakhand and Punjab, acting on the advisory issued by Ministry of Road, Transport and Highways in January 2019, have provided exemptions to electric vehicle users from paying road taxes.

The Indian automotive industry does not impose any specific entry barriers on the market. Being a capital-intensive sector, as may be the case in other countries, production has proven to be cost-effective only if large volumes are achieved. The new entrants thus often face financial challenges until economies of scale have been achieved. In an extremely competitive market such as India, building up a brand is challenging and can be time-consuming, specifically in this sector, owing to customer loyalty with the established manufacturers (such as Maruti in India). New entrants often face high costs and hurdles and find it difficult to compete with the well-established brands. The other general commercial issues are the huge costs involved in technological advancements and modifications to the product to suit the Indian customer base.

Over the past several years, the Indian market has been experiencing an upward trend in the entry of foreign automotive manufacturers including in the luxury and sports car segments, with companies such as Tesla, Maserati, Aston Martin and Lamborghini setting up dealerships and aftersales infrastructure in India. Large or small, it is a fact that even the well-established automobile manufacturers have to make continued efforts and investments to retain their customer base in view of increasing competition. For instance, Morris Garages (MG) entered the Indian market by setting up its first manufacturing facility in the western state of Gujarat in 2019. After making huge investments, MG has significantly grown and increased its market presence in India and registered 69 per cent growth in the first quarter of this year. The unique and latest technical features coupled with comfort in driving are also playing a huge part in increasing sales.

The MV Amendment Act also provides for a penalty, including criminal liability of manufacturers, importers and dealers of motor vehicles that fail to comply with the provisions of Chapter VII under MVA and CMV Rules, which relate to construction, maintenance, sale and alteration of motor vehicles and components. The penalty includes mandatory recalls, with imprisonment for a term that may extend up to a period of one year or with a fine that may extend to 100,000 rupees in usual cases, up to a maximum of 1 billion rupees in matters involving contravention of provisions regarding construction, maintenance, sale and alteration of motor vehicles and components, and other rules made thereunder by central or state government.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

MVA read with the CMV Rules authorise the central government to notify, from time to time, quality, safety and performance standards in relation to any part, component or assembly to be used in the manufacture of an automobile. Every manufacturer is required to obtain approval for the prototype of the part, component or assembly for which standards have been notified and approved by any agency referred to in the CMV Rules. After obtaining approval, every manufacturer is also required to certify its compliance under the statutory form prescribed under the CMV Rules.

The Ministry of Environment and Forests has laid down rules to ensure that standards for emissions of air pollutants from automobiles are kept in consonance with international standards. Schedule IV to the Environment (Protection) Rules 1986 provides for standards for emissions of smoke or vapour from automobiles. The Bharat Stage Emission Standards (based on European regulations) are emission standards that have been set up by the central government to regulate air pollutants from internal combustion engine equipment, including motor vehicles. Currently, the vehicle emissions standards adopted throughout the country are the Bharat Stage VI (BS-VI). The MVA requires every automobile owner to carry a valid pollution under control certificate, which is issued by the designated checking facilities to certify compliance with the prescribed emission norms. The MVA prescribes punishment by way of a fine in the event a person is found to be driving an automobile in any public place that violates the standards prescribed in relation to road safety and pollution.

The Ministry of Road Transpiration and Highways amended the CMV Rules to mandatorily require every vehicle manufactured on or after 1 April 2020 to be compliant with the new and stricter BS-VI emission standard. In fact, BS-VI emission norms were also made mandatory for quadricycles (L7), the new category of vehicle that was introduced on 22 May 2020 on the lines of the European Union's World Motorcycle Test Cycle.

Separately, special purpose vehicles are those that are constructed or altered to serve as a specific transportation requirement of goods or passenger transport. The CMV Rules mandate these special purpose vehicles to comply with prescribed automotive industry standards till the corresponding bureau of Indian standard specifications are notified under the Bureau of Indian Standards Act 2016. The automotive industry standards provide for the emission norms or procedures for type approval.

One of the most important developments in the automotive sector for reduction in pollution is the introduction of Vehicle Scrapping Rules. The Ministry of Road, Transport and Highways has formulated these Vehicle Scrapping Rules to ensure that all vehicles that have not renewed their certificate of registration, have not been granted a certificate of fitness, have been damaged due to fire or accident, have been declared obsolete or outlived their utility are taken off the road.

The Vehicle Scrapping Rules broadly provide for the following.

- They lay down the procedure to receive and record the end-of-life vehicles including depolluting, dismantling, segregation of material, safe disposal of non-reusable parts, and issuance of certificate of vehicle scrapping to the registered owner of a motor vehicle. End-of-life vehicles are defined as vehicles that are not validly registered, or are declared unfit through automated fitness centres, or their registrations have been cancelled or, they are declared as waste vehicles by a court of law or through self-declaration (ELVs).
- Registered vehicle scrapping facilities are those that hold a registration for dismantling and scrapping of ELVs. They have been provided connectivity and access to the VAHAN database of vehicle registration and are authorised to make suitable entries regarding the scrapping of the vehicle. They issue a certificate indicating transfer of ownership from vehicle owner to registered scrapper (Certificate of Deposit) and certificate recognising final disposal of a vehicle (Certificate of Vehicle Scrapping) and ensure that the minimum technical requirement for collection and dismantling centres, removal or re-cycling or disposal of hazardous parts of the scrapped vehicle are in accordance with the pollution board norms

and guidelines. This ensures environmentally sound management of ELVs.

- Additionally, to promote registration of vehicles under the Vehicle Scrapping Rules, the said Rules now offer tax concessions to automobiles registered against submission of Certificate of Deposit. The tax concession is offered in the range of 15 per cent to 25 per cent for a period of eight to 15 years, depending on the nature of vehicle.

Earlier, all recalls in the Indian automotive sector were voluntarily undertaken by automotive companies in accordance with the Voluntary Code on Vehicle Recall 2012 introduced by SIAM. However, in 2019, the MV Amendment Act introduced a mandatory recall provision for automobiles pursuant to which recalls in the automotive sector have now become regulated. This amendment seeks to empower the central government to direct manufacturers to recall their motor vehicles of a particular type or its variants if they suffer from a defect that may cause harm to the environment, drivers or occupants or other road users; and in the event of the defect being reported to the central government by a prescribed percentage of owners as notified by the central government, testing agencies or any other source. In the event a defect lies in a component of a motor vehicle, the manufacturer is bound to recall all such vehicles and their variants that consist of or contain that component.

Under the framework, the manufacturer is liable for every such vehicle recalled. The manufacturer is required to (1) reimburse the buyers fully subject to any hire-purchase or lease-hypothecation agreement or (2) replace the recalled vehicle with a vehicle having similar or better specifications that complies with standards under the MVA; or (3) repair the vehicle, and pay such fines as deemed fit by the central government. However, the manufacturer will not be held liable to a fine if it notices the defect and informs the central government.

The CMV Rules provide detailed provisions on various aspects involving recall, such as the recall procedure, grounds for conducting a recall and obligations thereto, notice requirements, assignment of responsibility, investigation related to safety defects, destruction of defective parts, role of the designated officer, record-keeping or auditing. Further, the CMV Rules provide for the levy of hefty fines by the designated officer to be imposed on the manufacturer, importer or retrofitter of the motor vehicle on the basis of the number of motor vehicles recalled, starting from 1 million rupees up to a maximum fine of 10 million rupees. The Ministry of Road, Transport and Highways has also recently by way of a notification passed in March 2021 prescribed a formula based on the percentage of complaints received from owners of automobiles that will trigger the requirement of mandatory recall of a particular model. The formula notified is based on percentage and is different for each category of vehicle, such as two-wheelers, three-wheelers, M1 or M2.

As per reports, vehicle recalls in India hit a five-year high in 2021 with more than seven lakh units recalled, which was more than the total number of recalls during the previous three years. As per SIAM, four-wheeler and two-wheeler recalls during 2021 stood at 7,07,318 units. The industry had seen 3,80,615 recalls in 2020, 1,59,992 in 2019 and 1,38,755 in 2018.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

At present, there is no legislation that deals with product liability specifically in the case of automobiles. In the event a customer suffers losses as a result of a defect in an automobile, the customer has a remedy against the manufacturer or supplier of the automobile (as the case may be) under the Consumer Protection Act 2019 (the CP Act), which is specific legislation for the protection of the rights of all consumers. Claims under the CP Act can be made before various forums at the district, state and national level (consumer forums). The term 'defect' has been widely defined in the CP Act to include any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard that is required to be maintained by or under any law for the time being in force or under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods or product.

A customer or purchaser of an automobile has a remedy against the manufacturer or the supplier of an automobile (as the case may be) under the CP Act as mentioned above. The usual and bare minimum remedy granted by the Central Consumer Protection Authority or District Consumer Disputes Redressal Commission is a refund of the price of the automobile along with interest or replacement of the automobile in cases of a manufacturing defect. Further, the consumer forums often grant damages for harassment and mental harm caused to the consumer if the consumer proves that the accident and the injury and losses were a result of the manufacturing defect.

It is within the power of the consumer forums to award damages in a case involving death or very serious permanent injury, but there is no typical range of such damages and they generally vary on a case-to-case basis. There is no limit on the damages that can be awarded and the consumer forum will take into consideration factors such as loss of income, nature of the family members dependent upon the injured or the deceased person, mental pain and harm suffered.

The Civil Procedure Code 1908 provides for class actions or group actions whereby one person may, with the permission of the court, sue or defend on behalf of all persons having the same interest. The CP Act also provides for consumers as a group or class to institute a complaint against a manufacturer or supplier. However, this has not been very popular, as opposed to class action, which lies before the High Court of each state or the Supreme Court of India (the apex court) in the form of a public interest litigation (PIL) for the enforcement of public interest.

A PIL may be moved not only by an aggrieved party but also by a public-spirited individual or a social action group for the enforcement of the fundamental rights or legal rights of an aggrieved party who is unable to approach the court for reasons such as being in a disadvantaged position on account of poverty, disability or other social or economic impediment. PILs form part of the writ jurisdiction of the High Courts and Supreme Court of India and accordingly can only be filed against an aegis of the state or any other party exercising public functions. Over the past decade, there has been an increasing number of PILs filed in the court concerning several issues. For example, pursuant to a very well-known PIL filed by an environmentalist before the Supreme Court of India, the higher or stringent emission standards for automobiles were introduced by the Delhi State Government. The stand taken by the auto manufacturers was that they were meeting the standards laid down under Indian laws and after the court order, the emission standards were tightened to reduce vehicular pollution.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

The Competition Commission of India (CCI) (the authority regulating competition in India) actively investigates allegations of anticompetitive behaviour in the automotive sector. The investigations carried out by the CCI are either initiated suo motu by the CCI, based on press reports and information flowing from parallel cases, or on the basis of information provided to it by third-party informants.

The most notable competition-related issue in the automobile sector was *Shamsher Kataria v Honda Siel Cars India Ltd & Ors*, case No. 03 of 2011 (CCI, 25 October 2014), in which the CCI investigated various automobile manufacturers for anticompetitive practices – it is understood they denied market access to branded spare parts and diagnostic tools and thereby hampered the ability of independent repairers to provide aftermarket repair and maintenance services to automobile owners.

Such practices have allowed automobile manufacturing companies not only to have monopolistic control over the spare parts and diagnostic tools market under their respective brands but also to charge arbitrary and steep prices for said products, in violation of the provisions of the Competition Act 2002 (the Competition Act).

The CCI observed that owing to technical specifications of the cars manufactured by each original equipment manufacturer (OEM), the spare parts of one brand cannot be used for the repair and maintenance of cars manufactured by another OEM. Since the spare parts of one OEM are not interchangeable or substitutable with those of other OEMs, each OEM is shielded from competition in the aftermarket from existing competitors in the primary market.

Further, the agreements entered into by OEMs with their original equipment suppliers (OESs) and authorised dealers prohibited the sale of spare parts to independent repairers in the secondary market. The CCI was of the view that each OEM holds a position of strength, which enables it to affect its competitors in the secondary market or aftermarket, thereby limiting consumer choice and compelling consumers to behave in a manner beneficial to the OEMs, which allows them to enjoy a dominant position and strength in the aftermarket for spare parts.

In addition to levying a heavy penalty, the CCI directed OEMs not to place any restrictions on the operation of independent repairers and to allow OESs to sell spare parts freely in the open market. However, OEMs have been permitted to charge royalties or fees where they hold intellectual property rights on parts provided that the same is not in violation of the Competition Act. The order of the CCI was appealed by some of the automotive manufacturers before the Competition Law Appellate Tribunal (COMPAT), established under the Competition Act. The COMPAT, while hearing the appeal, concurred with the findings of the CCI and upheld the penalty that was levied. This order of the COMPAT was stayed by the Supreme Court of India in November 2018. On 20 January 2020, the Supreme Court disposed of the matter while confirming the stay on the COMPAT order and directed that it stays or remains operative during the pendency of the National Company Law Appellate Tribunal (NCLAT) appeal (as described below).

While some of the automotive manufacturers chose to prefer an appeal to the COMPAT as mentioned above, others chose to file a writ petition in the High Court of Delhi, inter alia, challenging the constitutional validity of the decision-making process, adopted by the CCI while adjudicating matters. This writ petition was successful, and the High Court of Delhi in April 2019 held that the decision-making process provided for in the Competition Act was unconstitutional. In its order, the court allowed the appellant automotive manufacturers to file an appeal against the order of the CCI to the NCLAT (the appellate authority) and directed the NCLAT to entertain the appeals on their merits, unhindered by any period of limitation. This order of the High Court of Delhi was appealed against, before the Supreme Court.

Currently, this matter is sub judice before the NCLAT. It is now the appellate tribunal to hear and dispose of appeals against any direction issued or decision made or order passed by the CCI. The next hearing in the matter is on 19 July 2022.

Recently in 2021, the CCI dealt with matters relating to alleged anticompetitive conduct against Tata Motors Limited (Tata Motors) and its related companies providing financial services, namely, Tata Capital Financial Services Limited and Tata Motors Finance Limited (related companies) (collectively, Tata Motors and its related companies). The CCI dealt with *Neha Gupta v Tata Motors Limited and Ors* and *Nishant P Bhutada v Tata Motors Limited and Ors* (Case No. 21 of 2019 and Case No. 16 of 2020 (CCI, 4 May 2021) together as the anticompetitive activities alleged against Tata Motors and its related companies are similar in both cases. The matter was initiated based on complaints filed by the informants (being automotive dealers having dealership contracts with Tata Motors) against Tata Motors and its related companies for their alleged anticompetitive conduct.

The informants having dealership agreements with Tata Motors, have primarily alleged that the terms and conditions imposed by Tata Motors in its dealership agreements are unfair and in contravention of the Competition Act. Some of the conditions that have been indicated by the informants are imposition of high interest rates and other illegal charges and adjustments on the channel finance loan facility extended by the related companies of Tata Motors to automotive dealers. The informants have claimed that such type of arrangement is detrimental to the financial health of the automotive dealers. Also, it has been stated that the consumer loan instalments if unpaid by the borrowers, are adjusted arbitrarily against the channel finance loan facility provided to the automotive dealers. The informants further alleged coercion by Tata Motors in relation to the list of vehicles that the dealers are required to order.

In response to the allegations by the informants, Tata Motors and its related companies questioned the jurisdiction of the CCI to deal with contractual disputes and claimed that its related companies do not have a dominant position in the market as they attribute only a miniscule presence of 6 per cent share to the Indian corporate lending market. The CCI, while rejecting the contentions of Tata Motors and its related companies, on the jurisdiction of CCI has directed the director general to conduct an investigation within 60 days from the date of this order, dated 4 May 2021. It seems that the investigation is ongoing and as per the information publicly accessible to date, no further orders are available.

Another landmark case relating to alleged anticompetitive practices against auto companies is the *re: Alleged anti-competitive conduct by Maruti Suzuki India Limited (MSIL)* in implementing discount control policy vis-à-vis dealers, case No. 01 of 2019 (CCI, 4 July 2019). The CCI initiated an investigation into the matter based on an email sent by a Maruti Suzuki dealer anonymously alleging that MSIL resorted to resale price maintenance in Maharashtra, Mumbai and Goa. It was alleged that MSIL's independent agency performs 'mystery shopping audits' wherein a fake customer visits every dealer in Pune (for example) to check whether extra discounts are being offered. On the basis of this audit, dealers are penalised and a penalty is levied where extra discounts are offered to the end customers by the dealers and MSIL uses proceeds from these penalties for its expenses. MSIL, however, contended that it did not exercise control over its dealers, except to maintain uniformity in schemes and no agreement between MSIL and its dealers involved a discount control policy.

The CCI rejected MSIL's arguments and held that MSIL revealed a fit case for investigation in respect of alleged practice of resale price

maintenance agreements between the dealers and MSIL and ordered an investigation into the matter, which is currently under way.

In another matter, *re: Cartelisation in the supply of Electric Power Steering Systems (EPS Systems)* Case No. 7 (01) of 2015 (CCI, 9 August 2019), anticompetitive conduct was alleged in the electric power steering (EPS) systems market. The case was initiated on a lesser penalty application filed by NSK Limited, Japan, which revealed the existence of the cartel, and was followed by a lesser penalty application from JTEKT Corporation, Japan during the investigation by the Director-General. Through the investigation report and evidences presented, the CCI held both NSK Limited and JTEKT Limited liable for cartelisation in the EPS systems market for a period of about six years, directly or indirectly determining prices, allocating markets, coordinating bid responses, and manipulating bid responses of OEMs. However, NSK Limited was granted a 100 per cent reduction in penalty and JTEKT Limited was granted a 50 per cent reduction in penalty, in view of its approaching the CCI with the applications for lesser penalties.

Over the years, the investigation by the CCI is initiated on the basis of claims brought by private parties or government authorities, which are either directly or indirectly aggrieved by the industry or party in question. There has not been much change in the nature of informants over the years, which can be said to be a mixture of a private individuals, trade associations, chambers of commerce, direct competitors in the market, enterprises engaged in distributing activity for a dominant manufacturer and others.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

In the past few years, the disputes relating to the automotive industry that have made headlines primarily involve the hurdles faced in the acquisition of large pieces of land for setting up manufacturing plants and employee-related issues.

Until early 2014, land acquisition was regulated solely by the Land Acquisition Act 1894, which was an archaic law. Although the said Act permitted land acquisition by automotive companies, it became a platform for numerous farmers to challenge the adequacy of compensation given out by the automobile manufacturers and non-adherence of due process at the time of acquisition. This resulted in the stalling of the projects until the matter had been decided by the courts or the companies reached an out-of-court settlement with the owners of the land. The most talked-about of such cases involved Tata Motors Limited. In 2006, Tata Motors Limited announced plans to set up an automotive factory in Singur, state of West Bengal for its small car project. Shortly after, it faced protests by farmers against the state government's proposal to acquire 997 acres of farmland. The unrest continued until 2008, when Tata Motors Limited was forced to relocate its factory to the state of Gujarat. However, the government has made continued efforts to bring about legislation that makes the acquisition of land easier for the manufacturing industry. In 2014, the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act 2013 was enacted with the aim of making the process fairer and more transparent. The government further plans to propose new laws that would provide more benefits to the industries acquiring land.

Given the scale of the automotive industry, which involves the setting up of large industrial plants, often trade unions and worker associations are very strong and have the ability to influence the workers. Lately, one of the concerns for several automotive manufacturers has been unrest among workers who have been working as contract labourers continuously for a long period of time but have not been absorbed by the automotive companies as permanent employees. It was often found that these contract workers lacked the statutory benefits and protections that would be available to a permanent employee. There are judicial precedents where the courts have come down heavily on industries for adopting such a practice. However, with the changes introduced in the structure of Indian labour law, wherein the laws have been categorised in four labour codes, such issues are likely to be settled. Specifically, the draft Code on Social Security 2020 provides for contract labour to be entitled to receive social benefits as prescribed under this code, which is similar to the benefits applicable to employees of a company.

Further, over the years, automotive companies have experienced disputes with consumers in relation to quality control issues faced by them during aftersales services or malfunction of the car on the roads.

As a quick solution, automobile manufacturers have the option to seek interim injunctions from the courts, which are granted on a case-by-case basis after taking into account several factors and circumstances of a case. In relation to labour issues, Maruti and other automobile companies have been seen to engage in negotiations and settlement with workers. This has been a quick solution for some but not for companies that spend a long time negotiating with their workers.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

There is no prescribed procedure or process for dealing with distressed suppliers of automobile components or spare parts. However, to avoid any slowdown or breakdown in the manufacturing process, it is usually considered in the best interest of the automobile manufacturers to provide financial support to extricate suppliers from their crunch.

It has been seen that since the automobile manufacturers provide proprietary information to automobile part suppliers and vendors, several manufacturers are reluctant to let go of their suppliers and often take the commercial decision to extend financial help to the suppliers that would enable them to continue business.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The automobile industry is one of the most innovative industries and thus, intellectual property (IP) is a vital asset of automotive companies. Over the years, the industry has witnessed significant IP disputes ranging from disputes on patents to industrial designs and copyrights.

The aesthetic look of an automobile is the ultimate commercial feature of any automobile company. Automobile leaders such as Mercedes, GM, Honda, Toyota, Tata, Bajaj and many more have already established their own brands with unique design impressions. These industrial designs are extended protection under the Design Act 2000 upon registration with the relevant authority.

The Trade Marks Act 1999 provides, inter alia, for registration of a trademark, filing of multiclass applications, increasing the term of registration of a trademark to 10 years as well as recognition of the concept of well-known marks. Hence, protection of trademarks and marks in the automotive industry where an automobile is known by its marks and symbols becomes important. The Indian courts provide a plethora of precedents wherein infringement or violation of the Trade Marks Act has been analysed, and law has developed over the years through these precedents.

The Patent Act 1970 also plays an important role in the automobile industry. Any new invention in terms of technology and technique can be granted protection when registered with the concerned authority. The

software developed by automotive industries for further enhancement of the functions of the automobiles is also protected by way of copyrights under the Copyrights Act 1957.

As is apparent from the current scenario pertaining to the IP laws in India and their application in the automotive industry it can be said that registering any particular IP goes a long way and is extremely helpful when it comes to protecting oneself against IP theft.

The ease or difficulty with which an IP dispute can be resolved varies from case to case depending upon various factors such as the defence of the opposing party, available evidence, the ability of the adjudicating authority or officer. Generally, disputes involving issues relating to trademarks are resolved relatively faster as opposed to those involving patents. This is primarily because trademark issues are less complex than those relating to patents.

There could also be delays because of the misadministration of such matters, but this has not gone unnoticed and the state high courts have been questioned by the Supreme Court of India over such delays. For example, in December 2007, Bajaj Auto Limited filed a suit before the Madras High Court for an injunction against TVS Motor Company Limited for the infringement of Bajaj's patent. The relief in terms of an interim injunction in favour of Bajaj restraining use of the abovementioned patent by TVS was awarded in February 2009. Upon an appeal being preferred by TVS before the superior division bench of the Madras High Court, the earlier order of the single judge was revoked. Upon further appeal being preferred by Bajaj before the Supreme Court of India, the Supreme Court expressed its discontent at the pendency of the IP matter before the state High Court since December 2007 at the interlocutory stage and directed the state High Court to commence the hearing of the suit on a day-by-day basis.

In March 2020, the High Court of Delhi granted an ad interim injunction restraining the e-rickshaw manufacturer, Om Balajee Automobile (India) Private, from manufacturing, exporting, importing or offering for sale, advertising or dealing with goods (not just limited to e-rickshaws) bearing the mark DMW or any other mark that may be identical or deceptively similar to the Bayerische Motoren Werke AG (BMW) marks. The court found the two marks DMW and BMW to be visually and phonetically similar and acknowledged the reputed nature of BMW marks, thereby restraining Om Balajee Automobile (India) Private from using similar marks.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

A unionised workforce is common in an organised industry such as automobile manufacturing. Automotive companies with manufacturing operations in India have on many occasions witnessed labour unrest caused by a plethora of reasons, ranging from a demand for an increase in wages to a demand to reinstate terminated employees. One of the most talked about is the fiasco that occurred at the manufacturing plant of Maruti Suzuki in 2012. The growing unrest among the workers was mostly owing to miscommunication between the management and the employees, demand for wage hikes, permanent employment, reinstatement of dismissed workers and demand for recognition of labour unions, among other reasons. As mentioned above, several automobile companies came under scrutiny for adopting the practice of hiring contract labour to do almost every job in a factory and keeping them devoid of permanent employment, which would have required the provision of minimum statutory benefits to the workers. There seems to be growing consciousness among workers about this practice and hence, a large proportion of workers have been disgruntled with respect to the offered salary and benefits. However, with the introduction of changes in the structure of labour laws in India, this matter has specifically been addressed in the Code on Social Security 2020. Though the Code is yet to be notified, it provides that the contract labour will be entitled to receive the social benefits as prescribed under this code, similar to that of employees of a company. In fact, even inter-state migrant workers have now been included in the definition of contract labour, thereby expanding the provision of social security benefits to all workers.

In March 2013, a down-tools strike took place at Mahindra & Mahindra's automotive plant at Nashik in Maharashtra because of differences over wage negotiations and suspension of a few workers. Similarly, in July 2016, workers at Honda Motorcycles and Scooter India held large-scale protests with the objective of trying to reinstate employees who were leaders of the labour union. In October 2018, a large number of employees working at the manufacturing plants of several motorcycle manufacturers located in Chennai, including Eicher Motors and Japan-based Yamaha Corporation, staged a walkout demanding higher wages and permanent employment for those employees currently working as contract employees. Meanwhile, in March 2019, the employees from Asahi India Glass Limited, a joint venture between Asahi Glass Co Limited Japan and Maruti Suzuki India Limited, went on strike against the unlawful dismissal and suspension of employees and also demanded a wage increase.

In January 2020, the production of Honda Motorcycle and Scooter India's (HMSI) Manesar plant in Haryana and factories of various auto component manufacturers in Manesar-Bawal industrial belt were affected by a day-long strike by 10 major trade unions pressing for a 12-point charter of demands of the working class relating to minimum wage, social security and other matters.

Toyota Kirloskar Motors faced a significant backlash from its workers (at their plant in Bidadi in the southern state of Karnataka) who went on a four-month long strike from November 2020 till March 2021. The main concern of the employees seemed to arise from excessive workload without being allowed sufficient bathroom breaks or time to drink water. After various efforts by the State Government and the concerned labour department, the differences were reconciled and the strike was lifted with a final appeal from Toyota Kirloskar Motors to its employees requesting them to return to work from 5 March 2021.

Recently in February 2022, in the case of *Shankar Bhimrao Kadam and Ors v Tata Motors Limited* (MANU/MH/0760/2022), the Bombay High Court held Tata Motors Limited liable for unfair labour practices under the Industrial Disputes Act 1947. The dispute, which spanned over 17 years, was finally decided in favour of the workmen. The High Court of Bombay held that Tata Motors Limited was responsible for hiring hundreds of workmen in its manufacturing unit as temporary workmen and depriving them of the status and privilege of permanent workmen. The court directed the company to pay compensation to such workmen.

Over the years, one of the major reasons for employment disputes has been identified as a lack of a proper communication channel leading to poor management of the employer–employee relationship. This can be attributed to the fact that management often likes to deal with an employees' representative, but the representative is usually driven by the agendas of only a section of the employees. This results in mistrust in the minds of the employees against the management.

There have been numerous cases brought before the courts involving unrest among workers owing to suspension or termination of employment of a worker, which have been challenged as being unfair or arbitrary by the trade union or the employee. These cases have been decided by the Indian courts depending upon the merits of each case.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

There have been some legal developments related to technology and incentives for using technology in the automotive sector.

The government has introduced an electronic system of monitoring and enforcing road safety vide notification GSR 575(E) dated 11 August 2021. It has introduced electronic enforcement devices that include speed cameras, closed-circuit television cameras, speed gun, body wearable cameras, dashboard cameras, automatic number plate recognition, weigh-in machines and other prescribed technology specified by the state government (EE devices). Rule 167A of the CMV Rules provides that these EE devices will be installed by the state government at high-risk and high-density corridors on national and state highways and in critical junctions in major cities with a population of more than one million. These EE devices are used to issue fines for offences such as speeding, not wearing a seat belt while driving or jumping red lights. These auto-generate challans through EE devices are accompanied with clear photographic evidence of the offence, date, time and place of the offence. These EE devices have also paved pay to pay e-challans electronically on the portal specified by the state government, making it convenient for the public to pay their challans timely.

Separately, a new Chapter XI has been introduced in the CMV Rules for recognition, regulation and control of automated testing stations which provide registration certificates to vehicles after they pass the prescribed tests. Automated testing stations file an application for registration to the transport commissioner who is nominated by the appropriate state government and is empowered to issue preliminary registration certificates and renew them. This Chapter XI lays down the procedure for fitness testing of vehicles through automated equipment, and explains the eligibility criteria for automated testing stations, their infrastructure requirement, manpower requirement, detailed testing process and procedures for all kinds of automobiles, equipment required for testing, fee for granting registration certificates depending on test results. The appointment for fitness test by any automated testing station is booked electronically through the electronic portal set up by the central government. In the event the vehicle owner is aggrieved by the test results conducted by the automated testing station, he can appeal before the appellate authority (officer not below the rank of regional transport officer nominated by the state government) on the electronic portal.

The government has attempted to introduce legislation to regulate advancements in automotive and mobility technology. However, most has not yet become law and is still in the nascent stages of development.

Such legislation includes the Geospatial Information Regulation Bill 2016, which proposes to regulate the acquisition, dissemination, publication and distribution of geospatial information. This includes geospatial imagery or data acquired through space or aerial platforms such as satellites, aircraft balloons or graphical or digital data depicting natural or man-made physical features, phenomena or boundaries of the earth. The bill proposes the creation of a Security Vetting Authority, which will be authorised to carry out security vetting of the geospatial information of India. The government has also launched a number of schemes to encourage the growth of the automotive sector, such as:

- the Automotive Mission Plan 2016, which aims to increase domestic production of automobiles, increase automotive exports and address environmental and safety challenges;
- the National Automotive Testing and R&D Infrastructure Project, which has been set up to enable the industry to adopt and implement global performance standards by establishing nationwide automobile testing agencies;
- the National Electric Mobility Mission Plan 2020, which provides incentives to manufacturers of and purchasers of electric cars;
- the FAME-India Scheme, Phase II, which provides monetary incentives to producers and purchasers of eco-friendly vehicles in the country;
- the Production Linked Incentive Scheme introduced by the government in 2020 for large-scale electronics manufacturing including in the auto sector. The scheme offers an incentive of 4 to 6 per cent on incremental sales (over the base year) of goods manufactured in India to eligible companies, for a period of five years from the base year. Auto manufacturers also view the scheme as an opportunity to reduce dependency on import and become net exporters; and
- private cab aggregators such as Ola and Uber have revolutionised public transport in India by introducing the concept of pool rides, aimed at providing cheaper rides to customers while being eco-friendly at the same time. The central government, by way of the MV Amendment Act, provides for conditions for issuance of a licence to such aggregators and penalties in the case of contravention of relevant provisions applicable to them.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

The amendments to the MVA in 2019 vide MV Amendment Act have been one of the most important developments in the Indian automotive sector in recent years, which, in particular, introduced a mandatory recall mechanism. For vehicles, these amendments were a major step forward. Another important development was the implementation of the BS-VI emission standards with effect from 1 April 2020.

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The Ministry of Road, Transport and Highways has issued various notifications in draft form inviting comments and objections. Some of these are discussed below:

- procedure for accreditation of automobile testing agencies;
- the CMV Rules have proposed an amendment indicating that every goods carriage carrying any dangerous or hazardous goods shall be equipped with or fitted with a vehicle tracking system device as per prescribed automotive industry standards. This will enable owners to keep a track of all such carriages and ensure that goods that are hazardous and dangerous to human life are transported to the right locations;
- pursuant to the Vehicle Scrapping Rules and introduction of automated testing stations, draft amendments have been proposed. These include the option to voluntarily cancel the registration of certificate, no dues application for vehicle scrapping, changes in the scrapping procedure, definition clause, procedure for testing automobiles and being declared as ELVs, and other clauses to remove ambiguities in the procedure;
- taxes on automobiles to be levied online; and
- draft Inter-Country Non-Transport Vehicle Rules 2022, which regulate vehicles registered in countries other than India. However, these rules shall be superseded by any bilateral agreements between India and other countries.

Indonesia

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Hogan Lovells

OVERVIEW

Market

1 | Describe the significance of, and developments in, the automotive industry in the market.

In Indonesia, the automotive industry is one of the most important industries and one of the key sectors towards the government's road map 'Making Indonesia 4.0'. In 2021, over 800,000 units were sold domestically, and over 200,000 units were exported across the globe to over 80 countries. The biggest five export destination countries are the Philippines, Kingdom of Saudi Arabia, Japan, Mexico and Vietnam. The total investment from the automotive industry in 2021 reached 140 trillion rupiah, with around 38,000 people directly employed in the automotive industry (a total of 1.5 million people aggregate from the supply chain until the distribution of the automotive sector). During 2021, the investment value of the automotive industry reached 99.16 trillion rupiah with a production capacity of 2.35 million units. Around 230,000 units were exported, gaining an export value of 41.73 trillion rupiah.

COMMERCIAL OPERATIONS

Regulation

2 | What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The manufacture and distribution of the automotive industry are governed and authorised by multiple government authorities, namely, the Ministry of Industry (MOI), Ministry of Trade (MOT) and Ministry of Transportation (MOTR). MOI generally authorises the governance of the production or manufacture process of automotive products, which requires the manufacturer to obtain a business identification number (NIB) and standard certificate issued by the MOI. Distribution of automotive products falls under the supervision of MOT. Any party who undertakes the distribution of automotive products also requires a NIB.

Prior to production, assembly or importation of automotive products, vehicle type testing is required. Such vehicle type testing is organised by the MOTR through the Office of Vehicle Roadworthy Testing and Certification (BPLJSK), which, among other things, will examine multiple aspects of the products (eg, fuel tank, dimension, brakes, lights, speedometer and gas emission). By no later than three business days, BPLJSK shall issue a report based on the vehicle testing to the MOTR, and the MOTR shall issue the vehicle testing approval or rejection within five business days of receipt of the vehicle testing report.

There is no mandatory insurance requirement for automotive products in Indonesia, although in practice almost all automotive products are insured to cover any potential damage or loss risk.

Development, manufacture and supply

3 | How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Similar to other automotive structures in other countries, the Indonesian automotive supply chain structure is essentially divided into three layers, as follows:

- the first layer is made up of assembler companies or original equipment manufacturer (OEM) that manufacture end-products for the consumer market;
- the second layer is made up of tier-1 companies being suppliers to assembler companies; and
- the third layer includes tier-2 companies to supply automotive parts directly to tier-1 companies and do not provide automotive parts directly to assembler companies or OEM companies.

Indonesian automotive manufacturers make and assemble intermediate goods (eg, parts) or final goods (vehicles). Distributed vehicles in Indonesia may also be built in the origin country (CBU/Completely Built Up). In most cases, innovation, design, research and development are handled by parent companies. For vehicles that are manufactured and/or assembled domestically, several parts and components will also be provided by the group companies (ie, imported into Indonesia).

The relationship between manufacturer or producer and its supplier is usually business-to-business in nature and is not strictly regulated by the government. The development of an automotive company can be conducted by product intensification, M&A transaction or OEM cooperation.

To avoid any supply issues, the Indonesian government established several policies to nurture the automotive industry, including the TKDN policy (local procurement rate of components) or local production policy for technology transfer from foreign partners.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Distribution of vehicles by manufacturers is carried out by appointing distributors or dealers for the establishment of outlets, workshops and authorised sales or after-sales service and spare parts.

Producer or manufacturer companies (including vehicles) are prohibited from selling the product directly to end customers. Accordingly, vehicle producers or manufacturers shall appoint distributors or retailers (dealers) to distribute their products. In the event the producer appoints a distributor to sell the product, the distributor must further appoint a retailer or dealer to sell the product to end customers. Only the retailer or dealer is allowed to sell products (including automotive products) to the end customer.

A termination of distributor's appointment can only be conducted on a clean break basis, which then must be reported to the Ministry of Trade. In such cases, vehicle manufacturers undertake to provide spare parts and after-sales services to be carried out by newly appointed agents or distributors. If there is no intention to nominate a new agent or distributor, the law requires the manufacturer to supply spare parts or after-sales services through the terminated agents or distributors for a minimum period of two years from termination. This should be fulfilled to protect the customers.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no specific requirements for M&A or JV transactions for the automotive industry. In general, M&A transactions must comply with requirements under the Indonesian Company Law and satisfy requirements under a target company's articles of association, including the requirement to obtain approval from the shareholders of the target company and the transfer of shares shall be made in a notarial deed and also reported to or approved by the Ministry of Law and Human Rights. Specific for acquisition transaction (involving majority shares of the target company), there is a mandatory pre and post-acquisition announcement (in at least one daily newspaper), which is intended to inform the target company's creditors and also an announcement to the target company's employees. Any objections from the creditors must be settled before the acquisition transaction can proceed. However, any objection from an employee will have no effect on the transaction process.

Considering that the automotive industry usually involves significant investment, it is also worth checking whether the transaction needs to be notified to the Indonesian Competition Authority (KPPU) if the notification threshold is met (ie, 2.5 trillion rupiah of global assets or 5 trillion rupiah of domestic sales or revenue).

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

Currently, the government has provided a tax holiday for the sale of luxurious products in the form of specific vehicles (which includes four-wheeled vehicles with the maximum carbon emission of 120 grams of CO_2 per kilometre). Such tax holiday is imposed with the following schemes:

- 100 per cent tax holiday for January–March 2022;
- 66 per cent tax holiday for April–June 2022; and
- 33 per cent tax holiday for July–September 2022.

In addition, the Indonesian government has also exempted import duty for the importation of incomplete knock down electronic vehicles.

These policies aim to spur public interest in buying automotive products, which in turn will increase the sales figures of automotive products.

As for the entry barrier, the Indonesian government has just reformed the licensing process in several business sectors, including the industrial sector, by revoking the commitment-based licence to the risk-based licence in the Online Single Submission (OSS) system. Under the risk-based licence, each business sector shall be classified into four risk categories, namely low-risk, middle-low risk, middle-high risk and high risk. The risk category shall determine the relevant licences required by the company. Low-risk businesses only require a NIB for them to undertake business, while middle-risk businesses generally require a NIB and Standard Certificate as their business licence.

The Standard Certificate for middle-low risk businesses contains a statement from the Company regarding their compliance to the applicable standard of the relevant business, while Standard Certificate for middle-high risk businesses contains a standard or minimum requirement as determined by the relevant local or central government, which must be satisfied by the company. Meanwhile, high-risk businesses require a NIB and permit as their business licence. A permit is an approval from the relevant local or central government, which must be satisfied by the company prior to conducting their business. The Standard Certificate of business and product may also be applicable for high-risk businesses.

The new risk-based licensing regime has been implemented since June 2021. However, there are few technical issues in the OSS system such as interconnection with other government institution's system and unavailability of Standard Certificate for several businesses.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Type test and periodical test shall be exhausted for the operation of motor vehicles. The type test itself is a test conducted on the physical conditions for the compliance of technical or roadworthiness requirements, and its design or engineering prior to the production or assembly or mass importation of the motor vehicles. While the test is conducted periodically for every operated motor vehicle, the Ministry of Transportation (MOTR) will issue a certificate for both tests to substantiate that the motor vehicles have undergone and passed the tests.

In addition to the above, every manufacturer is required to register the types of motor vehicles that are produced, assembled, imported or modified by filing an application to the relevant directorate general at the MOTR along with the, among others, a copy of the type test certificate and the application fee for the issuance of a type test registration certificate. The aforementioned type test registration certificate is a prerequisite document to register and identify the motor vehicles to obtain the books motor vehicle owner, vehicle registration certificate and vehicle registration plates.

Failure to undergo the type test and registration of type test as aforementioned will be subject to administrative sanctions in the form of a written warning and administrative fines imposed by the MOTR.

MOTR has issued a specific rule of product recalls under its ministerial regulation where it governs the requirements and technicality of product recalls, this will be further elaborated on below.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

With respect to product recall, the Indonesian Consumer Protection Law generally provides that business owners or applicants are prohibited from producing or selling goods or services that, among other things, do not meet or are not in accordance with the standards required and the provisions of the laws and regulations, as well as not being in accordance with the condition, guarantee, speciality or efficacy as stated on the label, tag or information of the said goods or services. Failure to comply with the above-mentioned requires the business owners or applicants (in this regard, the automotive products' manufacturer or importer) to recall the goods from circulation.

Relating to the automotive products, if once the type test certificate has been obtained and later found that there is an indication or manufacturing defect within the motor vehicles, it shall undergo a recall. The aforementioned manufacturing defect comprises design flaws (during the design of motor vehicles' system or components that are not in accordance with the established design quality standards) or manufacturing errors (during the assembling or manufacturing process, resulting in the motor vehicle's component not performing optimally). Prior to the recall, MOTR, through its ministerial regulations, requires the manufacturer, importer or agents to have a standard operating procedure in place for recall procedures.

In January 2021, a group of consumers brought a class action suit against a Chinese automobile manufacturer at the South Jakarta District Court due to certain 1.5 CVT Turbo cars' performance. Prior to submitting the claim, the consumers had reported the issues to the manufacturer and had also tried to repair their cars. As the problem persisted, the consumers escalated their complaint to a local consumers community in Indonesia and decided to submit a claim to the South Jakarta District Court. The consumers claimed that the inability of the defendant's cars' uphill acceleration has caused material, as well as immaterial, losses and this shall be deemed as a hidden defect that was not disclosed earlier by its dealers in Indonesia. Responding to the claim through its attorney, the defendant stated to the Indonesian press that an investigation will be conducted to assess the consumers' claim. It is unclear how the dispute will be resolved as, prior to the tribunal rendering its decision, the parties are allowed to reach an amicable settlement.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

The KPPU is the competition authority of Indonesia. Through its multifaceted role, it can monitor, supervise, investigate, prosecute and enforce any violations related to the Indonesian Competition Law.

The KPPU has investigated and decided on several past cases in relation to the automotive industry, namely the tyre cartel case and the automatic scooter cartel case investigated in 2014 and 2015 respectively. It continued to have a heightened interest in the automotive industry – as with any competition authority around the world – as it has previously investigated the distribution schemes in the motorcycle industry, the exclusivity arrangement in the distribution of automotive lubricants, as well as the pricing of the low-cost green car. Therefore, both the horizontal (between competitors) and vertical (with suppliers or distributors) market competition in the automotive industry are under the KPPU's scrutiny.

In several instances, the KPPU raised concerns regarding the association meetings in the automotive industry, especially when there is a potential exchange of information on production capacity and plans.

There was a follow-on litigation in relation to the scooter cartel case; however, the Supreme Court of the Republic of Indonesia upheld lower court's decision that the case is inadmissible. However, this was the first follow-on litigation, and business owners must remain vigilant.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Issues in the automotive industry commonly arise due to contractual, as well as product liability issues, involving either the manufacturers, consumers or dealers. Alternative dispute resolution seemed to be the preferred mechanism for resolving consumer disputes in the automotive industry. Litigation or arbitration appear to not be the first choice in resolving issues as there is very limited case file history in the public case repository.

From the consumer protection perspective, issues relating to the use of automotive products can also be resolved by the Consumer Dispute Settlement Agency.

Indonesia recognised the interim injunctions procedure for intellectual property and civil cases, but a full lawsuit shall be lodged with the court, as an injunction cannot be sought independently under the procedural law.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

Current prevailing regulations in Indonesia are silent on the process for dealing with distressed suppliers in the automotive industry. Commercial discussions, as well as negotiations, are common and are undertaken to either mitigate or resolve issues surrounding the distressed suppliers. Should commercial discussions be deemed ineffective, the aggrieved party may pursue a legal remedy by following general dispute mechanisms, preceded by filing warning letters, right up to submitting a claim either to the relevant court or arbitration body as the preferred forum under the agreement.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The legal framework of intellectual property (IP) protection in Indonesia has been established, comprising the protection of trademark, copyright, patent, industrial design, geographical indication and trade secrets, as well as a layout design of an integrated circuit. The regulations govern the rights and obligations of the IP owners, as well as procedures for registration up to dispute resolution mechanism. In addition, Indonesia has a designated authority for matters relating to IP, namely the Directorate General of IP of the Ministry of Law and Human Rights (DGIP).

In general, IP disputes can be resolved either through litigation in court or alternative dispute resolution. For the in-court litigation process, IP disputes on trademark, copyright as well as patent infringement need to be filed to the relevant commercial court, while disputes on trade secrets must be filed to the relevant district court in Indonesia. Within the past three years, there are certain trademark infringement cases in the automotive industry in the context of intellectual property (IP) disputes. Whether you are suing or being sued due to trademark infringement, the issues are settled in the commercial courts that are only available in certain major cities in Indonesia, namely Jakarta, Semarang, Surabaya, Medan and Makassar.

With respect to alternative dispute resolution, the DGIP has concluded a memorandum of understanding (MOU) with the World Intellectual Property Organisation on the Provision of Alternative Dispute Resolution Services to Parties Involved in Cases Filed with the DGIP in May 2014. Such MOU was concluded as Indonesia deemed that alternative IP dispute resolutions in Indonesia need to be improved. Prior to the MOU, since 2012 Indonesia has an IP Arbitration and Mediation Agency (BAMHKI). However, the Supreme Court Directory does not disclose the statistics on registration of the BAMHKI award at the district court for enforcement purposes. In addition, through arbitration proceedings, parties could also resolve IP disputes through negotiation or mediation, as well as conciliation between the disputed parties.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Apart from the ratification of the Convention No. 98 of the International Labour Organisation concerning the Application of the Principles of the Right to Organise and to Bargain Collectively, the Indonesian law regime recognised the trade union concept through Law No. 21 of 2000 on the Labour Union (Labour Union Law) – enacted on 4 August 2000. The Labour Union Law guarantees the employees' rights to establish a trade union as to, among others, create harmonious, dynamics and fair industrial relations with the employer. There is a minimum requirement of 10 employees to establish a trade union, which shall be registered and notified to the local manpower office, as well as its employer. In addition to a trade union, the Labour Union Law also allows the establishment of a trade union federation, which comprises a minimum of five trade unions, as well as trade union confederation, with a minimum of three trade union federations.

As a rule of thumb, Law No. 13 of 2003 on Manpower, as amended by Law No. 11 of 2020 on Job Creation (Manpower Law) – enacted on 25 March 2003 and amended on 2 November 2020 provides that a company regulation, governing rights and obligations of the employer and its employees shall be concluded and registered to the relevant manpower office should they employ 10 or employees. If the employees then decide to form a trade union, a collective labour agreement can be concluded and shall also be registered to the relevant manpower office.

Another notable provision relating to employment issues are the amended termination grounds, as well as the multiplier of severance payment for terminated employees. Prior to the enactment of Law No. 11 of 2020 on Job Creation – enacted on 2 November 2020, termination grounds were governed under several provisions under the Manpower Law. Currently, those have been unified under article 154A of the Manpower Law where termination due to efficiency, either to prevent or caused by losses suffered by the employer is now allowed. In addition, the Manpower Law also introduced different multipliers of severance payment for certain termination grounds. These new provisions sparked controversy as they were deemed to adversely reduce the terminated employees' rights.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

The Indonesian government has raised its intention to develop electric vehicles in Indonesia. This is reflected by the issuance of a specific regulation pertaining to electric vehicles, such as (1) Presidential Regulation No. 55 of 2019 regarding Acceleration of Battery-Based Electric Vehicle Program (PR 55/2019) – enacted on 12 August 2019, (2) MOTR Regulation No. 44 of 2020 regarding Type Testing for Electric Vehicle (MOTR Regulation 44/2020) – enacted on 22 June 2020, (3) Ministry of Industry (MOI) Regulation No. 6 of 2022 regarding Specification, Road Map Development and Local Content Calculation of Battery-Based Electric Vehicle (MOI Regulation 6/2022) – enacted on 11 March 2022 and (4) MOI Regulation No. 28 of 2020 regarding Electric Vehicle in Completely Knock Down and Incomplete Knock Down Condition (MOI Regulation 28/2020) – enacted on 17 September 2020.

PR 55/2019 serves as an umbrella regulation on the development of electric vehicles in Indonesia. Several key provisions under PR 55/2019 include the calculation of local content for automotive products from 2019 until 2026 and onwards, ensuring the availability of charging depots for electric vehicles and provision of fiscal and non-fiscal incentives for the manufacturer of electric vehicles.

The local content requirement for electric vehicle manufacture is further regulated under MOI Regulation 6/2022, as follows:

- 50 per cent for 2020–2023 and 58 per cent for 2024 and beyond, for local content for the manufacture of main components;
- 10 per cent of local content for the manufacture of supporting components;
- 20 per cent for 2020–2023 and 12 per cent for 2024 and beyond, for local content for assembly activity; and
- 20 per cent of local content for development activity.

Similar to conventional vehicles, the electric vehicle will be required to pass testing type conducted by the Office of Vehicle Roadworthy Testing and Certification (BPLJSK). However, electric vehicle accumulator testing can be provided by another entity, such as (1) domestic testing type laboratory that has been certified by National Accreditation Body, (2) foreign testing type laboratory body that has been certified by Asia Pacific Accreditation Cooperation, International Laboratory Accreditation Co-operation or (3) another accredited international laboratory. The result of accumulator vehicle testing shall be the preliminary document of testing type procedure by the BPLJSK. The testing type by BPLJSK will focus on direct contact components in electric vehicles, functional safety and hydrogen emission.

The Indonesian government has also issued a regulation that provides additional tax breaks for electric vehicles, and is currently drafting a new regulation to boost sales of electric vehicles.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

In the Jakarta metropolitan area, electric vehicles are exempted from odd-even licence plate policy, currently being imposed in Jakarta. This

policy aims to encourage people commuting around Jakarta to migrate from using conventional vehicle to electric vehicle.

Currently, we are seeing an increasing number of vehicle electronic charging stations being developed throughout Indonesia to support the government's acceleration of a battery-based electric vehicle programme. In this regard, Indonesia's state-owned electricity company, PLN, foresees the need for more than 31,000 new electric vehicle charging stations to reach government goals by 2030. To start the initiative, Indonesian state-owned companies set up a US$16.2 billion electric vehicles battery developer holding company early in 2021, where it will manage the electric vehicle battery industry's ecosystems, as well as to develop partnerships with other third parties to reach the global market.

In addition, Indonesia has also marked the increase of completely built up and completely knocked down car exports during the first quarter of 2021. Such an increase aligned with the Ministry of Transportation (MOTR)'s vision, which is encouraging the automotive business sector to increase its competitiveness, as well as its productivity to expand market coverage. MOTR confirmed that the automotive business sector will attract at least US$2.3 billion by the end of 2025 for vehicle manufacture in Indonesia.

International events held in Indonesia, such as G20 Conference, is also utilised as one of the promotion tools to increase the use and awareness of electric vehicles. As of now, three types of electric vehicles have been confirmed to be available for use by world leaders in the G20 Conference. Those three electric vehicles are:

- Hyundai Ioniq 5 – 226 units are expected to be available for use in G20;
- Hyundai Genesis G80 – 123 units are expected to be available for use in G20; and
- Toyota bZ4X – 143 units are expected to be available for use in G20.

The G20 Conference will be held in Bali in October–November 2022.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The Italian car market is among the largest markets in Europe alongside Germany, the UK, Spain and France (they represent the 70 per cent all together).

Based on the estimates contained in a recent study involving the National Automotive Supply Chain Association (ANFIA), the automotive industry and its supply chain in Italy, under normal circumstances, would account for approximately 5 per cent of the GDP with their (roughly) €90 billion overall turnover, involving some 5,700 enterprises, many of which are small and medium-sized enterprises, employing around 250,000 workers.

In 2021, however, the Italian car market has continued to suffer the devastating economic impact of the covid-19 outbreak. Specifically, ANFIA reports that in 2021 there was a 2.4 per cent increase in industrial production of vehicles compared to 2020. However, if compared to 2019, the delta in industrial production of vehicles becomes negative, with a 13.1 per cent decrease. Indeed, for the second year in a row, the automotive industry has lost a significant share of returns with double-digit contractions.

In addition, employee sickness, supply chain issues and a dramatic surge in demand for electronics during the pandemic caused a major chip shortage. This lack of semiconductors severely impacted the automotive industry, leading to a production slowdown, delayed deliveries and, in some cases, even idle factories.

Against this background, the first three months of 2022 do not seem to show any sign of improvement – also considering the persisting chip shortage and the war in Ukraine. For example, January 2022 reports 107,826 registrations, a -19.7 per cent if compared to the 169,684 registrations of January 2021 (-30.8 and -34.8 per cent if compared respectively to January 2020 and January 2019).

In conclusion, the transition of the automotive sector into 2022 – still severely impacted by the covid-19 outbreak and now facing an enduring chip shortage as well as the financial effects of the war in Ukraine – does not show significant signs of upturn and the road to recovery is still undoubtedly tortuous.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

In Italy, the applicable rules arise from European legislation.

Type approval

Regulation (EU) 2018/858 contains administrative provisions and technical requirements for type approval and placing on the market of all new vehicles, systems, components and separate technical units and for individual vehicle approvals. It also lays down provisions for the placing on the market and the entry into service of parts and equipment that may pose a serious risk to the correct functioning of the essential systems of the vehicles, as well as requirements for the market surveillance of vehicles, systems, components and separate technical units that are subject to approval, and of parts and equipment for such vehicles. According to its article 13, manufacturers shall ensure that the vehicles, systems, components and separate technical units that they have manufactured and that are placed on the market have been manufactured and approved in accordance with applicable requirements and shall be responsible to the approval authority for all aspects of the approval procedure and for ensuring conformity of production.

Regulation (EU) 2018/858 has been implemented by:

- Commission Delegated Regulation (EU) 2020/683 of 15 April 2020 (with regards to the administrative requirements for the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles), as recently amended by Commission Delegated Regulation (EU) 2022/195 of 11 February 2022;
- Commission Delegated Regulation (EU) 2020/1812 of 1 December 2020 (with regards to the online data exchange and the notification of EU type approvals);
- Commission Delegated Regulation (EU) 2021/133 (with regards to the basic format, structure and the means of exchange of the data of the certificate of conformity in electronic format); and
- Commission Delegated Regulation (EU) 2021/1445 of 23 June 2021 (amending Annexes II and VII to Regulation (EU) 2018/858 of the European Parliament and of the Council).

Regulation (EC) 715/2007 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) – which has also been updated by Regulation (EU) 2018/858, as amended by Regulation (EU) 2019/2144 – provides emissions requirements related to the type approval process. In addition, some rules for in-service conformity, durability of pollution control devices, on-board

diagnostic systems, measurement of fuel consumption and accessibility of vehicle repair and maintenance information are provided (the latter are also contained in Annex X of Regulation (EU) 2018/858 as amended by Commission Delegated Regulation (EU) 2021/1244 of 20 May 2021).

The manufacturer has an obligation to demonstrate that all vehicles sold, registered or put into service in the European Union are type-approved in compliance with this Regulation. In addition, manufacturers' obligations include meeting the emission limits set out in Annex I of the Regulation.

Regulation (EC) 661/2009 on type approval requirements for the general safety of motor vehicles, their trailers and systems, components and separate technical units intended therefor sets out the technical requirements and the procedures to ensure that new motor vehicles (motor vehicles with at least four wheels used to transport passengers, motor vehicles with at least four wheels intended for goods transport and trailers) meet EU safety and energy efficiency standards. In particular, this regulation establishes requirements for the type approval of the safety of motor vehicles and their trailers, the energy efficiency of motor vehicles (the installation of tyre pressure monitoring systems and gear shift indicators is mandatory) and the safety and energy efficiency of tyres and their levels of noise emissions.

According to article 5 of the Regulation, car manufacturers must ensure that their vehicles are designed, constructed and assembled 'to minimise the risk of injury to vehicle occupants and other road users'. This regulation has firstly been amended by Commission Regulation (EU) 2019/543 and will eventually be repealed by Regulation (EU) 2019/2144 (on type approval requirements for motor vehicles and their trailers, and systems, components and separate technical units intended for such vehicles, as regards their general safety and the protection of vehicle occupants and vulnerable road users), which is already in force and applies – with specific regard to the above repeal – effective 6 July 2022.

Very recently, Commission Delegated Regulation (EU) 2022/545 of 26 January 2022 supplemented Regulation (EU) 2019/2144 by laying down detailed rules concerning the specific test procedures and technical requirements for the type approval of motor vehicles with regard to their event data recorder and for the type approval of those systems as separate technical units (including in accordance with UN Regulation No. 160) and amending Annex II to that Regulation. These rules shall also apply from 6 July 2022.

EU-type approval is granted by the Italian authorities once the concerned vehicles comply with the applicable regulations.

In Italy, the Directorate-General for Motor Vehicles of the Department of Land Transport and Intermodal Transport of the Ministry of Sustainable Infrastructures and Mobility, pursuant to article 75 of the Italian Highway Code, grants type approvals to vehicles that are in compliance with the European regulations mentioned above.

Registration requirements

Owners of motor vehicles have an obligation to register their vehicle pursuant to article 75 et seq of the Italian Highway Code.

Pursuant to the Decree of the Ministry of Sustainable Infrastructures and Mobility of 26 May 2021, vehicles of an approved type intended for the carriage of persons as well as vehicles not complying with Regulation (EU) 2018/858 or Directive 2007/46/EC or type-approved with derogations from the requirements of previous EU provisions are also subject to the requirements of suitability for circulation and type approval.

With Circular No. 414 of 10 January 2022 ECE-R58.03 (Supplementing Circulars Nos. 26311 of 24 August 2021, 26584 of 30 August 2021, 26878 of 1 September 2021, 27566 of 7 September 2021, 29095 of 21 September 2021, 30589 of 5 October 2021, 31963 of 15 October 2021, 32585 of 22 October 2021 and 33952 of 4 November 2021) the Ministry of Sustainable Infrastructures and Mobility authorised some derogations from registration of end-of-series vehicles, pursuant to article 49 paragraph 1 of EU Regulation 2018/858 for vehicles not conforming to Regulation ECE-R58.03, with effect for registrations from 1 September 2021.

However, the registration of the vehicle can only succeed if the vehicle has been type-approved by the authorities.

Insurance requirements

Directive 2009/103/EC of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability is essentially transposed in the Italian Private Insurance Code. Pursuant to article 122 of the Code, car owners have an obligation to insure their vehicles. In addition to this, Decree of the Ministry of Economic Development of 11 March 2020, No. 54, provides for the conditions of the mandatory insurance standard-contract for civil liability posed by the use of motor vehicles.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Overall, the motor vehicle production output nosedived considerably during the covid-19 pandemic outbreak. Indeed, in April 2020 the total motor vehicle production volume (which includes finished motor vehicles and bodies, trailers and semi-trailers, as well as parts and accessories) across the 27 European member states had a volume index of only 16.4, compared with the 2015 baseline of 100. More in detail, in April 2020, the covid-19 pandemic forced manufacturers to stop production and manufacturing facilities in most vehicle-producing regions have also been deeply affected after Europe had become the epicentre of the outbreak in March 2020. By July 2020, many factories reopened, even at reduced capacities and many manufacturing firms across Europe had to rely on state aid in order to pay furloughed workers. Despite the measures taken to contain the epidemic and stabilise economic activity, the emergence of a new economic crisis has weakened most worldwide economies in the period 2020-2022 and the leading producers of motor vehicles worldwide have registered a significant decrease in both their production and sales.

As anticipated above, the index of industrial production in the automotive sector for 2020 showed a decreasing trend of 21 per cent. Overall, in the semester August 2020 to January 2021, the Italian automotive market sector showed solid numbers when compared with the French, German and Spanish markets, with a positive trend of 14.8 per cent in October 2020, compared to the 0.3 on average in the EU, slowly decreasing to 2.3 per cent in January 2021 compared to a -7.4 per cent in EU. Production levels began to climb back towards the end of 2020 but, nonetheless, chip shortages and other supply chain uncertainties became the main cause of concern between December 2020 and March 2021.

Notwithstanding the above, the number of motor vehicles registered in Italy, considering the covid-19 pandemic, maintains Italy as one of the largest markets in the European Union, together with Germany, France and Spain, thus confirming its attractiveness to global motor manufacturers. The Italian automotive market is still dependent on Italian brands, in particular Fiat alone takes up to 15 per cent of the market share, a percentage that goes up to 38.9 when considering the new Stellantis Group. According to recent European trends, the development of mechanical and technological components for city and family cars is a result of collaboration agreements with other leading European or US companies, or between car manufacturers. Designs, however, tend to be developed internally as they constitute one of the core commercial assets of car companies.

Differences arise with respect to luxury brands, as they represent one of the leading manufacturing sectors in Italy. In the case of luxury brands, nearly all phases of the development, design, assembly and sale of vehicles are protectively dealt with internally by Italian automotive companies.

As for components and spare parts, there is a tendency in Italy to outsource, on the one hand, and to directly (or indirectly) manage such secondary business, on the other hand. Leading Italian companies tend to own or indirectly invest in the companies that are in charge of manufacturing and supplying their main mechanical components, body components and spare parts.

Both the transportation of vehicles, by means of car carriers, and that of spare parts is outsourced to professional transporters, which will also take care of customs duties.

The selection of external companies is usually on a non-exclusive basis and takes place by means of invitations to bid, addressed to pre-selected competitors on the market. Often the latter companies tend to enter into subcontracting agreements with authorised local and family-owned entities.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Generally, in Italy vehicles are distributed through selective distribution agreements entered into by local manufacturing companies, or the local representatives of foreign manufacturers, and autonomous Italian entities. The business dimensions of dealers vary mostly depending on the geographical regions in which they are located. In the central-northern regions and within the main Italian cities, dealers are usually representative of rather structured and economically sound companies owning more than one dealership. In the south of Italy and in smaller towns, where there might be a more evident economic depression, dealers tend to be small, family-owned companies.

With respect to contractual relationships with personnel, sales agents are often linked to dealers by means of agency agreements.

Notwithstanding the aforesaid general distribution mechanism, leading Italian automotive brands have recently developed new forms of sale chains by which they set up fully owned large dealerships where manufacturers promote and sell multiple vehicle brands. Clients are, therefore, offered the chance to see different car types and receive different services (sale, maintenance, repairs, post-sale assistance, etc) within the same vast premises. Following the Italian lead, other German and French-based manufacturers have adopted the same business model in Italy and have opened fully owned car dealerships in major Italian cities, such as Rome and Milan.

With reference to distribution agreements, due to the automotive market crisis experienced in the past decade, the number of mono-brand dealers has largely diminished over the years leaving space to multi-brand dealers, which are increasingly specialising in post-sale assistance services (eg, car registrations, services for disabled people accessing state benefits, maintenance, repairs, contractual warranties) and captive services (such as loans, insurance contracts, leasing and car rentals).

The recent economic developments in the automotive sector have also prompted the expansion of new mobility models in Italy, such as increasing rentals and car-sharing relationships rather than traditional sale schemes. This development has been promoted also as a way to avoid overcrowding means of public transport, to decongest urban traffic and improve air quality from vehicle pollution. That said, during the covid-19 pandemic, cautious behaviour has kept citizens away from shared mobility options. To reverse this cautious approach and increase public trust in shared mobility, sharing operators and short-term rental companies have applied thorough vehicle hygiene protocols to reassure users of their services as much as possible and guarantee these forms of mobility from future shocks. With this aim, national and local legislation is fostering the use of alternative means of transport, in particular in the biggest Italian cities, lastly by offering cashback on purchase of new bicycles or other electric micro-mobility vehicles such as e-scooters or cashback on vehicle-sharing services.

According to recent data, after the restrictions period, the mobility sector registered a very positive increase in the use of alternative means of transport including bike and scooter sharing and, most of all, electric scooters, which represent 40 per cent of the total offer of shared mobility services. In general, data from 2020 and 2021 show an increase of scooter and bike services in the biggest Italian cities and a decrease of car sharing services. In addition, 62 per cent of new registrations are made by physical persons while 38 per cent are made by companies, of which almost one out of five is by a rental company. The market is indeed consistently promoting long-term rentals of vehicles as opposed to vehicle purchase, leveraging on the advantages given by the lack of bureaucracy (from an insurance, tax and maintenance prospective) and by deferred fees without the need for an upfront payment. Seeking to benefit from this growing market, in recent years car manufacturers have been willing to get directly involved in offering long-term rental services, which often include a recurrent option to update the rented vehicle to a new model in exchange for a small additional fee, therefore generating a virtuous circle in terms of new vehicle production. The increasing trend is, therefore, also moving towards more efficient, luxury and high-performing cars available to a wider share of users than before.

Moreover, interestingly, recently the Italian Supreme Administrative Court (Consiglio di Stato), by totally reforming the previous Italian government's position on the matter, ruled in favour of sales of vehicles online through e-commerce channels. Despite this new overture, the practice of selling cars online has still not caught on in Italy, probably owing to practical difficulties and a cultural approach to the purchase of cars, which is still linked to traditional schemes. However, things may evolve in the future.

From a contractual point of view, there is no specific national legislation in Italy on distribution agreements; hence the same are governed by general contract law rules with reference also to sale, supply and franchising agreements.

Under EU legislation (Regulations No. 330/2010 and 461/2010 and the Supplementary Commission Guidelines No. 2010/C 138/05, currently under review), however, with specific reference to automotive distribution, there are limitations applicable to these kinds of vertical distribution agreements (ie, those contracts entered into by two or more companies at a different level of the production or distribution chain, and relating to the conditions under which the contracting parties may purchase, sell or resell certain goods or services). Selective distribution may be based on qualitative or quantitative grounds.

In purely qualitative selective distribution schemes, dealers and repairers are selected on the basis of objective criteria required by the nature of the product or service (eg, technical skills of sales personnel, layout of sales facilities, sales techniques and the type of sales service to be provided). These types of distribution agreements are usually deemed as not having anticompetitive effects, provided that three conditions are satisfied. First, the nature of the product in question must necessitate a selective distribution system, in the sense that such a system must constitute a legitimate requirement, having regard to the nature of the product concerned, to preserve its quality and ensure its proper use. Second, resellers must be chosen based on objective criteria of a

qualitative nature that are laid down uniformly for all and made available to all potential resellers and are not applied in a discriminatory manner. Third, the criteria laid down must not go beyond what is necessary.

On the other hand, distribution agreements based on quantitative grounds are seen as more restrictive as they set numerical limitations such as a maximum given number of permitted dealers or repairers, or a minimum level of sales.

Under the aforesaid EU legislation, there is a presumption that both qualitative and quantitative selective distribution agreements in the automotive sector do not limit competition if the parties' share of the market does not exceed 30 per cent, provided they do not:

- impose fixed sale prices on dealers;
- impose geographical restrictions (albeit with some exceptions, such as the restriction of sales by the members of a selective distribution system to unauthorised distributors in markets where such a system is operated);
- restrict active or passive sales to end users;
- restrict cross-supplies between distributors within the same selective distribution system or restrict the manufacturer's ability to sell components as spare parts to end users or repairers or to others who have not been entrusted by a specific dealer; and
- restrict the sales of spare parts by members of a selective distribution system to independent repairers that use those parts for the repair and maintenance of a motor vehicle.

With reference to time limits applying to the duration of vehicle selective distribution agreements, prior to the implementation, on 1 June 2013, of Regulation No. 330/2010 (which replaced the previous Regulation No. 1400/2002), such agreements were considered as not restrictive of competition provided they lasted for at least five years (in this case a non-renewal six-month notice period was necessary). On the other hand, in the case of unlimited duration of the distribution agreement, any withdrawal notice had to be of at least two years, unless the manufacturer indemnified the dealer or put in place a major distribution net reorganisation (in the latter two cases, the notice could be reduced to one year).

As soon as the market proved that the aforesaid legislation and time limits were, in fact, restricting competition rather than incentivising it, EU legislators amended the applicable provisions, by eliminating all references to limits on duration of such agreements.

As a consequence, the current legislation only permits non-compete obligations for a maximum period of five years from the date the distribution contract is entered into. No automatic renewal provision, which is deemed to extend the duration to over five years, is valid.

As regards the particular form of car distribution represented by the use of online platforms, it would appear that in the light of the evolution of the case law of the European Court of Justice (see ECLI:EU:C:2017:941), car manufacturers can prevent dealers from selling through online platforms, if the sale takes place over the platform itself in a manner visible to the consumer. This situation, however, seems to be materially different from the ones in which dealers (1) sell vehicles online through their own website, (2) carry out online advertising, and to this end, use price comparison tools and paid search advertising services and, last but not least, from the situation in which (3) the platform acts as a mere intermediary and refers to the dealer's website or shop when it comes to the conclusion and execution of the sale contract.

With reference to termination provisions, there is no specific time requirement under Italian law for a valid notice to be given, provided it is adequate and reasonable. The adequacy of the term provided within the termination notice very much depends on:

- the reason for termination (eg, breach of obligations by the dealer, justified or unjustified withdrawal by manufacturer);
- the contractual relations between the parties (eg, duration of the contract, exclusivity regime, number of dealerships, participation in the dealer's capital share by the manufacturer, existence of an economic dependency); and
- the reliance by the dealer upon the manufacturer's business strategies or the manufacturer's assurances or guarantees, which proved to be wrong or that induced the dealer to, as an example, get mortgages or loans, make infrastructural and technological investments, buy new premises, hire new personnel, etc.

In respect to restructuring of dealers, some criticisms arise. Recent trends have proved that most automotive manufacturing companies establish their own banks. On top of rendering financial services to private consumers, automotive banks also financially sustain dealers. This causes problems in Italy with reference to insolvency matters.

Indeed, considering that products, presale and post-sale services, technological infrastructure, platforms, business and sale conditions and strategies are supplied, developed and often imposed by manufacturing companies, it is frequently the case that dealers are subject to economic dependency upon manufacturers. Understandably, distributers also tend to resolve their financial issues by seeking more available financial allowances, and at better interest rates, from the manufacturers' banks. On the other hand, automotive companies have a high interest in ensuring that dealers do not become insolvent. However, they also need to make sure they do not contribute to the further indebtedness of the distributor by financing it when it becomes apparent that the distributor will not be able to repay its debt, as this conduct is prosecutable under the Italian legislation.

To mitigate the risk of not recovering the purchase price of vehicles and spare parts to be paid by distributors in case of insolvency, manufacturers usually subject the sale of vehicles to a right of retention of title. According to this provision, title of ownership on vehicles will be transferred to dealers only upon full payment. This measure, albeit valid from a legal standpoint, often does not prove to be as effective considering that, in the case of receivership proceedings against dealers, the receiver often happens to disregard the retention title, leaving the manufacturer with the burden of starting long and costly legal proceedings to enforce its rights and recover its vehicles.

Italy has adopted a series of measures that can help prevent and manage insolvency in the automotive sector. More precisely, Law-Decree No. 17/2022, known as Decreto Bollette, entered into force on 2 March 2022, established a €700,000 fund for the current year and €1 billion per year from 2023 to 2030 for the automotive sector. In particular, these incentives are targeting 'green transition, research, investments in the automotive sector aimed at the establishment, reconversion and requalification towards innovative and sustainable forms of production, in line with the European objectives of reduction of emissions harmful to the environment and digital development, as well as for the recognition of incentives to the purchase of non-polluting vehicles and to encourage the recovery and recycling of materials'.

Mergers, acquisitions and joint ventures

5 | Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no particularities for M&A or JV transactions for the automotive industry as such. As for other large industrial assets, the main areas to be carefully considered in the due diligence phase and in the preparation and negotiation of the transaction documentation (representations and warranties, special indemnities, price and price adjustment) are as follows.

- Production phase – the business is capital- and labour-intensive and it may have an environmental impact. So, real estate properties and other assets, employment, environment and waste management are areas to cover. Likewise, slow-moving inventory may be an issue. Single sourcing may be another issue to tackle.
- Distribution chain – the dealers' network is part of the value and dealership agreements may require careful analysis (eg, prices, competition restrictions, duration, change of control clauses).
- Finance – given the size of capital expenditure and operating expenses, financing agreements are key to business sustainability. Again, change of control clauses are a common practice.

More generally, the automotive space is likely to go through an unprecedented consolidation process driven by the huge investments needed for automation and electrification. This, in turn, according to some commentators, may result in relatively smooth clearances also with respect to concentrations leading to the combination of enormous assets and, thus, in principle, to a significant increase of market power. Against this background, one of the key issues that inevitably comes to mind in the merger control area is how and to what actual extent the automotive revolution will 'reshape' the boundaries of product and geographic markets and, in turn, the assessment of merging parties' competitive relationships and combined market power that still largely depends on the delimitation of the perimeter within which the latter are found to operate. One of the crucial factors in this regard is the development of business models alternative to ownership and possibly the transition from a system of 'owned transportation vehicles' – which represents the largely predominant although declining paradigm today – to a system of rented or even just borrowed vehicles that will ultimately eliminate the need for the final consumer to purchase his or her own vehicle. The foregoing is likely to result in a radical change in the relationship between market supply and demand and thus an unprecedented structural modification of the sector as a whole. In this respect, the Italian government is formally evaluating the Italian Competition Authority's proposal to amend the current merger control legislation with respect to both digital and more traditional sectors, so as to also include within the scope of the notification obligation transactions that do not meet the legal thresholds, in cases where an actual threat to competition nonetheless exists in the national market, or in a substantial part thereof, and within six months of the completion of the transaction.

Lastly, to close the circle in terms of approvals to be sought and obtained by the Italian government, it shall be clarified that the automotive supply chain per se is not subject to the Foreign Direct Investment (FDI) screening mechanism. However, the Italian government enacted – in late 2020 – a decree broadening the FDI scope so as to include high technological intensity 'assets or relationships', such as, among others, AI, robotics, semiconductors, microprocessors, automated or remote piloting technologies (including onboard sensors), automated manufacturing (a complete list is set forth in article 9 of DPCM No. 179/2020). In light of the foregoing, it should be carefully evaluated on a case-by-case basis if the automotive business of the target company as actually shaped (in terms of, for example, R&D activities, automatisation of the manufacturing process, etc) is captured by the aforementioned decree. Should the answer be positive, Italian FDI clearance shall be a condition precedent to closing of M&A transactions.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

From a broad perspective, it is worth noting how the automotive industry is radically changing. A current wave of vehicle innovation is emerging and reshaping even the most deep-seated features of the industry, from manufacturing processes to models of ownership. Digital transformation will affect the whole automotive value chain, from design to production and distribution. It has been estimated that there is US$3.1 trillion worth of societal benefits as a result of digital transformation of the automotive industry up until 2025.

A true game changer is the market entry of tech giants that not only can already benefit from significant economies of scale deriving from their market-leading position in transport-related services, such as mapping and artificial intelligence, but also from significant learning advantages when these firms will introduce prototypes of driverless cars whose data will be elaborated through cutting-edge algorithms. Silicon Valley firms are pouring substantial money into the car industry to develop new self-driving electric vehicles. It is a natural fit, given their status as prime innovators in modern technology, robotics and artificial intelligence. This entrepreneurial process constantly encourages tech firms to come up with better products and, as a result, disrupt existing market structures to ultimately benefit consumers.

In turn, automakers, which have been traditionally represented by a small number of very large companies, are now facing the most profound challenge to their business models in a century. The profound impact that technology is having on the automotive sector has given rise to a quandary for traditional automobile companies. Information technology is profoundly intertwined with the automotive sector and, in fact, electronic systems will be accounting for a significant part of a car's value in the next years.

In summary, going forward, with vehicles becoming more and more connected, autonomous, shared, and electric, the automotive industry is witnessing a disruptive technological tsunami that is about to bring major changes in the near future as regards both incentives and barriers to entry, with three big waves on the horizon rapidly approaching the shore: automation and connected car services, electrified vehicles and alternative models of 'ownership' such as car sharing and rental. It is worth highlighting that all these features have been identified by most of the respondents to the public consultation launched by the European Commission on the occasion of the review of the Motor Vehicle Block Exemption Regulation (Regulation (EU) No. 461/2010). Indeed, in their view, any changes affecting the automotive business since 2010 (such as connected cars, digitalisation, access to in-vehicle and users' data, remote connectivity/over the air technology), should be reflected in the objectives pursued by the block exemption rules covering the motor vehicle sector.

That being said, there are no specific tax incentives for investment in the automotive market. However, the following general tax incentives can apply:

The Patent Box regime, applicable to (1) Italian resident companies and to (2) Italian permanent establishments (PEs) of foreign companies residing in countries that signed an agreement to avoid double taxation with Italy and with which the exchange of information is effective (White-List Countries), allows for the non-taxability of a portion of the income resulting from the direct use of certain intellectual property (IP) rights or from the grant of those rights to third parties, provided that Italian companies or Italian PEs carry out R&D activities aimed at developing, maintaining and increasing the IP rights' value. The tax benefit consists of the exclusion from the entity's taxable basis for income tax purposes

of an amount equal to 50 per cent of the income generated from (1) the direct or the indirect use of or, at certain conditions, (2) the transfer of certain IP rights: software protected by copyright, industrial patents, designs, models (but excluding trademarks) and know-how. The calculation of the portion of the income that benefits from the favourable tax regime depends on whether the taxpayer exploits the IP rights directly or indirectly.

Italian subsidiaries and Italian PEs of foreign companies may benefit, among others, from the following tax credits.

Nature of the costs	Period of validity	Tax credit rate (%)	Calculation base
For expenses incurred in relation to 'experimental development', 'fundamental research' and 'industrial research' activities, as defined by Communication from the European Commission (2014/C 198/01) of 27 June 2014	Up to fiscal year running on 31 December 2022	20	
	From fiscal year running on 31 December 2022 to that running on 31 December 2031	10	Costs born calculated net of any other contribution and relevant within a maximum amount of €5 million
For expenses incurred to carry out a technological innovation activities aimed at realising new or substantially improved products or processes	Up to fiscal year running on 31 December 2023	10	Expenses to be calculated net of any other contribution and relevant within a maximum amount of €2 million
	From fiscal year following that running on 31 December 2023 and up to that running on 31 December 2025	5	Costs born calculated net of any other contribution and relevant within a maximum amount of €2 million
For expenses incurred to carry out technological innovation activity aimed at realising new or substantially improved products or processes functional to obtaining the ecological transition or digital innovation 4.0	Up to fiscal year running on 31 December 2022	15	Expenses to be calculated net of any other contribution and relevant within a maximum amount of €2 million
	For the fiscal year following that running on 31 December 2022	10	Costs born calculated net of any other contribution and relevant within a maximum amount of €4 million
	From fiscal year following that running on 31 December 2023 and up to that running on 31 December 2025	5	Expenses to be calculated net of any other contribution and relevant within a maximum amount of €4 million

The limits to the deduction of costs for income tax purposes related to cars used by companies in carrying on their business activities do not apply where the vehicles are an essential element for the company's business (eg, vehicles owned by a car rental company).

With respect to certain means of transportation such as buses, light commercial vehicles, trucks, road trains, articulated lorries, road tractors, vehicles for specific transport or special use, means of work used in the building industry, Italy Budget Law 2020 provides for a tax credit equal to 6 per cent of the cost incurred for their purchase (with effect from 2022). The above tax credit is limited to investments performed until 31 December 2022, or until 30 June 2023, provided that by 31 December 2022 the relevant order has been accepted by the seller and that down payments of at least 20 per cent of the purchase cost have been made and is not granted for the purchase of cars, scooters and motorhomes used by the company.

In addition to the above general tax incentives, Italian tax legislation often provided in the past tax measures aimed at fostering the purchase of least-polluting vehicles. More in detail, in recent years, a specific contribution (Ecobonus Auto) has been granted for the purchase or financial leasing of a new manufacturing M1 category vehicle (vehicles used for the carriage of passengers with no more than eight seats, in addition to the driver's seat) meeting certain CO_2 emissions requirements. The specific requirements to be met in fiscal year 2022 are still to be set out by the relevant Ministerial Decree.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

At European level, the most relevant automotive-related product compliance safety and environmental regulations are:

- Regulation (EU) 2018/858 of 30 May 2018 (as most recently amended by Commission Delegated Regulation (EU) 2021/1244 of 20 May 2021 and by Commission Delegated Regulation (EU) 2021/1445 of 23 June 2021), on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles;
- Commission Regulations (EU) 2017/2400, (EU) 2017/1347, (EU) 2017/1151, (EU) 2017/1154, (EU) 2018/1832, (EU) 2019/318 and (EU) 2019/543;
- Regulation (EU) 2019/2144 (as supplemented by Commission Delegated Regulation (EU) 2021/1243 of 19 April 2021), on type approval requirements for motor vehicles and their trailers, and systems, components and separate technical units intended for such vehicles, as regards their general safety and the protection of vehicle occupants and vulnerable road users, in turn implemented by Commission Delegated Regulation (EU) 2021/535; This Regulation is expected to make it mandatory to adopt the most advanced security technologies in order to obtain type approval for a certain vehicle: among the many, this security technology includes intelligent speed assistance, alcohol interlock installation facilitation, advanced driver distraction warnings as well as the installation of a black box on each vehicle;
- Regulation (EC) 715/2007 (on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles and on access to vehicle repair and maintenance information), as subsequently amended and supplemented by Commission Regulations (EU) 2017/1151, (EU) 2017/1154; Regulation (EC) 595/2009 (on type approval of motor vehicles and engines with

respect to emissions from heavy-duty vehicles and on access to vehicle repair and maintenance information; and

- Regulation (EU) 2019/631, setting CO_2 emission performance standards for new passenger cars and for new light commercial vehicles (as already amended by Commission Delegated Regulation 2020/22, 2020/1590, 2020/2173, and 2021/1961) that repealed, as of 1 January 2020, both Regulation (EC) 443/2009 on emission performance standards for new passenger cars and Regulation (EU) 510/2011 on emission performance standards for new light commercial vehicles.

Against such a backdrop, in Italy, Legislative Decree No. 285/1992 (the Italian Highway Code) and Presidential Decree No. 495/1992 (the Regulations implementing the Italian Highway Code), in turn implemented by a number of ministerial decrees, set forth the technical specifications that must be fulfilled by motor vehicles in order to obtain the type approval by the competent department of the Italian Ministry of Sustainable Infrastructures and Mobility.

Under Regulation (EU) 2018/858:

- the approval authority shall refuse to grant the EU type approval if it finds that a vehicle, system, component or separate technical unit, albeit in compliance with the required prescriptions, presents a serious risk to road safety or seriously harms the environment or public health (article 26.5);
- the approval authority that has granted an EU type approval shall take the necessary measures (including, where needed, revocation of the EU type approval) in order to ensure compliance with the type it has approved if it finds that the manufacturer no longer produces the vehicles, systems, components or separate technical units in conformity with the approved type, or establishes that the certificates of conformity no longer comply with the prescriptions of the Regulation (article 31.7);
- a manufacturer that has obtained an EU type approval and, under certain circumstances, the importer is required to take all appropriate corrective measures where a vehicle, system, component, separate technical unit, part or equipment that has been placed on the market or that has entered into service is not in conformity with the Regulation or where the type approval has been granted on the basis of incorrect data and to immediately inform the competent authority that issued the relevant EU type approval. The corrective measures may include withdrawing the vehicle from the market or recalling it (articles 14.1 and 17.1); and
- an economic operator is required to take all appropriate corrective measures if the market surveillance authority of one member state finds that a vehicle, system, component or separate technical unit presents a serious risk to the health or safety of persons or to other aspects of the protection of public interests. If it does not take such corrective measures, national authorities are entitled to adopt restrictive measures (including the withdraw or the recall of the vehicle from the market) (article 52).

In principle, non-compliance with applicable law requirements is, per se, punished with administrative sanctions that shall be effective, proportionate and dissuasive.

There are no industry-specific rules for product recalls.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Italy has a fairly strong tradition in product liability litigation, particularly since the adoption, in 2005, of Decree No. 206/2005 (known as the Italian Consumer Code), which incorporates previous Italian laws implementing Directive 85/374/EEC and Directive 2001/95/EC). On a side note, the Italian Consumer Code has been recently amended by Legislative Decree No. 170/2021 transposing Directive 2019/771/EU so as to lay down new rules on conformity of goods and commercial warranties. Product liability law is particularly significant to the automotive industry, given the large number of components (eg, braking systems, airbags, seat belts) that might in theory be subject to manufacturing or design defects and because of the seriousness of the risks in the case of defective parts.

Product liability litigation in the automotive sector can also be particularly complex, in light of the fact that consumers or users generally tend to direct their claims to the manufacturer, which, in turn, might need to involve the litigation suppliers or manufacturers of the allegedly defective components.

As regards recalls – regulated by articles 104 through 107 of the Consumer Code (implementing the General Product Safety Directive 2001/95/EC) – the automotive industry has long been one of the most affected by recalls generally. According to the European Rapid Alert System (RAPEX), throughout 2021 Italy submitted two Alerts for 'motor vehicles' and both were concluded with the manufacturer recalling the product from end users. The risks associated with the Alerts were injuries and environmental risks. In 2022, there was an Alert concerning 'a motor vehicle not complying with the Regulation on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles'. The adopted measure was recalling the product from end users.

Class actions have been allowed in Italy since 2010 and they have never represented an actual major risk for automotive manufacturers in Italy. Indeed, there were strict conditions for a class action to be considered admissible (and, thus, be decided on the merits) and this has historically discouraged consumers and consumer associations from relying on the class action system. Up until now, based on publicly available information, very few class actions have been filed against motor vehicle manufacturers. By way of example, in recent years Altroconsumo – one of the most prominent and active Italian consumer associations – started: (1) a class action against Volkswagen regarding emission tests, (2) a class action against Volkswagen for a specific version of one of its passenger cars and (3) another class action against the FCA for a different type of passenger car. All these lawsuits are grounded on the companies having declared different emissions or fuel consumption values than the actual ones (even through the 'defeat device'), which led plaintiffs to claim damages for conducts affecting the consumers' choice. Furthermore, Altroconsumo also started a follow-on class action in late 2019 as regards almost all automotive captive banks on the Italian market, seeking compensation for damages suffered by the consumers due to the allegedly inflated costs for their financial services purportedly ensuring a cartel among the defendants.

Because it did not turn out as an effective dispute resolution mechanism, unlike with other countries, a reform of the Italian class action law (aimed at removing some of the current obstacles) had long been envisaged and discussed. Following years of gestation, the Italian class action reform was approved on 3 April 2019. Its key features include:

- a broader scope of application, whereby class actions can now be brought for the enforcement of 'homogeneous rights' of anyone claiming damage redress caused by businesses;
- a long opting-in window whereby individuals can join the class action even after issuance of the decision on the merits;
- new figures in the class action management (ie, a 'common representative' of the class who will manage the merits and the subsequent enforcement phases on behalf of the individual class members; and
- a success fee for the attorneys of the winning party and for the common representative of the class.

The new class action law (Law No. 31 of 12 April 2019) was supposed to enter into force on 19 April 2020, 12 months after its publication in the Official Journal, but after a series of postponements – mostly determined by the covid-19 health emergency, the new class action law entered into force only on 19 May 2021. It applies to illicit conduct that occurred after its entry into force.

Another form of collective action, also modified by this year's reform, is the 'collective action for injunctive relief'. This action is aimed at obtaining a court ruling:

- inhibiting any conduct that is detrimental to the interests of multiple individuals or entities (whereby this action is defined collective);
- ordering appropriate measures to correct or eliminate the harmful effects of the assessed violations; and
- possibly ordering the publication in the media of the injunctive relief.

The court may also establish a sum of money to be paid as a penalty for each day of delay in the event of non-compliance.

On 24 November 2020, the Directive 2020/1828/EU on representative actions for the protection of the collective interests of consumers (repealing Directive 2009/22/EC) has been approved. Such Directive requires EU member states – including Italy – to transpose it by 25 December 2022 adapting their procedural collective action and redress mechanism, with application from 25 June 2023. It remains to be seen how the implementation of the Directive and the new Italian class action system will combine.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

In recent years, the automotive industry has been subject to market monitoring, competition advocacy as well as antitrust enforcement activities carried out by both the European Commission and the national competition authorities of the various member states. Noteworthy is the currently pending review of the Motor Vehicle Block Exemption Regulation (Regulation (EU) No. 461/2010) by the European Commission.

Regulation (EU) No. 461/2010, together with the general Regulation 330/2010 on vertical agreements, is one of the key pieces of EU legislation when it comes to the development, manufacture and supply of vehicles as it sets the general framework of the antitrust analysis of agreements for the manufacturing, supply and distribution entered into by the various market players throughout the automotive market chain. Regulation 461/2010 creates a 'safe harbour' (under the block-exemption mechanism) for particular categories of agreements that are key to the automotive industry and sets, therefore, a handful of clear-cut rules as regards the requirements to obtain access to such safe harbour. Therefore, it lists the hardcore clauses, which may possibly prevent such a benefit from the onset if included in the arrangement under scrutiny and also provides for a list of specific non-exempted clauses. On the other hand, the Regulation does not lay down any 'white clauses', that is to say, rules that the parties to the arrangement must obey or must comply with.

On 12 October 2020, the European Commission launched a public consultation that closed on 25 January 2021 to gather stakeholders' views and evidence to assess whether and to what extent the objectives of the Motor Vehicle Block Exemption rules have been achieved, as well as to identify competition issues arising in vertical relationships in the motor-vehicles sector. According to the stakeholders interviewed, the objectives that the Commission should pursue with respect to vertical agreements concern, among others, the impact of digitalisation on the automotive sector and namely:

- ensuring a level playing field with regard to access to in-vehicle data, including technical information and data linked to connected vehicles, for all stakeholders (while taking into account consumers' choice to share such data);
- guaranteeing cybersecurity of vehicles while enabling fair competition to protect the interests of the consumer; and
- considering the impact of over the air diagnosis, which allows vehicle manufacturers and authorised dealers to contact customers directly and to offer innovative services.

On 28 May 2021, the Commission published the Evaluation Report and Staff Working Document summarising the findings of its evaluation of the Motor Vehicle Block Exemption Regulation, which will be taken into account in the policy-making stage of the review. The report showed the need to take into consideration the emergence of new technologies and the increasing role of data in competitive dynamics in the industry, particularly in the aftermarket.

Indeed, one of the key antitrust issues will be the evolution of car maintenance services throughout the digital era. In the analogic sphere, car maintenance activity essentially starts when the consumer's vehicle enters the repairer's workshop, as repairers physically inspect vehicles in their workshop using advanced diagnostic and repair tools to identify and fix cars' malfunctions. Against this background, competition law rules are primarily aimed at safeguarding competitiveness in terms of an equal level playing field between independent service providers and authorised repairers, in terms first of all equal access to spare part supplies as well as diagnostic and repair tools. Digitalisation changes this paradigm.

Car maintenance in the digital era starts within the vehicle thanks to remote communications achieved via diagnostic software embedded in cars. Competitiveness will thus be increasingly measured against the possibility of carrying out preventive maintenance while having remote access to predictive information about the vehicle, before any problem with the latter occurs, hence, even before the need to bring the vehicle to the repair shop arises. Such a paradigm shift may have an impact on the conditions required to enable a fair and competitive vehicle service industry. In particular, competition agencies are likely to monitor car manufacturers' ability to act as gatekeeper for access to 'in vehicle data' and to the incentives and ability to design vehicles telematics systems in a manner that provide only themselves timely access to such data along with the possibility of being in direct contact with the driver.

Also, it is noteworthy how competition rules in this area will increasingly cross paths with another key body of EU and national provisions (ie data protection rules) if and to the extent that the exchange and circulation of in-vehicle information underlies the exchange and circulation of personal information on vehicle drivers (ie, personal customers data, such as drivers' habits or movements). Although the European Commission and the European Court of Justice stressed on a number of occasions that issues concerning the processing of personal data are not as such a matter for competition law, nowadays

it seems that these issues cannot be overlooked in the enforcement of antitrust rules. Notably, the European Court of Justice remarked in see ECLI:EU:C:2006:734, paragraph 63, that 'any possible issues relating to the sensitivity of personal data are not, as such, a matter for competition law, they may be resolved on the basis of the relevant provisions governing data protection.' Personal data is becoming more and more of a real asset and, as a result, privacy protection has become a central point of concern on the agenda of EU and national competition agencies.

At a national level, in the vast majority of merger decisions, the Italian Competition Authority (ICA) decided (without applying any EU or national rules, such as Regulation (EU) No. 461/2010, specific to the motor vehicle industry) not to open an inquiry because there was a lack of detrimental effects on competition. These decisions, which are apparently not likely to have relevance at an enforcement level, are instead highly important in defining the relevant markets in the spare parts industry.

According to the ICA, each spare part is, in principle, intended as a separate product market, and each individual market identified as such can be divided between the spare parts that have been produced by car manufacturers (the original equipment suppliers) and those that are distributed in the market with brands different from those of the car manufacturers (whose producers constitute the independent aftermarket). With regard to the geographical extent of these markets, the ICA has recognised that they have a local dimension.

As regards antitrust cases, instead, the ICA's concerns mainly focus on the exchange of sensitive information, especially through trade associations. In 2015, the ICA closed an investigation concerning restrictive practices implemented in the market of car seat foam by the main market players. In this case, it was ascertained that the parties had significantly exchanged information concerning their productive and commercial activities, therefore violating article 101 of the Treaty on the Functioning of the European Union (TFEU) (case I776 of 10 June 2015). By contrast, in case I791 of 30 March 2017, the ICA stated that an exchange of sensitive information between automotive companies also active in the long-term vehicle rental sector and the related industry associations did not infringe article 101 of the TFEU, as it was not able to restrict or delete uncertainty about the parties' conduct in the market. Even though the relevant market was highly concentrated, with significant barriers to entry, and the information was detailed, not public, individualised, referred to the past but frequently provided and related to multi-annual contracts, there was no connection (direct or indirect) between the information exchanged and their commercial policy. Last but not least, on 20 December 2018, the ICA sanctioned nine captive banks and their parent companies as well as industry associations for having engaged in an exchange of commercially sensitive information, concerning economic and other contractual terms applied to dealers and financing agreements and thus violated article 101 of the TFEU (case I811).

The decision has been appealed by the parties before the Administrative Court of First Instance (TAR Lazio), which, after having issued an interim order suspending the effects of the ICA's decision, has ultimately quashed it, on 24 November 2020, on grounds of unreasonable duration of the pre-investigation phase, erroneous identification of the relevant market, inconsistency of the investigation and absence of sufficient objective elements to establish the existence of a single and complex cartel. In January 2022, the Administrative Supreme Court (Consiglio di Stato) upheld the TAR Lazio decision.

The fining decision has been followed also by a collective damages action brought by an Italian consumer association before the Court of Milan. The Court has issued an order suspending the trial until the completion of the administrative proceedings.

More generally, as regard follow-on litigation, Italy has approved Legislative Decree 3/2017 that implements Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of the competition law provisions of the member states and of the European Union. The scheme of the Legislative Decree, proposed by the former Prime Minister and by the Justice and Economic Development Ministers and approved by the Council of Ministers on 27 October 2016, was approved in its definitive version during the meeting of the Council of Ministers held on 14 January 2017. This Legislative Decree, adopted on the basis of the aforementioned Directive to introduce a common regulation for claims for damages caused by infringements of competition law throughout the EU, will probably encourage the implementation of private enforcement litigation in Italy.

As regards the automotive industry 'digital dimension', which is rapidly increasing its momentum in Italy as elsewhere in the world, the ICA, on 27 April 2021 sanctioned one of the major global players in the digital economy for abuse of dominance in relation to a refusal to deal affecting the android auto environment with regard in particular to an app developed to provide end users with information and services for charging electric cars' batteries (case A529).

Moreover, in the context of its advocacy activity, in December 2018 the ICA issued a report pursuant to article 21 of Law No. 287/1990 (AS1556), concerning the regulatory provisions governing road testing of autonomous driving in Italy and, in particular, article 14 of the Decree of the Ministry of Infrastructure and Transport of 28 February 2018 – the Smart Road. The ICA considered that the need to apply for a vehicle manufacturer's authorisation to be allowed to experiment in the development of autonomous driving programmes is restrictive of competition since it reduces the possibility for independent developers to compete, to the advantage of car manufacturers already strongly active in a rapidly developing sector. This causes a slowdown in scientific progress in this area and limits interoperability among proprietary autonomous driving systems.

Last, for the sake of completeness, it is noted that the Italian parliament adopted, in August 2017, the Annual Market and Competition Law, although it did not intervene in this specific sector. On 23 March 2021, the ICA followed up on that by formally submitting new pro-competitive legislative changes to the Italian government, which is the institution in charge of the drafting of the Annual Market and Competition laws. With specific reference to the automotive sector, the ICA's last proposals focus on the need to ensure that no distortions of competition are created in the development of infrastructures for charging electric cars. In particular, attention is devoted to technological neutrality and equipment interoperability, so as to avoid possible restrictions of competition between operators. Moreover, the ICA has recommended that public administrations should follow transparent and non-discriminatory procedures for the allocation of public spaces for the installation of charging stations; similarly, adequate competitive procedures should be adopted by all public concessionaires. Finally, the ICA has proposed that prices for the new services should not be based on regulated tariffs. The Italian government is currently evaluating ICA's proposal in view of the adoption of the new Annual Market and Competition Law.

Dispute resolution mechanisms

10 | What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Most of the disputes involving the automotive industry in Italy relate to bodily harm, supply chain issues, disputes with dealers' networks (and connected after-sales repair and maintenance services), disputes with consumers over unfair advertising, violation of competition law, IP disputes and disputes over defective components.

Damage claims by consumers can be brought against:

- the manufacturer for product liability pursuant to article 114 of the Consumer Code or under the general provision on tortious liability (article 2043 of the Italian Civil Code); and
- the seller for hidden defects pursuant to article 1494, paragraph 2 of the Italian Civil Code.

Supply chain disputes are also common in Italy, but tend to be resolved via settlements (except when the dispute involves a bankrupt supplier). However, there are no specific interim injunctions under Italian law, and these are available only in summary or urgent proceedings and only in the case of urgency and prima facie strong grounds for the claim.

In relation to disputes on compensation claims arising from unfair practices, publicly available information reveals that very few class actions have been filed against motor vehicle manufacturers. For example, Altroconsumo – one of the most prominent and active Italian consumer associations – started three class actions claiming damages ensuing unfair practices. Specifically, summoned companies were sued either for having installed the 'defeat device' or for their declarations on fuel consumption in relation to a particular version of one of their passenger cars.

These procedures tend to be initiated with the main aim to raise an issue and to allow parties to develop a constructive dialogue in the interest of both consumers and enterprises. Indeed, in early 2021, two of the three class actions initiated by Altroconsumo have been terminated with a settlement between the latter and the defendants. The third class action is now pending before the Court of Appeal. Indeed, one of those automotive companies has recently decided to appeal against the first instance judgment, which condemned it to compensate consumers admitted to the class action initiated by Altroconsumo.

Covid-19 does not appear to have impacted the disputes arena in the automotive sector, except for the general slowing down of all procedures already in progress.

Distressed suppliers

11 | What is the process for dealing with distressed suppliers in the automotive industry?

First, the general rules of Italian insolvency law also apply to the automotive sector, and no specific provisions exist that allow a different treatment for distressed suppliers in this industry.

The new Italian Insolvency Code was published in the Official Journal on 14 February 2019 and will enter into force on May 2022, as a result of Law-Decree No. 118 of 24 August 2021 (except for the section concerning alert and assisted settlement procedures that will enter into force on 31 December 2023). The new rules provide for measures aimed at preventing insolvency of entities, such as suppliers, through certain early-warning tools (ie, internal reporting obligations by the statutory auditors of the company and external reporting obligations by qualified public entities such as social security agencies, tax agencies and tax collectors), in the presence of certain indicators of a situation of distress. Should the debtor fail to react promptly by taking the necessary measures, the auditors and the above entities must inform a newly created non-jurisdictional distress composition body named OCRI established within the Chambers of Commerce. Such reporting is aimed at triggering a 'composition procedure' to enable the distressed company to return to solvency through agreements with the creditors. Failing this (and recurring a state of insolvency), the Chambers of Commerce inform the Public Prosecutor, who can file before the court a motion seeking the opening of bankruptcy proceedings defined as 'judicial liquidation'. Appropriate incentives are provided to companies that voluntarily and timely resort to the composition procedure (including tax reductions, extra time for filing restructuring plans or debt restructuring agreements, some criminal exemptions or reduction of sanctions). Some entities (such as listed companies, banks and large-sized groups) are not obliged to apply the above-mentioned early-warning rules, but will benefit from the rewarding measures if they do.

In any event, caution should be adopted when dealing with a supplier showing clear signs of distress. Following the last reforms on creditor arrangements, an irreversibly distressed supplier will inevitably be declared bankrupt; however, if the degree of economic distress is not as serious, typically a troubled supplier will try to avoid bankruptcy liquidation through the new composition procedure described above or by seeking to be admitted to a creditor arrangement scheme by either filing a motion for a composition with creditors or presenting a debt restructuring agreement, both of which set aside any motion for bankruptcy liquidation filed by third-party creditors in the meantime, and entail a clawbackexemption.

These creditor arrangement procedures lead to drafting plans or restructuring agreements between the distressed supplier and its creditors to agree on a way to repay the debt – by liquidating the company's assets and assuring a higher satisfaction for creditors than in a bankruptcy liquidation scenario – and possibly continue the business including all pending contractual relations with creditors and third parties (which shall be allowed to terminate them only for cause), thus avoiding a bankruptcy liquidation scenario where instead pending contractual relations are suspended and resumed only on the bankruptcy receiver's election.

As opposed to bankruptcy liquidation, these procedures can be activated only on the initiative of the distressed supplier, and solely at a later stage will creditors be entitled to intervene and even propose concurrent plans. If the legal requirements for the arrangement schemes are not met, the supplier may ultimately be declared bankrupt.

Aside from creditor arrangements, bankruptcy liquidation is the ultimate procedure to ensure debt recovery for creditors. A bankruptcy declaration is issued by the competent bankruptcy court on a motion that can be submitted by the distressed supplier, or by any creditor thereof or any interested third party. The former management is divested of its powers and a court-appointed receiver will take control over the bankrupt entity with the aim of liquidating any assets thereof and maximising the outcome of the liquidation to assure the highest satisfaction for creditors, whose claims shall be repaid proportionally based on their ranking.

Bankruptcy liquidation rarely assures adequate percentages of satisfaction, especially for unsecured creditors. Moreover, as said, whenever a supplier is declared bankrupt any pending contractual relations with creditors and third parties are automatically suspended, and will be resumed only if the receiver decides for their continuation – and obtains specific court leave – because they may prove useful for the recovery and liquidation process.

Another important aspect characterising bankruptcy liquidation is that receivers will typically try to maximise incomes for the bankrupt estate, and they will often do so also by attempting clawbackactions to reverse the effects of payments (or other asset disposals) performed by the distressed supplier in the look-back period prior to the bankruptcy declaration (or prior to the creditor arrangement, if this was unsuccessful and led to bankruptcy). These actions are more likely to succeed if there is evidence of the payee's awareness of the debtor's distress when the payment was made. Another option sought by receivers to maximise incomes for the bankruptcy estate is to sue the distressed company's former managers for company mismanagement.

The way the automotive industry should deal with suppliers that face distress indicia must be determined on a case-by-case basis, depending on the factual circumstances at hand. In any event, a cautious approach should always be adopted, especially in relation to changing the existing contractual terms and conditions, by seeking authoritative approval thereof in a creditor arrangement context, and by avoiding changes in a bankruptcy liquidation scenario to avoid a significant risk of claw-back.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

A significant portion of intellectual property disputes in Italy involve business operators in the automotive industry, particularly in relation to spare parts covered by trademark or design rights. Italian courts have recently addressed in a number of cases the issue whether the overall shape of automotive products (eg, motorcycles or even engines) may be protected both as a registered or unregistered trademark and as a copyright work, under specific circumstances where the products in question may be regarded as design icons having both creative character and artistic value (such as the Piaggio Vespa or the Ferrari 250 GTO).

In this vein, the Court of Milan recently found that the unauthorised display of Ferrari cars in the advertising campaign of a clothing collection entailed a misuse of the well-known Ferrari trademarks, giving rise to an illicit association with the Italian sports cars brand and an undue advantage for the fashion house producing the advertisement (Court of Milan, 3 June 2020, No. 3109, *DeJure*).

However, the threshold to recognise the artistic value of the overall shape of an automotive product has been set particularly high by Italian courts. In a recent proceeding, Jaguar Land Rover enforced its shape trademarks allegedly covering the old 'Defender' vehicle design and its copyright-protected shape. The Court of Rome, rebutting the plaintiff's claims, declared the design of the well-known English off-road vehicle not protectable as a copyrighted work. In its reasoning, the Court highlighted that the 'Defender' shape lacks the artistic value required by the law (with creative character) to enjoy such protection. Indeed, Jaguar Land Rover failed to provide the Court with any evidence proving the artistic recognition of the old shape of the English car. The Court also excluded any likelihood of confusion between the defendant's product and the Defender's shape trademarks (Court of Rome, 4 August 2021, in Sprint).

Still, trademarks protecting the shape of iconic cars are subject to the general rules on trademark cancellation for non-use. And the same Ferrari recently saw the revocation for non-use by the European Union Intellectual Property Office of the Ferrari GTO 250 EU shape mark (EUIPO, 29 May 2020, No. C 30 743).

Patents and utility models are also at stake in many automotive disputes, concerning for instance braking systems, engine features or electronic functionalities of vehicles.

The number of patent disputes in this field is expected to escalate in the near future, as a consequence of the upcoming innovations relating to self-driving cars and connected cars technologies. In fact, an increasing number of patent applications concerning said technologies are being filed with the European Patent Office and further complexity may derive from the circumstance that some of the resulting patents are standard essential patents.

Most provisions covering intellectual property rights in Italy are embodied in the Italian Intellectual Property Code and in the Copyright Act, as amended from time to time to implement international agreements and, most importantly, EU directives. EU regulations, such as those on the European Union trademark and on Community designs, are directly enforceable in Italy.

Specialist courts dealing with intellectual and industrial property matters were established in Italy in 2003 and reformed in 2012, when they became subsections of the newly introduced commercial courts. The commercial courts are also European Union trademarks and Community designs courts.

Generally, proceedings before the commercial courts follow the procedural rules of ordinary civil proceedings, including the possibility to institute preliminary proceedings before initiating a full-blown case on the merits, or in the context of a pending case on the merits. The Intellectual Property Code, however, provides for some specific evidentiary, precautionary and enforcement measures, also according to Directive 2004/48/EC on the enforcement of intellectual property rights and to Directive (EU) 2016/943 on the protection of trade secrets, as implemented in Italy by Legislative Decree No. 63 of 11 May 2018, which came into force on 22 June 2018.

Preliminary proceedings are a cost- and time-effective solution for IP rightholders to tackle infringements. Indeed, a preliminary injunction may be obtained in around six months, whereas it takes no less than two to three years to obtain a first-instance decision on the merits.

Italian courts would grant a preliminary injunction when the petitioner's claims appear prima facie grounded (fumus boni iuris) as regards both validity of the relevant IP rights and infringement thereof, and the claimant substantiates that he or she would suffer irreparable harm until the outcome of ordinary proceedings on the merits (urgency requirement or periculum in mora). In this regard, Italian courts usually find the urgency requirement to be met even if a few months (up to 10 months) have passed from the moment when the right holder discovered the allegedly infringing activity. Other forms of preliminary relief available to IP rightholders in Italy are seizure (to prevent disposal of the infringing goods) and, most importantly, preliminary search orders to secure evidence of the infringement, which is usually requested in the first place and granted with an ex parte order. A preliminary injunction is then granted at a second stage, following a discussion hearing, subject to the relevant requirements (prima facie case and urgency) and based on the evidence collected during the search. If the preliminary injunction is granted, additional measures such as penalties and publication of the decision are available and commonly ordered by Italian courts.

Most intellectual property disputes are resolved based on the outcome of preliminary proceedings, often by means of settlement agreements. If this is not the case, and some material damages are claimed by the rightholder, ordinary proceedings on the merits follow their regular path up to a first-instance decision, which may then be appealed before the Court of Appeals and ultimately challenged before the Supreme Court on purely legal issues.

Over the past few years, the Italian Supreme Court has affirmed the principle that patent infringement proceedings must be stayed, under certain circumstances, when invalidity proceedings concerning the same patent are pending and until a final judgment on validity is issued (Italian Supreme Court, 4 April 2019, No. 9500, *Sprint*). This principle was followed by a recent decision of the Court of Genoa, still subject to Supreme Court review, in a case between two major players of the automotive sector concerning road milling machines, even though the patent invalidity proceedings were initiated by the alleged infringer after the institution of the infringement proceedings.

According to the Italian Intellectual Property Code, damages are based primarily on the rightholder's lost profits, taking into account all the relevant circumstances. Lost profits cannot be lower than the reasonable royalty corresponding either to the amount the rightholder would have received if a normal licence agreement had been entered into or to a typical licence fee in the industry. In any event, the right holder may claim the disgorgement of the infringer's profits, when the amount is higher than the compensatory damages that would be awarded or as an alternative to the rightholder's lost profits.

The court may appoint a technical expert to assess damages. Where an analysis of the defendant's business is necessary the court may issue a search order or may order the disclosure of the defendant's accounting records.

Alternative dispute resolution methods such as mediation and assisted negotiations are available and increasingly used in Italy, although they are not mandatory in intellectual property disputes.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

The automotive sector is historically characterised by a high level of unionisation.

In recent years, due to the fluctuating profitability of the sector, automotive companies operating in Italy reduced their workforce and made significant use of welfare measures to cushion periods of reduced demand.

The ongoing covid-19 emergency still in place and its implications on the national economy caused huge losses in the market demand. Such huge losses have been reiterated by the recent lack of chips and the crisis of raw materials and energy, which led many companies in the automotive sector (including those operating in side businesses) to implement additional furlough programmes and to interrupt their economic operations in Italy.

In terms of working conditions, after a period of forced closure of factories in March and April 2020, automotive companies could restart their operations, on condition that they comply with the stringent requirements on health and safety to limit the covid-19 contagion at the workplace, as set out by the law and the Protocol on H&S signed on 24 April 2020 and then recently updated on 6 April 2021, which is still in place. Among the main measures adopted are: smart working for all activities that can be carried out remotely, daily sanitisation, safety distance (one metre) among employees and use of personal protection equipment (if individuals are not in condition of self-isolation).

The renewal of the National Collective Labour Agreement of the manufacturing sector was signed on 5 February 2021. Following the renewal, a number of agreements integrating the National Collective Labour Agreement of manufacturing sector were signed by the employees' and employers' trade unions (the last one was signed on 11 November 2021). The main items covered by the renewal of the National Collective Labour Agreement and the additional agreements are the following:

- salaries of employees;
- levels of classification;
- complementary pension system and supplementary healthcare;
- involvement of trade unions in the case of change of provider or public service contracts; and
- professional training of employees (with specific regards to digital skills) and smart working.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

From a mobility standpoint, one of the main concerns in Italy at the moment is the necessity to implement all relevant measures to achieve 'technological neutrality' aimed at reducing emissions. To boost the sale of hybrid and plug-in electric vehicles, the Italian legislator introduced, with Law No. 178 of 30 December 2020, some economic bonuses that apply upon purchase of a new vehicle. For example, low-emissions vehicles benefit from a monetary bonus up to €10,000 and families with limited revenues can benefit of a discount up to -40 per cent for the purchase of electric cars meeting certain criteria.

The hybrid and electrically-chargeable car market recorded a significant increase in volume in 2021. Overall, in 2021, in Europe, the hybrid market accounted 19 per cent of all car sales (compared to the 5.7 per cent in 2019 and the 11.9 per cent in 2020) and the electrically chargeable vehicles one accounted 10.5 per cent (compared to the 3 per cent in 2019). Indeed, the total sales percentage of hybrid and electrically chargeable cars is only 2 points lower than the total sales percentage of diesel vehicles (which amounts to 21.7 per cent). According to forecasts, electrically chargeable vehicles will definitely supersede diesel vehicles in 2022. This prediction is supported by the fact that at the end of December 2021 the market registered the first overtake, with 29.3 per cent of electric and hybrid plug-in vehicles sold compared to 18 per cent of diesel vehicles. This significant increase is due not only to the governments bonus but also to covid-19. Indeed, as a consequence of this pandemic, a significant percentage of car drivers decided to switch to alternatively powered vehicles.

According to the Italian Competition Authority, the development of electric infrastructures for the recharging of motor vehicles as envisaged by the EU and Italian regulatory framework represents an important step towards sustainable mobility. The said Authority considers the development of the electric mobility sector in accordance with competitive dynamics to be highly desirable for the benefit of consumers and the entire economic system and society. In this respect, legislative measures have been adopted to, on the one hand, simplify procedures and provide incentives for the installation of recharging infrastructures, and, on the other hand, to require the Italian Regulatory Authority for Energy, Networks and Environment to regulate the price of energy distributed through recharging infrastructures. Lastly, the 2021 Budget Law requires motorway concessionaires to provide their concession networks with an adequate number of high-power recharging stations. Furthermore, the National Recovery and Resilience Plan (PNRR) is set to provide massive investments in green mobility infrastructures for a grand total of approximately €25 billion: these investments include the installation 21,355 fast and ultra-fast public charging stations for electric and hybrid vehicles. In addition, the development of 40 hydrogen fuelling stations for wheeled vehicles and nine for rail transport is planned.

EU Directive No. 2014/94/EU on the deployment of an alternative fuels infrastructure, implemented in Italy by means of Legislative Decree No. 257 of 16 December 2016 and further integrated by Commission Delegated Regulation 2018/674/EU, sets out, for the first time, a common framework of measures aimed at establishing alternative fuel infrastructure, including the minimum requirements for the construction of charging points for, among others, electric and hydrogen vehicles, with the purpose of mitigating the environmental impact in transportation all around Europe. In 2020 the European Commission has invited the general public and stakeholders to express their opinion and share information on the impact of said directive to support the evaluation and the impact assessment that the European Commission is currently carrying out as well as possible additional policy measures for its revision. It is hoped cooperation at a European level will lead to satisfactory results in the short term. Indeed, with respect to technological advances, all European countries have recently been focusing their energies and investments on autonomous cars, also known as self-driving cars or driverless cars. Such new systems are aimed at enabling cars to drive around with no human contribution needed. By means of sensors, radars, navigators and highly technological computers, autonomous cars are able to identify surroundings and assess whether there are any obstacles or external phenomena that may impact the driving. Such innovation is deemed as extremely useful to lower the risks of collisions and injuries, reduce insurance costs, lower fuel consumption,

ease traffic, facilitate elderly and disabled people and help avoid intoxicated driving.

Having achieved great technological results, the main concern appears now to be of a legal and social nature. Principally, there is a general concern and resistance among the public with reference to safety issues (relating both to system defaults and to possible hacker attacks).

From a legal standpoint, great concerns have arisen over potential liability for defects, especially since cars will remain under the control of owners who may not diligently carry out all the relevant checks and maintenance.

Moreover, it appears obvious that corrective measures will have to be set forth in Italy, from a legislative point of view, to enable the driving of autonomous cars. By means of an example, article 46 of the Italian Highway Code, implemented through Legislative Decree No. 285 of 30 April 1992, defines as 'vehicles' cars of any type that circulate on roads and are driven by a human being.

The first steps towards legal innovation have already been introduced by Directive No. 2010/40/EU for the establishment of a framework for the deployment of intelligent transport systems (ITS) in the field of road transport and for interfaces with other modes of transport, implemented in Italy by Law Decree No. 179 of 18 October 2012, transposed by Law No. 221 of 17 December 2012. Such legislation, as subsequently integrated by the Decree issued on 1 February 2013 by the Ministry of Infrastructure and Transport, finally resolves one of the main juridical uncertainties: with reference to liability relating to systems and ITS services, it is stated that the applicable regulation will be the same for product liability under the 2005 Italian Consumer Code.

In addition, the Ministry of Infrastructure and Transport has passed the Smart Road Decree, with the aim of closing the gap between Italy and other EU countries, as well as the United States, where driverless car field testing programmes have been under way since 2010. According to the Smart Road Decree, the Ministry of Infrastructure and Transport can authorise driverless car field testing on specific stretches of roads, subject to specific requirements and surveillance during the field testing, aimed at ensuring that the testing programmes are carried out in conditions of utmost safety. Request for ministerial authorisation is available to various entities, including university research institutes, private and public research entities, manufacturers of vehicles equipped with automated driving technologies, etc. In May 2020, the Ministry of Infrastructure and Transport signed a memorandum of understanding with the Ministry of Technological Innovation to further support research, experimentation, definition of prototypes, identification and training of new professionals in the field of innovative self-guided and connected vehicles and means of transport. Lastly in September 2020, the technical support commission for smart roads, created under article 20 of the Smart Road Decree, published its first report on the activities carried out and the state of the art of the initiatives identified on the national territory in the field of smart roads and connected and self-driving vehicles, proposing a few amendments to the Smart Road Decree to further promote innovation.

At the same time, the Italian legislator is also working to provide ground rules on the shared use of private vehicles in the form of either car sharing or car-pooling. The aim is twofold: on the one hand, fostering sharing-economy activities carried out by non-professional individuals through third parties' platforms, to ultimately reduce the number of vehicles circulating in the cities and, therefore, their economic and environmental impact; on the other, providing national rules offering a secure legal base for commercial businesses to operate, in contrast with the current panorama where commercial car-sharing activities offered by professional businesses via mobile application are regulated at local level – mainly via public calls of interests published by the competent municipalities looking to share mobility services.

On a side note, under article 1-ter of the 'Transport Decree' (Law-Decree No. 121 of 10 September 2021), effective 30 September 2022, e-scooters must be marketed with turn and brake light indicators on both wheels and those already in circulation must be adapted by 1 January 2024. In addition, e-scooters may not exceed the speed limit of 6km/h when riding in pedestrian areas and the 20km/h speed limit in all other cases; to this end, all e-scooters must be equipped with a speed regulator configurable according to said speed limits.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Hot topics for prospective regulation and legislation at either EU or local level include the following:

- the future of connected and autonomous vehicles, in particular whether 5G or Wi-Fi should be the preferred communications technology for connected and autonomous vehicles. The EU institutions are leaning towards taking a technology-neutral approach that could accommodate 5G and other future technologies, while debate between car manufacturers and telecommunications companies continues. In this context, on 2 October 2020, the European Commission announced the release of the preliminary version of the 5G Strategic Deployment Agenda (SDA) for Connected and Automated Mobility (CAM) and the roll-out of 5G corridors. More specifically, EU countries are cooperating to develop large-scale testing sites for connected and automated driving on European motorways in the form of cross-border corridors. This will enable a better environment for the testing and deployment of 5G technologies within the EU;
- EU Directive 2019/1936/EU amending Directive 2008/96/EC on road infrastructure safety management, to be implemented by all EU member states by the end of December 2021. The Directive aims at the establishment and implementation of procedures relating to road safety impact assessments, road safety audits, road safety inspections and network-wide road safety assessments by the member states. The deadline for its national transposition was 17 December 2021. Italy transposed the EU Directive by means of Legislative Decree No. 213/2021, containing provisions for the establishment and implementation of procedures for road safety impact assessments, which applies to roads that are part of the trans-European road network, freeways and main roads, whether they are planned, under construction or already open to traffic, other roads and road infrastructure projects that are located in suburban areas, which do not serve public or private areas bordering them and which have received funding from resources allocated by the EU, with the exception of roads which are not open to the general automobile traffic, such as bicycle paths, or roads not intended for general traffic such as access roads to industrial, agricultural or forestry sites;;
- Regulation 2019/2144/EU amending Regulation 2018/858/EU on the general safety of vehicles and the protection of vulnerable road users. The Regulation aims at significantly reducing deaths and serious injuries on EU roads by introducing state-of-the-art safety technologies as standard vehicle equipment, and to enhance the competitiveness of EU car manufacturers on the global market by providing the first-ever EU legal framework for automated and fully automated vehicles. It entered into force on September 2020 and will apply from 6 July 2022;

- on 9 March 2021, the European Data Protection Board adopted its guidelines on processing personal data in the context of connected vehicles and mobility-related applications. It has factored in the feedback received from several stakeholders during the public consultation period and addressed, from a data protection standpoint, the evolution of cars from an expression of freedom and autonomy to another 'controlled' environment;
- EU Regulation on privacy and electronic communications. The proposal is still being debated in the EU Institution and aims at ensuring the respect for private life and the protection of personal data in electronic communications relevant for communications between connected and autonomous vehicles and users;
- the European Battery Alliance, launched in 2017 by the EU Commission, continues to grow. To date, 440 industrial and innovation actors have joined the alliance, which aims to develop an innovative, competitive and sustainable battery value chain in Europe. On 12 March 2021, Vice-President Šefčovič gave a speech highlighting that Europe will continue to push forward closing the investment gap with Asian competitors by supporting more than 70 industrial projects, expecting to create three to four million jobs by 2025;
- EU Commission Implementing Regulation 2020/239 of 20 February 2020, amending EU Implementing Regulation 901/2014, with regard to the adaptation of the templates for type approval procedures for two- or three-wheel vehicles and quadricycles to the environmental steps Euro 5 and Euro 5+ requirements;
- on 23 February 2022, the EU Commission proposed the Data Act, which includes measures for a fair and innovative data economy. More specifically, such rules concern who can use and access data generated in the EU across all economic sectors. The proposal for the Data Act includes (amongst other things) measures to allow users of connected devices to gain access to data generated by them, which is often exclusively harvested by manufacturers, and to share such data with third parties to provide aftermarket or other data-driven innovative services. This proposal (which has now been presented to EU countries and to the EU Parliament) would impact a variety of services including information collected in machinery and connected devices such as cars; and
- at Italian level, Legislative Decree No. 17/2022 provides for some specific measures for the automotive sector, with the aim to promote conversion, research and development. In particular, the main goals are green transition and investments in the rapidly changing automotive sector, in order to reach innovative and sustainable manufacturing techniques. Indeed, in line with the European aims to reduce emissions, promote recovery and recycling of materials and foster the purchase of clean vehicles, the Italian government, effective as of January 2022 has allocated a fund of €150 million to support dealers operating in the automotive sector, which have been much impacted by the covid-19 pandemic, including by postponing the term to use the bonus to replace old engines with electric ones in cars.

* *The authors would like to thank Francesca Angeloni, Sabrina Borocci, Giada Cagnes, Filippo Chiaves, Emanuela Cocco, Maria Cristina Conte, Enrica Ferrero, Zoe Gabrielli, Martina di Nicola, Marina Maccagno, Luigi Mansani, Marina Massaro, Vittorio Moresco, Flavio Parigi, Serena Pietrosanti, Luisa Pomello Chinaglia, Andrea Schettino and Francesco Stella for their support in writing this chapter.*

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry is one of the most important sectors in Japan. Although Japanese automotive manufacturers have been increasing localisation of their production, Japan manufactured over 6.9 million passenger vehicles and it exported over 3.7 million automobiles in 2020. Japan also produced over 480,000 motorcycles, and 64 per cent of these were exported in the same period. The production amounts to over ¥21.6 trillion. These original equipment manufacturers (OEMs) accompany the complex ecosystem of parts suppliers whose production amounted to ¥20.4 trillion in shipment value in 2019. In fiscal year 2019, OEMs and parts suppliers employed approximately 912,000 persons across Japan, and the workforce employed in the automobile-related sectors – including sales, transportation, service and maintenance, and electronics or other manufacturing industries – amounted to approximately 5.42 million persons, which is equal to 8.1 per cent of the Japan's working population. The automotive industry in Japan is supported by ¥2.9 trillion of research and development investment (financial year 2018) and ¥1.5 trillion of capital investment (financial year 2018).

Japan is also the third-largest automotive market in the world. By the end of 2019, approximately 5.2 million vehicles were sold in Japan, of which 4.3 million were passenger vehicles and 0.90 million were buses and light or heavy trucks. Approximately 28.5 per cent of the passenger vehicles were Japanese 'kei'-standard light vehicles (vehicles designed with limited size and equipped with an engine no larger than 660cc). Japan also imported approximately 300,000 vehicles from non-Japanese manufacturers in 2019. The number of registered passenger vehicles at the end of 2019 was over 78 million, and 80 per cent of Japanese households have at least one vehicle.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Automotive regulation is generally governed by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) and its related governmental entities such as the National Agency for Automobile and Land Transport Technology (NALTEC). Every automobile in Japan is required to comply with extensive safety and environmental standards (the Safety Standards for Road Transport Vehicles (Ministry of Transport Ordinance No. 67 of 1952, as amended); the Safety Standards), pass an inspection and be registered before being operated on public roads under the Road Transport Vehicle Act (RTVA) (Act No. 185 of 1951, as amended).

Type designation

Mass production automobiles would need type designation before being launched onto the market. Filings for type designation are reviewed from the perspective of compliance with the Safety Standards and quality control measures. Vehicle manufacturers are required to file for type designation pursuant to the RTVA, the Vehicle Type Designation Regulations (Department of Transport Ordinance No. 85 of 1951), and the Vehicle Type Approval Operation Guidelines by applying for testing at NALTEC, the agency that handles vehicle certification and homologation matters under MLIT.

The relevant framework for the type designation of vehicles in Japan is as follows:

Type designation system (TDS): this is the standard type designation regime for most passenger vehicles, which includes inspections of sample vehicles and quality control systems to ensure uniform quality of the models. Vehicle manufacturers are required to have their vehicles inspected by qualified staff members before shipping out of the factory pursuant to the Operation Guidelines for Vehicle Type Designation (Guidelines for Vehicle Type Designation (Notification No. 1252 of 1998 of the Road Transport Bureau Type Designation and Recall Division of MLIT)). For imported cars, NALTEC dispatches its staff overseas to conduct sample inspections and examine data produced by overseas test institutions. The type designation will be granted generally within two months of applying.

The vehicle manufacturer of type designated vehicles is required to ensure the quality of the vehicles and issue a 'completion inspection certificate' upon the transfer of the vehicles. Owners of type designated vehicles are allowed to register their vehicle with the local MLIT Transport Branch Office by submitting the completion inspection certificate issued by the vehicle manufacturer and some simple paperwork.

Preferential handling procedure for imported motor vehicles (PHP): this is a simplified system to promote the sales of imported cars and is applied to models imported in quantities of 5,000 or fewer per year. The procedure consists of the submission of documents and presentation of the actual vehicle to NALTEC. The data and specifications submitted to the authority of other jurisdictions where the original type designation was granted can generally be used for the application of PHP, but an emissions test must be implemented anew under the Japanese standards. No sample inspection is required, but one in 50 vehicles is tested for emissions.

On 11 November 2020, MLIT announced that it had approved type designation for a vehicle produced by one of the Japanese vehicle manufacturers, being the world's first production car equipped with Level 3 automated driving technology.

Vehicles that are not type-approved can also be registered and operated on public roads, which is the case for parallel import vehicles and heavily customised vehicles produced in a small number. The owner is required to have the vehicle inspected to confirm compliance with the Safety Standards.

TDS incidents from 2017

Pre-shipping inspection under TDS must be conducted by the manufacturer's staff who have been internally qualified as inspection staff by passing certain internal screenings and identified to MLIT in advance. In September 2017, an on-site investigation by MLIT discovered that a vehicle manufacturer's pre-shipping inspection certificates for completed vehicles had been signed by non-qualified staff. The vehicle manufacturer voluntarily stopped shipment of its products for two weeks. After MLIT requested that other car manufacturers check their operations, an additional vehicle manufacturer was also found to have had the same non-compliance issues. In the course of investigations, it was discovered that both vehicle manufacturers had not been complying with TDS (which requires inspection by qualified inspectors) for more than 30 years. Following the investigation, in November 2017 MLIT established a commission to review the current TDS inspection regime. In April 2019, a third vehicle manufacturer was also found to have the same non-compliance issues that had continued for years. This series of incidents resulted in bitter criticism of vehicle manufacturers by the market and cost billions of Japanese yen to conduct recalls to redo completion inspections. However, some experts also point out that this TDS requirement is an outdated formality, and there is no equivalent inspection requirement for vehicles manufactured for export. As such, Type Designation Regulations for vehicles were amended and promulgated on 30 June 2019.

Mutual recognition

The UNECE World Forum for Harmonization of Vehicle Regulations held in November 2017 (WP29) adopted the International Whole Vehicle Type Approval (IWVTA) together with UN Regulation No. 0 (UNR0), which came into effect in 2018. Under the IWVTA, countries that ratify UNR0, including Japan and European countries, will reciprocally accept vehicle inspection certificates enabling effective and speedy vehicle approval as well as promotion of higher safety and environment standards. MLIT has announced that it will take the lead in furtherance of UNR0 to developing countries in Asia.

Registration and periodic inspection

Under the RTVA, vehicles are required to be registered before being operated on public roads. The registration procedure is handled by the local MLIT Transport Branch Office where a licence number plate is issued. As a prerequisite for the registration, vehicles need to comply with the Safety Standards. With regard to TDS-approved vehicles, owners of vehicles who intend to register their vehicle are not required to conduct an inspection of each vehicle by presenting the vehicle at the registration centre. On the other hand, the PHP processes require the presentation of each actual vehicle as part of the registration process, although inspections for these types of approved vehicles are more simplified than those without type designation. Automobiles without type designation (eg, those that are produced in very small quantities or imported by individual users) may also be registered and placed on public roads, but need to go through the full-scale inspection in advance. To register, the owner of a vehicle is also required to certify at the local police station that an appropriate parking area is secured for the vehicle. Any change in the registration details, such as the transfer of ownership, should be registered within 15 days. Three years from the first registration, vehicles need to be re-inspected at a designated service centre (and every two years thereafter) to ensure compliance with Safety Standards; this is commonly referred to as 'shaken'.

Insurance

Every driver is required to participate in the compulsory liability insurance scheme under the Automobile Liability Security Act (Act No. 97 of 1955, as amended), which automatically pays a specified amount to the victim of a traffic accident without identifying the person at fault or apportioning negligence between the parties involved. This is commonly referred to as *jibaiseki* insurance. The *jibaiseki* insurance provides minimal basic coverage with a cap of ¥1.2 million for injuries, ¥0.75 million to ¥40 million for permanent disability, and up to ¥30 million for death. It does not provide any compensation for damage to vehicles or other property. Thus, approximately 90 per cent of drivers also take out additional insurance, and the annual net premium in the auto insurance sector amounts to over ¥4 trillion.

Type designation of automobile parts

Automobile parts manufacturers are also entitled to take advantage of the separate automobile parts type designation regime pursuant to the RTVA and the Parts Type Designation Regulations (No. 66 of 1998). Once the model for a part is approved by NALTEC, the manufacturer is not required to undertake further inspections of the part regardless of the vehicle model into which the part is incorporated. Japan is also a party to United Nations-sponsored Agreement Concerning the Adoption of Uniform Conditions of Designation and Reciprocal Recognition of Designation for Motor Vehicle Equipment and Parts signed in Geneva on 20 March 1958 (the 1958 Agreement), which provides technical prescriptions for wheeled vehicles, equipment and parts that can be fitted or used on wheeled vehicles, and the conditions for reciprocal recognition of designations is granted on the basis of these prescriptions. Japanese regulators have been increasingly promoting the harmonised standard and reciprocal recognition of designations, and as at December 2020, Japan has adopted 93 categories of rule out of 159, including categories regarding brakes, safety belts and tyres.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The development, manufacturing and supply of automobiles and auto parts involve close and long-term relationships between vehicle manufacturers and suppliers. Such long-term relationships usually consist of a master agreement covering terms and conditions common to the entire transaction between the parties, and a relatively simple individual agreement or purchase order form is used to conclude each individual transaction. Vehicle manufacturers usually enter into supply agreements with auto parts manufacturers or other suppliers with respect to manufacturing. Supply agreements are also governed by regulations to protect 'weak' suppliers from unfair trade practices of 'strong' vehicle manufacturers and high-tier suppliers (Act against Delay in Payment of Subcontract Proceeds, Etc to Subcontractors (Act No.120 of 1956, as amended)). Some generic parts and maintenance parts are handled not only by suppliers but also by Japanese 'trading houses', or companies specialised in import, export, distribution and marketing of goods.

Traditionally, Japanese vehicle manufacturers have formed strong alliances with parts suppliers, called *keiretsu*, acting in close and exclusive cooperation 'in the same boat' with regard to the supply of parts and semi-processed components as well as research and development. *Keiretsu* are hierarchical structures with the vehicle manufacturers at the top and several layers of suppliers broken down into Tier 1, Tier 2 and Tier 3 suppliers, securing a stable supply of high-quality

components optimised to the vehicle manufacturer's end product. Some of these companies often have equity relationships; however, contractual relationships are more common and so are de facto continuous transactions without any specific written agreements. However, instead of the traditional *keiretsu* structure, car manufacturers are increasingly procuring parts from diversified suppliers because of increasing competition in the global market, complex supply chains, and the development of common architecture and modularisation. Therefore, the traditional *keiretsu* structure is said to be gradually dissolving. This means that suppliers newly participating in the market will have more business opportunities, while contracts with new suppliers that do not have a history of previous transactions will need closer review. Also, in this context, some vehicle manufacturers and high-tier suppliers are insourcing their supply by means of acquisitions of other suppliers and emerging high-tech companies, resulting in increasing M&A demands.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Vehicles are usually distributed through dealerships of distributors, some of which are subsidiaries of the vehicle manufacturer's group, and others are independent local companies. One dealership, even that of an independent local company, usually handles vehicles of only one vehicle manufacturer and does not mix vehicles from several vehicle manufacturers in its product line-up. Generally, distributors purchase vehicles from the vehicle manufacturer pursuant to the vehicle manufacturer's standard terms and sell them to customers pursuant to the standard terms instructed by the vehicle manufacturer. Vehicle manufacturers provide extensive instructions regarding the service quality, promotions and incentives, and the use of trademark and signage. More often than not, vehicles are distributed on a built-to-order basis – vehicles are manufactured with customised options upon the purchase order by the customer – instead of being sold from the stock stored in the backyard of the dealership. Imported vehicles are generally sold from the dealer's stock.

The importer of vehicles who obtained the type designation is identified as the vehicle manufacturer of such vehicles in Japan and is responsible for the purpose of a recall. Many dealerships provide financial arrangements for customers such as auto loans and leases (with or without a buy-back option), and vehicle manufacturers usually have their own financing company and contract with credit companies to facilitate such financial arrangements. This area is heavily regulated by the Money Lending Business Act (Money Lending Business Act (Act No. 32 of 1983, as amended)) and the Instalment Sales Act (Instalment Sales Act (Act No. 159 of 1961, as amended)).

Contracts with distributors are governed by the Civil Code (Civil Code (Act No. 89 of 1896 as amended). As the automotive industry is brand oriented and each vehicle manufacturer is keen to control the vertical channels for its automobiles, they pay close attention to dealership-related competition issues such as zoning of dealership, restrictions on methods of sale and selective distribution. For example, abuse of dominant bargaining power such as the exercise of excessive control or undue influence is prohibited under the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Act No. 54 of 1947 as amended) and the government guidelines (Guidelines Concerning Distribution Systems and Business Practices (JFTC, 11 July 1991, as amended)). Since vehicles must be inspected every two years, many dealers provide qualified vehicle mechanic services to enhance customer loyalty and to market new cars. Vehicle maintenance services require certain physical facilities and qualified staff, as well as regulatory certifications by a local MLIT Transport Bureau. Also, to trade in second-hand vehicles a second-hand dealer licence is required.

Restructuring of dealerships can be achieved through the termination, amendment, transfer or assignment of the dealer contract. Under the general principles of the Civil Code, when termination of a dealer agreement is disputed, the court generally tends to favour the continuation of the existing agreement, to provide support for the 'weak' distributor against the 'large' vehicle manufacturer. If the contractual relationship between a vehicle manufacturer and a dealer has continued for a protracted period, it may be difficult for the vehicle manufacturer to terminate the contract easily, even if there is a right to terminate in the contract. In other words, the Japanese courts sometimes do not interpret the contract at face value but require the terminating party to have a justifiable reason for wanting to terminate the contract. There are some judicial precedents where a contractor (dealer) of a vehicle importer challenged the validity of the termination of the dealer contract by the importer owing to a poor sales record and the dealer's non-compliance with the importer's business strategy. To minimise this risk, manufacturers may prefer to enter into fixed-term contractual arrangements with dealers without automatic renewal, and instead review the relationship every year. Even where unilateral termination right exists, a car manufacturer still might attempt to have the dealer agree to voluntarily terminate the contract to minimise the risk of future disputes.

Other main concerns, specific to these kinds of transactions, include competition issues, the provision of maintenance services, warranties, and auto loans and lien arrangements with customers. Although there are no special requirements in the restructuring of dealerships in the automotive industry as compared to other industries, restructuring is always a tough challenge owing to the above-mentioned principle protecting long-term relationships and the significant impact on both the distributor and the vehicle manufacturer. In April 2017, a vehicle manufacturer announced a major restructuring of its 2,100 dealers across Japan, which is expected to finish in FY2020. Similarly, in November 2018, another vehicle manufacturer, in the course of a major restructuring of its dealer network, announced a sweeping sales channel reform. This will involve a merger of dealers in Tokyo directly held by the vehicle manufacturer in April 2019. The vehicle manufacturer has approximately 280 partner distributors with 5,000 stores across Japan, which are currently classified into four channels that sell different combinations of branded vehicles. Many of these partner distributors are local businesses with no equity relationship with the vehicle manufacturer's group. The vehicle manufacturer has announced that it will integrate these four channels and reduce its product line-up from 40 to approximately 30 models effective from 2022 to 2025. Also, a third vehicle manufacturer announced a merger of its two 100 per cent affiliated distributors in February 2019. In November 2020, two vehicle manufacturers announced that they will integrate four affiliated parts suppliers and completed the transaction in January 2021.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are generally no particularities in terms of M&A or JV transactions for the automotive industry. However, given the complex and highly regulated nature of the industry, key features in terms of the due diligence and drafting of relevant agreements include regulatory compliance, employment, competition and intellectual property issues.

Regulatory compliance is a key concern in M&A and JV transactions in the automotive industry today. After a series of non-compliance incidents in recent years, the regulator is keen to ensure compliance by

exercising its supervising authority, and brand and market reputation are the most vulnerable assets even for well-established companies with decades of tradition.

Although the rate of employees who are unionised has been drastically decreasing in the past decade, the traditional style labour unions still have a certain level of presence in the automotive industry. Under the labour-management harmonising style in Japan, although strikes and aggressive negotiations are rare, in some companies, the cooperation of the union is indispensable for the smooth closing of an M&A deal and the subsequent post-merger integration.

Competition issues are also important. Under the Japanese merger control regulation, the merger and acquisition of companies exceeding certain thresholds require prior filing with the JFTC and may not be closed within a 30-day waiting period, which can be shortened upon request from the parties.

A notable recent trend is M&A involving companies outside of the traditional automotive industry, such as carbon fibre, image sensor, laser radar, next-generation battery, and automated drive technologies. This trend is supported by the dissolution of the *keiretsu* regime and divergence in the automotive industry itself.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no special incentives for investment in the automotive market. Government branches, including the Small and Medium Enterprise Agency, have been providing financial aid to ventures and small-scale enterprises with innovative business models, and some municipalities offer financial aid and tax reductions through by-laws to attract investment in factories and regional business hubs. These benefits are also applicable to the automotive industry.

The Ministry of Economy, Trade and Industry (METI), through the Next Generation Vehicle Promotion Centre provides financial aid for the purchase of plug-in hybrid vehicles, electric vehicles (EVs) and fuel-cell vehicles (FCVs), depending on the energy efficiency of the vehicle as well as the investment in EV charging facilities and hydrogen stations for FCV, and some municipalities have similar arrangements. As a result, for example, FCVs can receive a governmental incentives of over ¥3.6 million (¥2.5 million from METI and ¥1.1 million from Tokyo Metropolitan government).

The safety and environmental standards are increasingly conforming to those of other jurisdictions. However, the type designation process and regulations on environment and safety standards are prepared only in Japanese, and the procedures are quite complicated, which may represent short-term practical barriers to entering the market. Also, there are established common market practices and standards. Thus, it is advisable for new market participants to consult appropriate experts.

The traditional manufacturing and distribution sectors have many powerful incumbent players in Japan. Therefore, the impact of new entrants will not likely be significant. However, at the dawn of new technologies such as autonomous vehicles, connected vehicles and ride sharing, entrants from other industries could be game changers.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The RTVA is the fundamental statutory source of product compliance, safety and environment regulations. Under the RTVA, vehicles shall not be put into operational use unless their structure complies with the technical standards for safety, pollution prevention and other environmental conservation as specified by ministerial ordinances of Ministry of Land, Infrastructure, Transport and Tourism (MLIT) with regard to certain matters including length, width and height, total vehicle weight load applied to the wheels, and ratio of the load on the wheel to the total vehicle weight. Guidelines prepared by the MLIT provide detailed numerical standards for each component of the vehicle as well as the testing methodology. Driving a non-conforming automobile may result in administrative and criminal charges.

Environmental standards

Fuel economy

The standards for fuel economy are regulated by the Act on the Rational Use of Energy (Act No. 49 of June 22, 1979). This Act has provided the unique 'top runner programme' fuel economy standards since 1998, which takes the fuel consumption of the most fuel-efficient vehicle in the segment currently in the market, and sets that consumption level as the standard for the next generation of vehicles. The standard requires vehicle manufacturers to keep the average fuel consumption of their products below the standard established by MLIT and the Ministry of Economy, Trade and Industry (METI) for a certain period depending on vehicle weight. Underachievement is publicly announced. The most recent standard was announced on 31 March 2020, which includes electric vehicles and plug-in hybrid car with 2030 as the target year.

In addition to the 'top runner programme', MLIT introduced the 'corporate average fuel efficiency' (CAFE) regime where vehicle manufacturers are required to keep the CAFE value, which is calculated through the weighted average of fuel economy achievement in each category of vehicle weight, above the CAFE standards calculated through the weighted average of fuel economy standard in each category of vehicle weight.

The weight, type of engine, fuel consumption (in four testing modes: Worldwide Harmonised Light Vehicle Test Procedure (WTLP), urban, suburban and motorway) and other specifications are required to be stated in the catalogue for each vehicle. Vehicle owners are entitled to receive preferential tax treatment and incentives depending on the achievement of standards by their vehicles; however, vehicles that do not comply with the standards are not prohibited from being driven.

The testing method for compliance with environmental standards for passenger vehicles is the WTLP, which replaced the previous 'JC08' mode from October 2018 onwards, applicable to vehicles with a weight of less than 3.5 tons. The test consists of several driving cycles representing real-world vehicle operations on urban and suburban roads and motorways. Although the fuel consumption tested under the worldwide harmonised light vehicles test cycles (WLTC) usually indicates a lower score than that tested under the JC08 procedure, some manufacturers have already started to indicate fuel consumption of their vehicles in the WLTC mode.

Fuel consumption was not traditionally regulated by the RTVA, but after a series of worldwide fuel consumption incidents, MLIT included fuel consumption under the prescribed testing methods in the Safety Standards, and the type designation can be revoked if the vehicle

manufacturer falsifies the fuel consumption. False or misleading statements regarding emissions may also trigger enforcement under Act against Unjustifiable Premiums and Misleading Representations (Act No. 134 of 1962, as amended) including administrative surcharges of up to 3 per cent of the relevant sales. In 2017, the Consumer Affairs Agency imposed an administrative surcharge of ¥480 million on a vehicle manufacturer for false representation of fuel consumption in its advertisement materials. The Consumer Affairs Agency also imposed an administrative surcharge of ¥3.17 million on another vehicle manufacturer for selling the vehicle manufacturer-badged version of virtually the same model procured from a different vehicle manufacturer; however, interestingly, the vehicle manufacturer later challenged this enforcement and was successful in having it overruled in December 2018.

Emissions

The regulation of emissions consists of three components.

Individual regulation: this applies only once when the new vehicle is registered, and regulates CO, non-methane hydrocarbon, NOx and particulate matter (PM), based on the RTVA and the Safety Standards. With regard to heavy-duty vehicles, the Safety Standards have incorporated the worldwide harmonised heavy-duty certification procedure and off-cycle emission testing, which from 1 October 2016 are gradually being applied to each class. Vehicle type regulation: this applies to vehicles with diesel engines and prohibits the operation of underachieving vehicles in designated zones to prevent diesel air pollution in metropolitan areas pursuant to the Amendment Act on the Reduction of the Total Amount of Nitrogen Dioxide and Particulate Matter Originating from Automobiles in Designated Areas (Act No. 70 of 1992 as amended, the PM/NOx Act). Traffic regulations: some local governments respectively provide emission control rules. For example, Tokyo and three surrounding prefectures have by-laws restricting diesel vehicle PMs under stricter standards than the above-mentioned regulations.

After the emissions issues in 2015, MLIT and the Ministry of Environment conducted a series of real-world driving emission tests for eight models with diesel engines via a portable emission measurement system (PEMS) and published the results; however, MLIT has decided not to impose mandatory testing via PEMS for all vehicles because of difficulties in homogenising test conditions to account for variations in weather and traffic.

Recycling

End-of-life automobiles are mandatorily recycled pursuant to the Act on Recycling of End-of-Life Vehicles (Act No. 87 of 2002 as amended (the Automobile Recycling Act)). Vehicle owners pay a recycling fee when purchasing a new vehicle and the fee is pooled by the Japan Automobile Recycling Promotion Centre (JARC), as designated by the government. The scrapping work is conducted by a wrecker registered with a relevant local authority, and the manufacturer and importer are required to take over and destroy or recycle the shredder dust, airbags and chlorofluorocarbons using funding from JARC. A breach of recycling procedures, such as scrapping by an unauthorised wrecker; failure to collect airbags, batteries, waste oil and fluid; wrecking without sorting hazardous materials; and unauthorised export of automobile wreckage, may result in criminal liability. (Waste Management and Public Cleansing Act (Act No. 137 of 1970, as amended, Customs Act (Act No. 61 of 1954, as amended, Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended).

Recall of vehicles

The key Japanese laws and regulations relating to recall are the RTVA and the Safety Standards.

There are three types of corrective measures under Japanese law:

- improvement measures (*kaizen sochi*) (ie, a recall) under article 63-3, paragraph 1, of the RTVA (the Recall Provision), where a notification to MLIT is legally required if certain conditions are satisfied; and
- two types of voluntary countermeasures under MLIT's Guidelines for Handling Recall Notifications, Etc (the Recall Guidelines), where a notification to MLIT is not legally required but should be filed nonetheless if the countermeasures are to be taken. The two types of countermeasures are:
  - improvement countermeasures (*kaizen taisaku*); and
  - service campaigns.

While, strictly speaking, notifications to MLIT or customers are not legally required under the Recall Guidelines as the Recall Guidelines are not law, in practice they should be and typically are complied with.

Under the Recall Provision, a notification to MLIT is legally required to be filed if a vehicle manufacturer:

- finds that the structure, a device or the performance of a vehicle (ie, a vehicle within a certain range of a type-approved vehicle manufactured, or imported into Japan, by the vehicle manufacturer) may not or does not comply with the Safety Standards;
- finds that the cause of that noncompliance arises in the design or manufacture process; and
- intends to take improvement measures (*kaizen sochi*) to rectify the issue.

Recall of automobile parts

With regard to defective automobile parts, the defect should be dealt with by way of a recall of the entire vehicle by the car manufacturer, except for two categories of parts.

As exceptions, tyres and child safety seats are subject to an independent recall procedure pursuant to the Order for Enforcement Regulations for RTVA (Ordinance No. 185 of 1 June 1951) and parts manufacturers are to carry out the recall process rather than the car manufacturer.

Technically, vehicle manufacturers can claim compensation for loss or damage incurred as a result of conducting a recall owing to defective parts from a supplier. However, this type of litigation has historically been relatively rare in the *keiretsu* structure. Therefore, it might have been surprising to many in Japan when a Japanese vehicle manufacturer sued one of its major Tier 1 suppliers in 2014 claiming more than ¥15.6 billion as compensation for damage incurred as a result of a recall caused by a defective power steering device produced by the parts manufacturer.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability is an important subject in the automotive industry. Customers who have incurred losses owing to a vehicle may bring claims against the vehicle manufacturer and the dealer based on a tort or warranty theory under the Civil Code. In the tort claim under the Civil Code, coupled with the Product Liability Act (Act No. 85 of July, 1994), if the product has a defect, or lacks the level of safety that the product ordinarily should have, and if such a defect has caused damage to the life, body or property of others, then the manufacturer or importer shall be liable for such damage. This regime imposes strict liability, regardless of whether the manufacturer or the importer has been negligent;

however, where the defect could not have been discovered given the state of scientific or technical knowledge at the time of delivery, the manufacturer would not be liable for the defect. Dealers, rent-a-car companies, repair service providers, and suppliers of parts are not subject to strict liability and may be held liable only when they have been found to have been negligent. The judgment is solely made by the judge. There is no jury trial in the Japanese litigation system. The parties to the case as well as the court may request expert witnesses to testify or produce documents regarding the analysis of issues in the case, but the judge is not bound by the expert's opinion. The plaintiff may claim actual damages, as well as consequential or incidental damages attributable to the defect or negligence; however, the court does not grant punitive damages, and an award for punitive damages in other jurisdictions is not enforceable in Japan. Overall, however, product liability claims for a defective vehicle or a recall are relatively rare.

On 1 October 2016, a new 'class action'-like regime was introduced in Japan (Special Provisions for the Civil Procedure for Collective Recovery of Loss of Assets of Consumers (Act No. 96 of 2013)). This class action-like regime is two-tiered. At Tier 1, a qualified consumer organisation must prove that the relevant manufacturer owes common liability to a number of consumers. Then, at Tier 2, each consumer can have a consumer organisation file its claim with the summary court. The Tier 1 action may only be taken by a qualified consumer organisation (QCO) that has received the required designation to act from the prime minister pursuant to the Consumer Contract Act (Act No. 61 of 2000, as amended). As at February 2022, there were four QCOs (out of a total of 21 QCOs in Japan) that had designation from the prime minister.

This class action-like regime does not cover strict product liability. Furthermore, it only entitles the recovery of actual losses and specific performance and does not extend to an indemnity for any consequential losses, loss of profits, injury or bodily harm. The action can only be made against a defendant who has direct privity of contract with consumers – not against third-party car manufacturers, importers or parts suppliers. Thus, this class action-like regime has limited application, and it does not significantly impact the automotive industry in Japan.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Antitrust enforcement

Antitrust measures are enforced by the Japan Fair Trade Commission (JFTC) based on the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Antitrust Act) (Act No. 54 of 1947 as amended, the Antitrust Act). Traditionally, the JFTC has been active in the automobile parts sector in terms of enforcement against cartel activities. The JFTC undertook major enforcement actions against cartels in this industry during 2012 and 2013 – comprising antitrust surcharges of nearly ¥12.9 billion against four major wire harness manufacturers in 2012, nearly ¥3.4 billion against seven electrical component manufacturers, and nearly ¥4.7 billion against three headlamp manufacturers.

In recent years, however, the JFTC has not implemented aggressive enforcement. The JFTC issued only 11 cease-and-desist orders in financial year 2019 imposing aggregate surcharges of approximately ¥69.27 billion, eight cease-and-desist orders in financial year 2018 imposing aggregate surcharges of approximately ¥260 million, 13 orders in financial year 2017, imposing aggregate surcharges of approximately ¥1.89 billion, and 11 orders in 2016 imposing aggregate surcharges of approximately ¥9.14 billion.

The rate of surcharges is generally up to 10 per cent of sales in the event of a cartel for large-scale manufacturing companies. Companies can take advantage of leniency by voluntarily reporting the violation to the JFTC, and the first reporter before initiation of the JFTC's investigation may receive a 100 per cent reduction in the surcharges. In practice, many cases are closed without formal cease-and-desist orders or surcharges. Companies subjected to the JFTC's investigation are entitled to hearings at the JFTC.

However, as the automotive industry is becoming increasingly competitive and is facing the rise of game-changing new technologies, manufacturers are becoming keen to participate in joint development and joint procurement of new technologies (electric vehicles; next-generation batteries, radars and sensors; etc), horizontally with their competitors in the market as well as vertically with suppliers and parts manufacturers. This trend would inevitably increase tension with antitrust regulations, and participants in the market should be aware of the antitrust risk when developing new business models.

Brand owners are becoming more conscious of the brand strategy of increasing control of dealerships to develop a more effective distributorship network and redefining their brand image. Japanese competition regulations provide extensive rules against unfair trade practices and abuse of superior bargaining power, and in this context, brand owners should be aware of the risk that heightened control over dealership and service providers may give rise to competition law concerns.

Follow-on litigation

There could be three types of follow-on litigation in competition cases: (1) litigation against the JFTC; (2) civil litigation raised by a party who has incurred damage; and (3) a derivative suit by shareholders against the directors of a company that has participated in cartel activities.

Litigation against the JFTC

A company that is subject to a JFTC enforcement action may challenge the same in court. This type of litigation is relatively rare but includes large-scale disputes involving important Antitrust Act issues.

Civil liability to affected parties

Private parties affected by a violation of the Antitrust Act such as consumers, suppliers, distributors and competitors can bring a civil action for damages and an injunction against the company that allegedly committed the violation. A company that has been subjected to enforcement by the JFTC as having been involved in cartel activities could have civil liability for damages incurred by customers and end users, and once enforced by the JFTC, the company may not raise a defence that they had no wilful misconduct or negligence. This type of litigation can be used not only in a protective manner, but also in an aggressive manner to attack unfair trade practices or abuses of superior bargaining power of vendors, customers or competitors.

Director's liability

Directors of a company that has participated in cartel activities might be sued by shareholders of the company by way of a derivative suit. In the above-mentioned wire harness cartel case, the shareholders of a related company sued its 22 directors in a derivative suit for negligence based on the participation in the cartel and, in particular, the failure to apply for leniency by cooperating with the JFTC. This case was finally settled with the payment of ¥520 million by the directors to the company in 2014.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

There is no specific type of dispute especially significant to the automobile industry. Automotive industry companies should be prepared for contractual disputes with customers or suppliers, product liability and consumer issues, and intellectual property issues (including disputes). Typical types of disputes may involve: termination of the supply or distribution agreement; product liability; and misleading advertisement and employment issues. However, automotive-related disputes are relatively rare in Japan as compared to other jurisdictions. Disputes between domestic companies that have not been successfully resolved through negotiation are usually submitted to the courts for litigation, while large-scale international cases are submitted for arbitration. Japanese courts tend to resolve disputes by in-court settlement.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

To ensure a continued supply of parts, automotive manufacturers tend to have two choices: finding an alternative supplier or assisting the distressed supplier to continue its operations. As disruption of a supplier's business may potentially have a substantial impact on the automotive industry, vehicle manufacturers and suppliers sometimes support distressed suppliers to mitigate the systemic risk. Banks are another key player that can exercise initiative and consultancy in the course of dealing with a distressed supplier under the Japanese traditional 'main bank' regime. M&A in this context is also common.

The distressed suppliers may go into insolvency procedures including: (1) a bankruptcy procedure (Bankruptcy Act (Act No. 75 of 2004, as amended)); (2) a civil rehabilitation procedure (Civil Rehabilitation Act (Act No. 225 of 1999, as amended)); (3) a corporate reorganisation procedure (Corporate Reorganisation Act (Act No. 154 of 2002, as amended)); and (4) a special liquidation procedure (Companies Act (Act No. 86 of 2005, as amended)). Among those, the bankruptcy and the special liquidation procedures are classified as liquidation-type processes, while the civil rehabilitation and the corporate reorganisation procedures are recovery-type processes where the focus is on preserving the business as a going concern.

Companies seeking restructuring tend to choose civil rehabilitation procedures where the existing management can keep control of the company as a debtor-in-possession (DIP). The management of the distressed company may ask for assistance from banks, vendors and customers to rebuild the distressed business, or transfer the intact part of its business to a competitor to raise the liquidity available to inject in the distressed business. In cases where the distressed company has made an early decision to initiate restructuring, a pre-packaged bankruptcy strategy is often used to mitigate the impact. On the other hand, the use of non-DIP-style corporate reorganisation procedure is limited to a small number of bankruptcies of large-scale or listed companies.

After an airbag defect issue, one supplier filed an application for the civil rehabilitation process with the Tokyo District Court in June 2017, and its 14 affiliate companies around the world filed similar insolvency procedures in their respective jurisdictions. This civil rehabilitation process became the largest insolvency procedure of the manufacturing industry in the post-war era in terms of its debt amount of ¥1.082 billion. Pursuant to the civil rehabilitation plan submitted to the court in February 2018, the supplier transferred its assets, including its intact seat belt and child safety seat business, to a Chinese-owned US company in the same industry in April 2018, and distributed compensation to its creditors, which appears to cover only ¥500,000 and 1 per cent of any amount exceeding ¥500,000 for each creditor. Vehicle manufacturers were exempt from this settlement and will be compensated at a later stage from the rest of the fund after repayment to non-vehicle manufacturer debtors, which will not cover a significant percentage of the aggregate debt amount. Despite the impact of the case, no bankruptcy owing to the supplier's issues was reported. This is because the supplier had been continuing to make payments to its suppliers based on the existing contractual conditions, which is allowed under the Civil Rehabilitation Act. Affected suppliers may take advantage of the 'safety net guarantee' by the Small and Medium-sized Enterprise Credit Insurance Act (Small and Medium-sized Enterprise Credit Insurance Act (Act No. 264 of 1950, as amended), as well as the 'safety net loan' from the Japan Finance Corporation, a Japanese government-affiliated financial institution, both of which are designed to minimise systemic risk or domino effects on the whole industry.

Another route for distressed suppliers is business rehabilitation Alternative Dispute Resolution (ADR). On 30 January 2019, Akebono Brake filed an application for Business Rehabilitation ADR with the Japanese Association of Turnaround Professionals (the Japanese Association of Turnaround Professionals is the only Specified Certified Dispute Resolution Business Operator as of March 2019). In this regime, the debtor, with the involvement of a Specified Certified Dispute Resolution Business Operator under the Act on Promotion of Use of Alternative Dispute Resolution (Alternative Dispute Resolution (Act No. 151 of 2004, as amended)) and the Act on Strengthening Industrial Competitiveness (the Act on Strengthening Industrial Competitiveness (Act No. 98 of 2013, as amended)), requests that financial institutions allow the rescheduling of loan payments and that the financial institutions not file for insolvency procedures. If the rehabilitation plan is approved by a unanimous vote of the financial institutions that are creditors, the loan arrangement is collectively modified in accordance with the rehabilitation plan. Business Rehabilitation ADR only covers debts to financial institutions, and does not affect transactions with other parties including suppliers, distributors and customers. This regime is designed to combine the advantages of private rehabilitation such as flexibility, speediness, confidentiality and preservation of the going concern value of the distressed company, with the fairness and stability of the statutory procedures.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The automobile industry is one of the most intellectual property-oriented sectors. For example, three of the top 10 companies that were granted the most patents in Japan in 2018 were automobile-related companies and many more companies with automobile parts divisions are listed in the top 100. Therefore, IP-related disputes could be significant in the automotive industry.

However, intellectual property disputes are actually rare in the Japanese automotive industry. Vehicle manufacturers and parts suppliers tend not to resort to aggressive measures even if they suspect infringement of their intellectual property. This is in part because the intellectual property divisions in the automotive industry are like a small society, and it is often more profitable to cooperate, instead of dispute, typically through a cross-licence agreement. In addition, an increasingly common strategy for vehicle manufacturers is to disclose, instead of monopolise, core intellectual property such as hybrid vehicles and fuel cell vehicles, in view of leading the technology trends.

Other reasons may include the fact that intellectual property (IP) litigation is usually costly and lengthy, and the expected recovery

awarded by the court does not cover the cost. In 2019, the average timeline for all types of IP litigation was 14.9 months and many cases are settled without the court issuing any judgment. Given this, intellectual property disputes are not easily resolved.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Although the automotive industry has long outgrown the traditional labour-intensive industry, employment is still a critical issue in the automotive industry. There remains a hard-working culture in some Japanese companies, especially in the countryside where many manufacturing facilities are located, and this may cause employment issues such as overwork, harassment and non-compliance with regulations. The major sources of employment law include the Labour Standards Act (Act No. 49 of 1947, as amended), the Labour Contracts Act (Act No. 128 of 2007, as amended) and the Industrial Safety and Health Act (Act No. 57 of 1972, as amended). In the course of the government-led work style reform initiatives, a package of regulatory updates came into effect from 1 April 2019, which set shortened overtime limitations and mandatory paid leave requirements.

Japanese employment law provides extensive protection for employees against termination and salary cuts, and it is extremely difficult to terminate employees even for redundancy or underperformance. Many OEMs and suppliers, therefore, use temporary staff and dispatched workers to procure a workforce with flexibility to deal with the volatile market demands. This area of employment law is heavily regulated, and employers should be aware of the detailed regulatory requirements. For example, if an employer hires a fixed-term employee for an aggregate period of over five years, the employee is entitled to indefinite employment under the same conditions (the employer may reset the aggregate periods by placing a six-month non-hired period in between). A survey by the Labour Standards Bureau of the Ministry of Health, Labour and Welfare revealed in December 2017 that seven out of 10 major OEMs in Japan have limited the term of fixed-term employees to avoid lapsing into indefinite employment. At the same time, as Japan is facing population decline and a shortage of workers, it is crucial to secure competent employees without incurring inadvertent future risks.

One characteristic of the employment environment in the automotive industry is the labour union. Many OEMs and auto parts suppliers have active labour unions, and the industry-wide Confederation of Japan Automobile Workers' Unions (JAW) purportedly has approximately 790,000 members. While the unionisation rate is drastically decreasing across all industry sectors (17 per cent on industry average in 2019), JAW maintains a relatively high unionisation ratio. This is supported by a union shop arrangement, or a type of collective bargaining agreement between an employer and a labour union under which the employer will ensure that all employees belong to the labour union and fire those who do not wish to join any union (the Labour Union Act (Act No. 174 of 1949, as amended)). The unions negotiate the following year's salary review every spring, which is referred to as *shunto*, or 'spring labour offensive', but strikes and serious labour disputes have been relatively rare in recent years under the Japanese collective bargaining culture described as 'labour-management harmonisation'.

The 'conservative' government party have been promoting a campaign to raise wages to boost the economy and have requested that major automotive companies increase wages, while the Japan Business Federation, also known as *keidanren* – an association composed of the management of major companies and industry associations, has been reluctant to take on major salary reform.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

Automated or autonomous vehicles

The Japanese government has established a roadmap for the introduction of automated driving in Japan. The roadmap has defined the five automated driving levels in Japan, with fully autonomous driving at Level 5. The roadmap also addresses the steps required for the implementation of automated driving levels from 2 to 5, with the goal of realising the operation of autonomous vehicles on public roads. In accordance with the previous discussion, the government issued the Outline of the Legal Framework Preparation for Automated Drive in April 2018, setting out necessary regulatory updates and potential legal issues posed by automated vehicles.

On 1 April 2020, amendments to the Road Transport Vehicle Act (RTVA), the Safety Standards and the Road Traffic Act (Act No. 105 of 1960 (the RTA) took effect making it permissible for vehicles operating based on automated driving systems (ADS) classifiable as SAE Level 3 to be generally driven on public roads in Japan. (The SAE Levels of driving automation, developed and published by SAE International, offer one of the most globally recognised systems for defining the different levels of driving automation. They are set out in SAE International's Recommended Practice J3016, last published in June 2018.) More specifically, 'automated operation device' was added to article 41, paragraph 1, of the RTVA, which sets out the list of parts and devices that may be incorporated within vehicles subject to their complying with the Safety Standards. Article 48 of the Safety Standards and article 72-2 of the Notice Providing for Details for the Safety Standards. were newly added to set out the standards that must be satisfied with respect to the functions and performance of the automated operation device. The definition of 'driving' under the RTA was amended to include driving by the use of an automated operation device.

As the RTA continues to prohibit the general use on public roads of vehicles relying solely on SAE Level 4 ADS technologies, the guidelines issued by MLIT and the NPA (discussed below) still provide useful guidance for conducting tests using vehicles equipped with SAE Level 4 ADS technologies.

From 2017, insurance companies are offering a discount of up to 10 per cent on the insurance premium for vehicles equipped with advanced safety technologies including pre-crash brakes.

Requirements

The Ministry of Land, Infrastructure, Transport and Tourism (MLIT) issued Guidelines for the Safety Technologies of Automated Vehicles in September 2018. These guidelines, although not legally binding, set out 10 elements to ensure the safety of automated driving:

- setting of 'Operational Design Domain';
- safety of the automated driving system;
- compliance with the Safety Standards;
- human-machine interface;
- data logging;
- cybersecurity;
- emergency measures for the autonomous transportation system;
- safety evaluation;
- in-use improvement; and
- provision of information to the user.

These guidelines were designed to be interim standards for the development of automated vehicles until legally binding standards are established. Some of these standards are now provided for in the newly

added clauses of the Safety Standards, which are legally binding. The Road Traffic Act (RTA) sets the obligation of safe driving upon the driver, and the government maintains the concept that the driver should be responsible for driving, and any resulting accidents, even during level-3 automated driving.

Level 4 is still under debate owing to the Convention on Road Traffic (Geneva, 1949) and the RTA, both of which assume the existence of a driver on board. However, MLIT announced an amendment to the Safety Standards enabling experimental operations of a 'Level 4' autonomous vehicle without a steering wheel, or acceleration and brake pedals on a public road under certain conditions including the time, weather, speed limit, route of operation, emergency kill switch and safety staff.

Experiments on public roads

MLIT requires no special designation for the experimentation of automated vehicles on public roads as long as it satisfies the Safety Standards and has a driver in the vehicle. MLIT may also grant special permission for vehicles that do not comply with the Safety Standards to enable experiments on public roads. In both cases the testing must comply with the specific guidelines issued by the National Police Agency (NPA) in May 2019.

A number of exceptional permissions for testing have been granted, for example:

- in January 2019, as part of a series of experiments ongoing since 2018, MLIT and the Ministry of Economy, Trade and Industry (METI) jointly conducted an experiment for automated truck platooning using cooperative adaptive cruise control that will enable autonomous driving in platooning trucks on the motorway. MLIT and METI are contemplating commercial service in 2020. One impetus for this programme is Japan's ageing society and workforce shortage;
- an IT venture company and a major taxi operator conducted a series of experiments with autonomous taxis (with a security attendant in the driver's seat) and provided services to passengers on public roads in the urban area of Tokyo;
- the prefectural government of Aichi tested an autonomous vehicle on public roads in a suburban area in December 2017;
- an OEM and an IT venture jointly conducted a series of experiments of autonomous taxis (with a security attendant in the driver's seat) and provided services to passengers on public roads in the urban area of Yokohama; and
- METI and MLIT started experiments on public roads in Fukui. This experiment tested autonomous vehicles controlled by a remote autonomous driving system and which has been authorised as Level 3 autonomous driving, a first for Japan.

The National Agency for Automotive Safety and Victims' Aid has included pre-crash braking systems and lane keep assist systems in the list of test items from 2014. From 2017, insurance companies are offering a discount of up to 10 per cent on the insurance premium for vehicles equipped with advanced safety technologies, including pre-crash brakes.

Expected legislation

In December 2018, the NPA announced the draft of an amendment to the RTA to allow the use of a mobile phone in Level 3 autonomous driving. The amendments to the RTVA and the Safety Standards discussed above that introduce the automated operation device also newly require that the vehicle maintains a log of automated driving and that the driver submit the log to the police under certain circumstances.

Legislative reform also extends to the civil liability of the driver. Under the Automobile Liability Security Act (see above), the primary liability for losses caused by a traffic accident is assigned to the operator of the vehicle (eg, the owner of the vehicle or the business owner of a transportation service – not necessarily the driver). The burden of proof (to disprove negligence) in an accident is shifted to the operator, and the operator will be held liable for damages caused by the accident unless the operator successfully proves: that the operator exercised due care; the victim or a third-party was at fault; and the vehicle did not have any defect. MILT working group confirmed on 20 March 2019 that this framework will be maintained for autonomous vehicles.

On 4 March 2022, the Japanese government made a cabinet decision for a draft amendment to the RTA, which once incorporated into law will permit "Level 4" automated vehicles to be driven on public roads in their fully automated driving modes under certain conditions. The current Diet session passed the bill on 19 April 2022, and the RTA amendment will take effect within one year from 27 April 2022 on a date to be separately specified by government ordinance. It is anticipated that such vehicles will be able to be driven in their Level 4 automated driving mode on public roads by the end of FY 2022. One condition is that they may need to be able to run on unmanned, automatic mobile services in depopulated areas. The system of permission for specific autonomous operation of vehicles that the RTA amendment will establish can be summarized as follows:

- a person who wishes to engage the Level 4 autonomous operation of a vehicle without a driver (specific autonomous operation) must obtain the permission of the Prefectural Public Safety Commission;
- the Commission must hear the opinions of the mayors and other heads of municipalities of the prefecture before granting the permission; and
- the RTA amendment will also set out the matters to be observed by permitted persons and the measures to be taken in the event of a traffic accident, such as the establishment of a system for remote monitoring.

Connected vehicles

OEMs and suppliers should note that advanced equipment for connected vehicles may be subject to additional regulations, namely, radio devices and wireless communication are as regulated as automobiles. For example, the available bandwidths and requirements for the use of radio devices are regulated by the Radio Act (Radio Act (Act No. 131 of 1950, as amended)), and on-board communication services for automobiles may trigger filing obligations with the Ministry of Internal Affairs and Communications under the Telecommunication Business Act (Telecommunication Business Act (Act No. 86 of 1984 as amended)).

The amendment to the RTVA will require that online updates of automated driving programmes be approved by the National Agency for Automobile and Land Transport Technology in advance.

The use of big data will raise concerns regarding personal information protection.

Hybrid, plug-in hybrid, EVs and FCVs

The strategy for low- and zero-emission vehicles varies depending on the vehicle manufacturer. Hybrid vehicles (HVs) are commonplace today and are also increasing in popularity for heavy-duty vehicles. METI has been promoting plug-in hybrid, electric and fuel cell vehicles (FCVs) by offering financial aid for the acquisition of such clean energy vehicles and the establishment of battery chargers and hydrogen stations. The Tokyo Metropolitan Bureau of Transportation and Keihin Kyuko Bus have placed fuel cell (FC) buses on regular service.

On 12 March 2019, the Agency for Natural Resources and Energy under METI revised its roadmap for the promotion of the FCV strategy, which was first published in June 2014 and later revised in March 2016. According to this ambitious roadmap, the agency is aiming to increase the number of FCVs to approximately 200,000 by 2025, and to 800,000 by 2030, and to increase the number of hydrogen stations to 320 by 2025, and up to 900 by 2030. In addition to revising old targets and setting new targets (such as reducing the price gap between FCVs and HVs from ¥3 million to ¥700,000 and halving the cost of FC buses to ¥52.5 million),

the 2019 roadmap establishes a committee of experts for evaluating and following up on progress in each field under the roadmap.

Also, the Safety Standards are constantly being updated to accommodate the requirements for these clean automobiles, including in relation to batteries, high-voltage cables, fuel cells and hydrogen tanks.

Car or ride sharing

Pursuant to the Road Transport Act (Act No. 183 of 1951), a licence is required to operate a taxi or operate a passenger vehicle transportation business, which is defined as a service that gives rides in a car to others for consideration on demand. Therefore, paid 'ride-sharing services' cannot operate under the current legislation in Japan (though one ride sharing service limits its services to hailing of high-end licensed taxis with a professional chauffer). By the same token, a Chinese transportation network company recently launched a taxi booking service, instead of a ride-sharing service, in Japan.

In 2015, one ride share application service provider started testing its service in Japan without the passenger paying the tariff to the driver. Instead, the driver received remuneration from the ride share company on the basis of a 'data provision fee'. Nevertheless, MLIT requested that the service provider stop the tests on the basis that such a payment still falls within the definition of 'consideration'. However, MLIT also noted that the payment of a small amount that can be seen as a voluntary expression of gratitude or reimbursement of the actual expenses incurred, such as fuel, motorway and parking fees, will not be regarded as 'consideration' and is, therefore, acceptable. Some companies have launched this kind of matching app.

A car sharing service is feasible as a sort of rent-a-car service subject to the licence requirement under the Road Transport Act, and several rent-a-car companies have been operating car sharing services in urban areas making use of vacant parking lots. However, it is prohibited for individuals to hire out cars as a business. In addition, drop-offs in places other than registered parking spots are not permissible because the vehicle registration system requires the specification of a 'primary place of use' where the vehicle is usually parked.

However, in contrast with the above, the government has been promoting various 'sharing economy' policies and designated a rural town in Kyoto prefecture as a national strategic special zone to experiment with deregulation. The first ride-sharing service operating without a taxi licence was launched in May 2016.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

There are no updates at this time.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

Similar to most core industries, the covid-19 pandemic had a profound impact on the automotive industry in Mexico. Among other difficulties that arose from the emergency, were disruptions in the supply chain as well as shortage of commodities and raw materials. Considering that a huge part of the automotive industry, and in particular when talking about actual manufacturing, depends on 'just-in-time, supplies, the above-mentioned difficulties greatly impaired the ability of Mexican based original equipment manufacturers (and their suppliers) from meeting their timely and full production and distribution goals.

In addition to shortages and disruptions, the economic crisis resulting from the pandemic, as well as the lockdowns enforced in most of the world, meant a massive reduction in actual vehicle sells, which had an evident impact on the industry as a whole. Among some relevant facts and figures, is the 2 per cent production decrease in all vehicles, as well as a 6.8 per cent increase in vehicles sales as a whole in comparison with 2021. The automotive industry is showing a modest recovery, but still far from the levels reached before the pandemic.

Notwithstanding the above, it is important to keep in mind intricacies and the complexity of the North American automotive industry, in which Mexico is a key player. As such, as economic recovery becomes increasingly apparent, the Mexican automotive industry has a slow-but-sure rebound in both its manufacturing capacity, as well as in its ability to actually sell and distribute assembled vehicles.

In recent years (barring 2020 for obvious reasons described above), the automotive industry has grown to be one of the economy's industrial manufacturing pillars, currently representing approximately 3.5 per cent of Mexico's gross domestic product and 18.3 per cent of the national manufacturing GDP, standing as the second most important manufacturing activity after the food industry. It creates roughly 1 million direct jobs (even considering the 62,000 jobs lost in the industry during the pandemic) and is one of the main sources of foreign investment with over US$52 billion invested each year.

The automotive industry in Mexico has been growing at a fast pace. Among the advantages that Mexico offers to original equipment manufacturers (OEMs), as well as to Tier 1 and Tier 2 companies, are a skilled workforce, a privileged geographical location and, thanks to the number of international treaties signed, the ability for those companies to have excellent access to multiple international markets (over 45 countries and counting).

To better understand the Mexican market and the current situation in the industry, we should highlight that production is generally divided into three main categories: light vehicles, heavy vehicles and auto parts. For purposes of clarity, we will still use now 2019 numbers, as we believe that the covid-19 emergency shows outlier figures that do not necessarily adequately reflect the importance of the industry for the country: as such, the figures for those sectors show that in 2019 around 3,705,841 light vehicles (a 4 per cent decrease compared with 2018) and 213,933 heavy vehicles were produced (a 10 per cent increase in 2018); the auto parts sector increased 2.2 per cent compared to 2018, resulting in Mexico being the fifth-largest auto parts producer in the world and the largest in Latin America, while climbing one position to become the sixth-largest vehicle manufacturer globally.

The national auto parts industry has forecast that production of Mexican auto parts will continue to grow in the coming years, along with the generalised recovery of the global economy and an expected 5.5 per cent increase in the Mexican economy alone.

Currently, Mexico has over 22 assembly plants (with further plants being planned for construction) and a powerful Tier 1 supplier network with over 600 suppliers countrywide (at least 95 per cent of all Tier 1 companies are present in Mexico). Historically, the states of Sonora, Coahuila, Puebla, Mexico, Guanajuato, Nuevo León, Querétaro and Aguascalientes generated the vast majority of the total vehicle production.

Regarding exports, although 2019 and 2020 resulted in a decline in exports, Mexico ranks as the fourth-largest exporter in this industry; during 2021 Mexican exports increased around 1.0 per cent compared to 2020. Mexico currently exports over 88 per cent of its total vehicle production, accounting for approximately US$1 out of every US$3 received by the country from exports.

There are many destinations for Mexican exports, the main one being the United States, which counts Mexico as its main automobile supplier, receiving around 77 per cent of its vehicle production, Canada receiving around 7 per cent, Germany 5 per cent, Colombia 1.5 per cent and Brazil 1 per cent. Nevertheless, exports to other destinations have also risen. For example, in the past few years, China has become Mexico's sixth most important destination.

As a result of investments and the establishment of new local plants, Mexico currently ranks as the world's seventh-largest vehicle producer and the fifth-largest exporter. Many predict that in the next year or two (with the arrival of Japanese and German OEMs, and the expected investment from Chinese companies) the industry may reach production of 5 million light vehicles in more than 30 plants. Also, despite recent new plant cancellations, industrywide suspension resulting from the covid-19 pandemic, and a light vehicle sales decrease, foreign investors still find Mexico a suitable and convenient option. For example, European automotive suppliers have recently inaugurated a new factory in San Luis Potosi, and one of the leading American OEMs has decided to shift the production line of one of its best-selling vehicles to Mexico from abroad.

Figures for 2021 are still not finalised for many areas relevant to perform an in-depth analysis; however, it is abundantly clear that the industry has taken a significant hit as a whole, although recovery has

begun, as shown by a December 2020 production increase, as well as preliminary numbers for 2022 suggesting an industry-wide recovery and job recoup.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

To export to new markets, original equipment manufacturers (OEMs) must comply with several legal and technical requirements. In Mexico, imports and production of new vehicles are subject to a wide range of directives and regulations.

There are several Mexican official standards (NOMs) regulating the technical requirements of certain products. The government main agencies that are authorised to issue NOMs in the automotive sector are the Ministry of the Environment and Natural Resources regarding environmental issues, the Ministry of Communications and Transportation for all transportation and safety matters, and the Ministry of Economy.

Several models have now been discontinued as a result of the application of NOMs setting minimum security measures, and are currently being substituted with other models. For illustrative purposes, in 2017, a pre-eminent OEM decided to stop producing one of its historically best-selling vehicles, as well as terminating production and sales of the fairly successful model that had arguably taken its place. Some other manufacturers are looking for alternate models to sell in the Mexican market as a result of stricter security measures required by the government (items such as ABS, airbags and defrosting systems, among others, which were not mandatory in past years). As at 2021, manufacturers are not permitted to sell automobiles that do not comply with the new minimum safety features.

The environmental issues addressed by such NOMs are mostly on fuel emissions and regulation of noise, clean energies and diesel. In the case of safety matters the requirements are mostly about mechanical conditions and dimensions of the vehicles, as well as brakes, brake calipers, airbags and other safety devices and features, some of which are industry standards in other countries, but were not yet mandatory in Mexico.

It is essential to meet the NOM requirements and provide evidence of compliance with such standards to import or produce vehicles in the Mexican market. Under Mexican law, the NOM certificate holder is responsible for warranty, maintenance and product liability. Such certificates are not transferable, although manufacturers with NOM certificates may extend their usage rights to their distributors.

In addition, the government has historically granted certain facilities to support companies complying with responsible environmental practices. This is part of a corporate social responsibility drive aimed at the incorporation of fair values into business practices.

Finally, a new free trade agreement (Mexico–United States–Canada Agreement (USMCA)) has become effective, replaced the old North American Free Trade Agreement. This new treaty allows for a transition period of a couple of years for automakers to use at least 75 per cent North American-made parts in imported vehicles. Forty per cent of that rule of origin must be accounted for by labour that is paid at a salary not below US$16 per hour, which means that low labour costs cannot account for the entire calculation of the rules of origin. Automotive companies will need to adapt to this new reality within their fixed costs, and being able to implement this into their supply chains.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Automotive companies usually operate using an IMMEX *maquiladora* programme, which allows a Mexican entity to engage in manufacturing activities (mainly for exportation purposes) and temporarily import parts and materials on a duty-free basis. The usual IMMEX *maquiladora* structure is through a principal, which is a foreign entity residing in a country with which Mexico has a tax treaty in place. This entity will hold the manufacturing agreements. Such agreements set forth the organisational, operational and economic terms, and are entered into by the principal and the manufacturing Mexican entity.

Maquiladoras may be established anywhere in the country and, if certain requirements are met, they can also sell a part or even all of their production locally (in which case import duties for the final products must be paid based on the corresponding harmonised tariff number). Usually, *maquiladoras* are incorporated as stock corporations or limited liability companies, which have very low capital requirements, and allow foreign investors to own up to 100 per cent of the corporate capital of such entities.

Among the many advantages of operating under the IMMEX programme are temporary duty-free imports on raw materials, exemptions on import duties, VAT refunds, and others.

There are also sectorial relief programmes applicable to the vehicle and auto parts industry that aim to give companies a preferential tariff rate to import goods intended for production, regardless of the country of origin, and which also foresee preferential trade tax rates to export the resulting products.

In an effort to create manufacturing clusters, lower transportation and insurance costs, and reduce idle inventory volumes, assembly plants commonly require that their suppliers be as physically near to them as possible, prompting suppliers to set up locally. This accumulation of manufacturing plants and multiple suppliers is not uncommon, and has been the source of significant growth of the industry and impact on investment, employment and economic relevance.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Before starting the importation procedure, the vehicle's compliance with Mexican NOMs and applicable regulations must be fulfilled. The actual importation process is handled by a customs broker.

Since 2004 it has been possible to import new vehicles from the United States, Canada and member states of the European Union without any import tariff. Recently, Brazil and Mexico eliminated import tariffs on light vehicles and auto parts, while the import tariff on heavy vehicles was eliminated during 2020. There are many regulations on this type of import establishing several requirements for such vehicles, including maximum mileage allowed for the vehicle to be considered as new, compliance with applicable NOMs, etc.

A few years ago, governmental decrees were issued in an effort to reduce the flow into Mexico of used vehicles purchased cheaply in the United States. This was the government's reaction to growing concerns about potential damage to the industry in Mexico, the increasingly ageing motor pool, higher pollution levels, fuel efficiency, maintenance costs and difficulties identifying such vehicles. However, on 20 January 2022, the current administration issued a decree to regulate this type

of cars in 10 states in the country (Baja California, Baja California Sur, Chihuahua, Coahuila, Durango, Michoacán, Nayarit, Nuevo León, Sonora and Tamaulipas). This decree is seemed as a setback by the automotive industry.

Distribution is generally handled through distributors that enter into distributorship agreements with the automotive manufacturers. These agreements usually contain standard contractual termination clauses (eg, failure to reach certain thresholds for certain periods of time, other performance requirements). Mexico does not have protective laws that require statutory indemnity when distributors or agents are terminated. Freedom of contract is the substance of any conditions between the parties to such relationships.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Mergers and acquisitions in the automotive industry are fairly standard compared to other M&A operations and can be done by purchasing assets, stock or shares of a targe company or more companies to create a new one, or merging one into another.

Joint venture companies (ie, the creation of a new entity into which two existing entities transfer assets or capital) in Mexico are independent from their parent companies and must obtain a separate Federal Taxpayer Registry number and separate permits, and authorisations. Usually, these new entities have shareholder agreements in place that provide for the corporate structure, management or business plans. Of special note when entering into an M&A or JV transaction of this nature are the manufacturing facilities and logistics of the target entity, as this will play a key role in the entity's access to the market and ability to take advantage of the USMCA provisions, considering that the North America region is likely to continue to account for the vast majority of the entity's business.

Companies should get local legal advice to comply with all applicable laws, especially those regarding antitrust and economic competition, environmental, tax, labour and administrative provisions, all applicable NOMs and all authorisations, licences or permits required before beginning operations. Given the size of players and greater consolidation, the antitrust analysis is relevant, although a mitigating factor is that the market is usually analysed with a worldwide perspective and not merely what happens in Mexico, a point of view that is not prevalent in other industries when reviewed by the competition agency (Cofece).

English is widely spoken in Mexican M&A transactions, and agreements are often drafted in English, while jurisdiction and applicable law may be set to be Mexico or a foreign jurisdiction (most commonly New York). Arbitration clauses are not uncommon in larger deals and contracts, and are considered to be a valid trade-off with local parties to avoid domestic courts asserting original jurisdiction.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

Among the factors that may be considered as an incentive to invest in Mexico is its geographic location as neighbour to the world's largest vehicle market, the relative low cost of the workforce, the high-level degree of specialisation of Mexican labour and the extensive network of free trade agreements, among others.

There are incentives such as tax privileges granted to companies operating under IMMEX programmes, providing many tax and administrative benefits such as avoidance of the general import tax and VAT payment, VAT refunds, reduced customs fees and simplified import and export declarations.

Other incentives can be found in the form of sectorial promotion programmes, which through their application may reduce most-favoured-nation import duties. These programmes support 22 different sectors, including the automotive and auto parts sectors. They also enable manufacturers to import their inputs at preferential tariffs to ensure they remain competitive. Most automotive inputs can be imported duty-free thanks to this programme. In addition, companies that comply with all regulations contained in the 'eighth rule' (licence issued by the Ministry of the Economy) may access a mechanism that allows such companies to import materials, inputs, parts and components using a zero per cent rate.

Several Mexican states such as Sonora and Yucatan have developed their own policies and benefits for the industrial sectors that can be translated into several benefits and incentives for investors. These measures include reductions in real estate prices and taxes, discounts or reductions of payroll taxes and even employee training programmes.

Federal and state governments are actively attracting automotive manufacturers into Mexico, providing additional benefits that should be analysed on a case-by-case basis.

Since the USMCA has become effective, many vehicle manufacturers have communicated their interest in expanding their investments in Mexico (and some actually have begun doing so). In addition, Mexico is expected to continue to reap benefits from the continuing US–China strained relationship; with the US–China rivalry not ebbing, Mexico's advantageous geographic position, and the rise of electric and hybrid vehicles in the industry (in which China is a leader) Mexico and China may become natural business partners, and other companies may seek relocation to Mexico to avoid potential American tariffs imposed on their Chinese interests.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Technical and quality standards regarding safety and emissions that must be met for the Mexican market are contained in official standards (NOMs). Some of the most relevant NOMs include:

- NOM-194-SCFI-2015 contains minimum security measures for new light vehicles, including provisions on the technical requirements for many parts of the vehicle such as tyres, ABS, braking lights, reverse lights, evaluation methods and verification procedures;
- NOM-042-SEMARNAT-2003, NOM-044-SEMARNAT-2006 and NOM-076-SEMARNAT-1995 regulate vehicle emissions such as the maximum emission levels for vehicles, evaluation methods and verification procedures; and
- NOM-079-SEMARNAT-1994 and NOM-082-SEMARNAT-1994 regulate the maximum noise level for vehicles and the evaluation method thereof.

There are also regulations on security measures such as marking of doors and frames so that the vehicle is equipped with adequate and accessible information to protect consumer rights and avoid theft. Additionally, there are many safety measures regulating technical specifications on seat belts, tyres, brakes and other vehicle parts to protect consumers from bodily harm. These standards are generally issued in such a manner as to be aligned with international regulations.

Manufacturers must be frequently updated on any new NOMs and additional requirements for them to comply and be able to continue business operations.

As an outstanding environmental measure applicable in the Mexico City Metropolitan Area, there is the 'Hoy no Circula' programme, which prohibits driving certain vehicles on certain days, depending on the results that such vehicles achieved in a mandatory contaminants emissions test. This measure only applies to the Mexico City metropolitan area, but other states are constantly looking at the implementation of similar strategies. The Mexico City metropolitan area encompasses Mexico City, the State of Mexico and Hidalgo.

Recalls are handled by the Consumer Protection Bureau through the issuance of a non-binding recall request issued to the relevant party to recall certain products. These recall requests are standard and in the case of non-compliance the consumer protection authority may assist the affected parties in filing suit. Additionally, manufacturers may recall defective products, which is common in large-scale recalls with a global reach.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability law in Mexico for defective products is based only on the fault of the manufacturer or any other person in the production chain whose actions or omissions result in damage. If direct damage is not caused, and there is no direct link between the damage and the alleged guilty party, it will be difficult to support liability claims.

Mexico's civil law considers product liability as an extra-contractual obligation (similar to tort, in common law countries). The law provides that whoever has acted illegally or against good custom, and has caused damage to another, must repair the damage caused. Therefore, liability can only be asserted if damage was caused by such breach. The state does not operate any compensation schemes for particular products, but consumers may be able to file a claim if the defective product damages the individual and causes civil liability. These events are ruled by the Civil Code (federal or local).

Mexican law does not provide an obligation to recall defective products. But there are many companies with recall policies for defective products or failures that are used as a quality standard and as a practical measure to prevent future damage to consumers and to protect their brand and public perception.

Although Mexican legislation does not foresee recalling products as necessary, failure to do so may result in a possible liability claim based on negligence. A possible defence against any liability claims exists if the accused party can prove it has complied with all legal and technical specifications for a product.

In such regard, collective actions are available in Mexico to prosecute consumer clams; these actions may also be brought directly by government agencies such as the Consumer Protection Bureau.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Mexico is considered as one of the most competitive countries in this market in terms of available products. In terms of the automotive industry, there are well over 50 brands with a presence in Mexico and around 2,600 auto parts companies.

In competition matters, the 2014 Federal Economic Competition Law, along with an amendment to the Constitution, created a new Federal Economic Competition Commission (Cofece). Even though this commission follows the legal framework established by the previous one on monopolistic practices, some changes have been introduced regarding defining entry barriers to competition and access to essential raw materials. Even though Cofece has been very aggressive with its investigations and fining activities in other sectors, there has as yet been no major competition litigation related to the automotive industry in Mexico.

Cooperation between the competition enforcement agencies of Canada, the United States and Mexico has continued to strengthen, and Mexico's participation in joint investigations has increased. If a company is being investigated by one of these countries for a possible antitrust violation, its conduct and statements could also be reported and investigated by the authorities of the other countries.

Annual trilateral meetings of the aforementioned countries take place with the objective of ensuring and improving cooperation and coordination of antitrust policies and their enforcement.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Disputes in the Mexican automotive industry are often resolved through arbitration if an agreement includes such provision. If parties involved in the dispute are also United States-Mexico-Canada Agreement (USMCA) parties they often resolve their dispute through the special arbitration provisions applicable for said countries, which mechanism has generally been maintained from the former North American Free Trade Agreement (NAFTA), and with some specific provisions authorising NAFTA investment-related claims being submittable in a term of up to three years after the USMCA came into effect on 1 July 2020. Likewise, if parties are signatories to any other trade agreement that Mexico has entered into, an arbitration solution may be available for them.

Mexican courts recognise and enforce awards obtained by these mechanisms; however, if such dispute resolution mechanisms are not available to them, the dispute must be resolved through the application of Mexican law by the competent courts, which may not be as expedient as arbitration.

Finally, Mexican courts do not enforce remedies such as injunctions or other equitable remedies except for preliminary relief specifically enumerated in the Commercial Code, as well as stay of execution of the claimed act (similar to injunctions or stop orders) in *amparo* proceedings. Mexican courts do not award damages other than actual, direct and immediate damages and lost profits, and may not enforce judgments awarding them.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

To strengthen the supply chain, Tier 1 and 2 companies as well as original equipment manufacturers are generally clustered near assembly plants. Nevertheless, sometimes supply interruptions can arise and adversely impact operations and organisations. Therefore, a first important step to avoid these scenarios is for manufacturers to be aware of the status, finance and reputation of their suppliers.

Although there are no legally established processes for this situation (other than bankruptcy laws), generally it is recommended for the

manufacturer to consider three main preventive activities regarding its suppliers:

- reviewing information such as financial statements and analysing internal performance and price trends to develop a risk profile of each supplier;
- identifying issues such as distinguishing troubled suppliers from healthy ones and determining most likely areas of distress; and
- analysing and, if necessary, undertaking different options such as changing supplier (if alternative suppliers are an option and an efficient transition is commercially feasible), investing or acquiring said supplier, developing efforts with the supplier to improve communication and material process flows or creating an inventory stock to be used as a reserve.

We recommend having provisions included in the agreements entered into by manufacturers and suppliers that cover scenarios in which the supplier is distressed or failing. Obligations for suppliers to ensure an efficient transition to a new provider are common practice in similar agreements. As did NAFTA, the USMCA notably contains certain regional value content specific to the automotive industry that has been increased from those found in NAFTA, so that manufacturers with a high North America export rate must be careful to comply directly, and through their suppliers, with such regional content to keep exporting into the United States and Canada. The rules of origin in the automotive industry were an important driver for the US-driven effort to replace NAFTA, and thus those changes are not insignificant and must be carefully analysed and implemented by any company in the sector with cross-border trade.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The current state of intellectual property (IP) protection in Mexico is an ongoing concern. The legal system is sometimes considered inefficient and violations are punished with weak penalties. Therefore, it is highly recommended for automotive companies to aim for appropriate protection of IP rights upon doing business in Mexico.

Although registering IP rights in another country may offer some benefits, foreign protection does not always extend to Mexico. As such, to ensure and duly protect IP rights, such property must be registered and enforced under Mexican law.

Local legal advice is needed when licensing and transferring technology or any IP right to prepare the agreements and fully protect IP from unauthorised use; franchising is a growing option to be considered.

Notwithstanding, intellectual property rights have received improved protection under the USMCA. This treaty includes a copyright term extended to 70 years, prohibitions on circumvention of technological protection methods, and criminal and civil penalties protections for trade secret theft, among other things.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

The right to work in Mexico is protected by the Constitution, specifically articles 5 and 123. The Federal Labour Law broadly regulates all main topics contained in article 123 of the Constitution and is also responsible for regulating all labour aspects between employers and workers, including establishing minimum worker protection rights.

The United States-Mexico-Canada Agreement (USMCA) also provides certain rights to the workers in this industry that were not previously standard practice. The USMCA includes wage requirements that might tighten up one of Mexico's competitive edges, such as a provision that requires employees in the automotive industry to pay their workers at least US$16 (at least for 40 per cent of the parts and services that count toward the regional rule of origin), which is considerably higher than the previous median wage. Although this has resulted in Mexico being pressured by these provisions since it has proven its economic competitiveness through low labour costs, different formulas have been discussed to lessen the impact that higher wages may have upon the industry. This treaty also provides that Mexican authorities must allow workers to form unions and be able to vote in a secret ballot to choose their union leader.

Historically, many entities decided to establish an operating company holding all relevant assets and actually undertakes business operations, together with a services company that 'houses' the employees, which in turn is engaged by the operating company (in such a way that the employees are subcontractors of the operating company). However, this structure was subject to recent legal reforms that banned outsourcing structures and only certain services are allowed to be 'subcontracted' as specialist services, as a general rule this practice is now prohibited. As a result of these reforms, many entities decided to merge services entities into their operating structure, or simply wind up the services entities and transferring all relevant employees into the aforementioned operational entity.

Also, the law provides for alternative types of labour relationships such as by season, probation period, initial training and indefinite contract for fixed and periodic tasks, among others. Regarding the working week, a six-day, 48-hour working week is standard. Overtime pay is required if this level is exceeded (double pay for up to nine hours of overtime and triple pay for overtime of more than nine hours).

Among the main rights enjoyed by employees are holidays, paid leave after one year of service, holiday bonuses, and an annual bonus equivalent to at least two weeks' pay. Employers are responsible for these additional costs, which can add 30 to 35 per cent to an average salary.

Other relevant obligations of employers are: compliance with safety, health and environment regulations and Mexican NOMs; mandatory handicapped access if employing over 50 employees; obligation to give employees access to the full text of the collective bargaining agreement that may exist in larger companies; informing employees of the risks and dangers associated with their activities in the workplace; confirmation of paternity leave; and the establishing policies against harassment and discrimination.

Pursuant to the Federal Labour Law, at least 90 per cent of the employees of a Mexican entity must be Mexican nationals, excluding directors, managing directors and general managers. Therefore, foreign personnel shall not exceed 10 per cent of the total number of workers in a Mexican company.

Trade unions in Mexico have significant influence over the labour market. The Federal Labour Law protects the right of workers to associate without prior authorisation and provides the framework to create a trade union. For unions to be valid and in force they must be registered with the local labour authorities or with the Ministry of Labour. As a result of having labour unions, collective negotiations and agreements are signed by representatives of unions and the employer.

In practice, employees may be forced to have their workers unionised. This may occur when a trade union discovers that any given entity is not a party to a collective bargaining agreement, and may then demand that they are contracted with. For such purposes, it is common to have 'white unions', which are practically dormant but comply with the

requirement, instead of having active unions, which may cause complications depending on the nature and intent of such union.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

As shown by recent pivots in their R&D approach by several of the most well-known automotive brands, the development of new automotive technologies has experienced growth. Although the acquisition by consumers of vehicles equipped with new technologies is somewhat limited by their relatively high prices, the Mexican government has supported consumers by creating many incentives to encourage them to buy these types of vehicles.

In Mexico, sales of hybrid and electric cars are not abundant, but they are growing. In 2021, around 39,100 hybrid and electric vehicles (which accounted for the better part of all 'green vehicles' sold in Mexico) were sold in the country, which shows an increase of around 60 per cent for 2020, while in October 2021 alone this vehicle sector sold 2,666 units, 255 of those were electric and 567 were connectable hybrids. As expected, 2020 resulted in a dramatic slump for these types of vehicles, the recovery of which will depend largely on that of the Mexican economy, as these types of vehicles tend to be higher priced than their petrol-powered competition.

Among some of the government incentives to acquire these types of vehicles is an exemption for hybrid and electric vehicles from the federal tax on new vehicles. The Federal Electricity Commission has also developed several measures to foster these vehicles such as the installation of a different type of domestic measuring device for billing purposes, as well as preferential rates on electricity consumption. Regarding local government support, the regulations of some states include exemptions on the ownership and use local tax. These vehicles are generally not affected by the 'Hoy no Circula' programme or subject to emissions verification processes.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

The covid-19 pandemic and resulting economic crisis, coupled with the effects of worldwide lockdowns and travel restrictions, had a profound effect on the automotive industry worldwide. In Mexico alone, we saw a 35.5 per cent year-to-year decrease in light-vehicle production from January to June 2020, with an expected 23 per cent year-to-year decrease in sales.

To compound the negative effects of the pandemic, a higher demand for remote working resulted in a higher demand for microchips used in such technologies, which are also used in the automotive sector. As such, original equipment manufacturers and their suppliers have had to slow down production as chips have become an in-demand commodity, with higher prices and reduced availability. Although we expect this to be corrected by the markets in the short term, the impact has already been felt in automotive manufacturing in the country.

In terms of recovery, the Mexican automotive industry is deeply interconnected with the respective industries in the United States and Canada, and they can essentially be considered as one regional industry encompassing all three countries. The implementation of the United States-Mexico-Canada Agreement (USMCA)) and the gradual recovery of the economy in both the United States and Canada has resulted in a manufacturing and sales pick-up for the Mexican automotive sector. In this regard, experts expect that the USMCA is still likely to provide a stable and inviting framework for the automotive industry. China, Brazil and Spain, among others, have announced their intention to invest in and trade with Mexico in the automotive sector in the future.

Finally, although without any as of yet clear results, the recent Trans-Pacific Partnership (TPP-11) creates a free trade bloc accounting for 15 per cent of the world's global trade, and will benefit 500 million people spread around the 11 signatory countries. Although it came into full effect in December 2018, it is expected that the TPP-11 will increase competitiveness of the signatory countries, create better work and health standards, and open new options for the Mexican market, which will become an even more attractive country for both domestic and foreign vehicle manufacturers.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The Netherlands is a relatively large player in the global automotive industry. It hosts a number of cars and trucks manufacturers. VDL Nedcar is probably the best-known car manufacturer in the Netherlands, currently producing passenger cars for BMW. In addition to VDL Nedcar, there are a few truck manufacturers located in the Netherlands, including Scania, DAF Trucks and Ginaf Trucks.

The Netherlands is predominantly known for its vast number of suppliers in the automotive industry. It is said that almost every passenger car contains products that are manufactured by Dutch suppliers. The group of suppliers located in the Netherlands is very divers and innovative and consists of suppliers that are active in a wide variety of sectors relevant to the automotive industry, such as the parts industry, the rubber and plastic industry, mechanical engineering and the electronics industry. The widespread competitors in all of these sectors involve a significant number of companies. This is best shown by the number of manufacturers and suppliers that are a member of the RAI Association (*RAI Vereniging*). Almost all of the manufacturers and suppliers located in the Netherlands are members of this Dutch association. According to its website, RAI Association represents the interest of over 700 (Dutch) manufacturers and importers of, inter alia, passenger cars, trucks, trailers and special vehicles.

RAI Automotive Industry NL is one out of nine sections of the RAI Association. This section (with over 200 members) represents the interests of the Dutch automotive industry on a national and international level. The section focuses on global automotive and mobility solutions by joining forces with industry members and stakeholders and acting as a catalyst in the fields of innovation and education.

The Dutch automotive industry has benefitted from high levels of skilled labour, a multilingual workforce, supportive corporate tax structure as well as being close to Europe's largest automotive markets, including Germany. This has encouraged strong growth of the industry over the past five years.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

In the Netherlands, a type approval is required for the registration, sale and entry into service of vehicles and vehicle parts. The most important regulation in this regard is Regulation (EU) 2018/858 (Regulation (EU) 2019/2144 amends Regulation (EU) 2018/858 and will be applicable as of 6 July 2022). This Regulation has repealed the Framework Directive 2007/46/EC. The Framework Directive was mainly implemented in the 1994 Road Traffic Act and the Vehicles Regulation.

The Regulation provides for a revision of certain parts of the (type) approval system and in addition to the administrative provisions and general technical requirements, the regulation contains new provisions on market surveillance measures for vehicles already on the market.

In principle, a regulation has direct effect and therefore does not require implementation. However, member states are required to adopt necessary implementing regulations to ensure that the regulations can be effectively applied and enforced in a member state. In the Netherlands the 1994 Road Traffic Act and the Vehicles Regulation have therefore been amended. The National Vehicle and Driving Licence Registration Authority (RDW) was already appointed as the type approval authority and remains the type approval authority. The Human Environment and Transport Inspectorate (ILT) has been designated as the market surveillance authority and is responsible for all tasks assigned to the market supervision authority in the EU regulations.

The Netherlands Vehicle Authority (RDW) is in charge of granting (EU-) type approvals. Before applying for a type approval the manufacturer must demonstrate, by submitting a wide variety of documents, that the production process is in order. The RDW issues the type approvals after assessing the test reports, information documents and a verification on the basis of the new requirements.

Once a type approval has been granted, it may become invalid if stricter rules come into effect. In that case, the manufacturer must apply to the RDW for a supplement to the approval. This must also be done in the case of technical modifications.

Registration of vehicles

Pursuant to the Road Traffic Act all vehicle owners must register their vehicle to the vehicle register of the RDW and hold a vehicle registration certificate. The registration can only succeed when the vehicle has been type approved by the RDW. The RDW issues registration certificates in credit card format (also known as registration cards), which

card complies with all the applicable European legislation. A fine of up to €410 can be imposed upon the vehicle owner if it does not have a valid registration card.

Insurance requirements

Pursuant to the Motor Vehicle Liability Insurance Act, the owner of a motor vehicle and the person in whose name it is registered, is obliged to take out and maintain insurance for the motor vehicle. The RDW checks daily whether vehicles comply with the insurance obligation. The RDW carries out this duty on behalf of the Ministry of Security and Justice. If the vehicle owner fails to take out any maintain insurance, he or she can be punished by imprisonment for a maximum of three months or to a second-category fine. In principle, a standard fine of up to €650 will be imposed).

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The way automotive companies are operating in the Netherlands does not seem to differ from the way in which this is done in the neighbouring European countries. The supply is usually done on the basis of a purchase order with a contract structure that is – generally – implemented by automotive OEMs and similarly flows down the supply chain. This generally includes contractual provisions to safeguard trade secrets and intellectual property rights.

The supply relationships are to a large extent based on the application of the OEMs or the higher tier suppliers' (as the case may be) purchase terms. Special arrangements do exist, such as, for instance, volume contracts with particular suppliers) and – as far as the distributor contracts are concerned – most often comprehensive written agreements are in place. In addition, OEMs apply additional highly standardised documents though to cover specific issues, such as, for instance, quality requirements, warranties, logistic requirements and indemnities. In cases where parties cooperate on the basis of a joint venture or similar arrangements, often detailed individual arrangements on the joint venture are concluded.

With new technology and innovative companies entering the market and with connectivity becoming more and more important in the automotive industry, concluding strategic cooperation with companies specialising in connectivity and mobility becomes more and more important.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

As far as the distribution of vehicles is concerned, this generally starts (at the first level) with the OEMs (or their national importers) who have set up a network of authorised distributors. The distributors (at the second level) enter into specific arrangements with the dealers, who (at the third level) sell and market the vehicles in their own name and for their own account to the end consumers.

The contractual arrangements within the distribution chain vary depending on the type of customer. Contracts entered into with high-volume or special customers, such as fleet-owners or lease-companies, materially differ from the contractual arrangements entered into with other customers.

As a general trend, direct relationships with end users are becoming increasingly important to OEMs.

This trend is accelerated by personalised connectivity and mobility services that are made available to end users, and the offering of online vehicle services fit to satisfy the end users' needs. In turn, personalised transport services fuel the demand for mobility as a service (MaaS). Based on some of these MaaS concepts, customers pay a flat rate subscription fee in exchange for being provided with a car and – on top of that – a wide range of car-related services as well as the option to change car models in frequent intervals or on demand. It is expected that MaaS will continue to gain popularity, potentially causing a decline in car ownership and an increase in innovative new mobility services, such as innovative rental or lease and car-sharing services, thus making direct relationships with the end users all the more important for car manufacturers. Dutch law does not provide for any specific statutory provisions on distribution agreements. Under Dutch law a distribution agreement is – like all other contractual arrangements – governed by general provisions on contract law and thus by the principle of reasonableness and fairness (article 6:248 Dutch Civil Code). This principle of reasonableness and fairness may, under certain circumstances, limit or extend the contractual arrangements made by parties.

In the case of termination of distribution contracts, Dutch courts may, on the basis of this principle, extend the notice period parties have agreed upon. Neither Dutch legal literature nor case law confirm whether this principle of reasonableness and fairness should be considered to be a rule of Dutch mandatory law. The general perception, however, is, that the principle of reasonableness and fairness should have no effect on a distribution agreement that is governed by foreign law or, if so, this effect should be very limited. The Dutch legal authors who defend a limited effect of the principle reasonableness and fairness state that the effect is limited to the possibility of granting the distributor financial compensation in the event the contractual notice period should be considered unreasonably short.

Under Dutch law a reasonable notice period is determined bearing in mind all circumstances of the case at hand. One of the critical circumstances in this regard is the term of the agreement. Other circumstances that may affect the actual length of the notice period include the following.

Purpose of a notice period

The purpose of a notice period is to give the terminated party the opportunity to adjust its position in view of the (forthcoming) termination of the agreement. The length of the notice period should be appropriate for allowing the terminated party to adapt its position accordingly.

The length of a notice period also depends on the question as to what extent the distributor depends for its supplies from the distributor. Important factors for this assessment are: (1) to what extent are there substitutes for the products; and (2) to what extent do the products of the supplier form a part of the entire product range of the distributor?

The duration of the distribution agreement

The duration of the distribution agreement is also significant in determining the duration of a reasonable notice period. A long duration of an agreement would justify a longer notice period.

Reason for termination

The reason for terminating the distribution agreement and the manner in which this is communicated to the terminated party may also have an effect on the duration of the notice period.

It should, however, be noted that in the event that a contract expressly provides for a notice period, and this notice period is observed, it is unlikely that this notice period will be considered unreasonable.

Upon a valid termination of a distribution agreement entered into for a definite or fixed period of time, in principle, there is no ground for a termination fee. It is generally assumed that a distributor makes

its profit by reselling the products (at a higher price). Any investments made by the distributor must be considered to be accounted for in the purchase price of the products. This is a key difference with an agency agreement, where the agent is entitled to a termination fee (provided certain conditions are met) on the basis of European law.

Background of this different approach is the difference in how a distributor operates in comparison to how an agent operates. A distributor makes its own (re)sales to its own customers. After termination of a distribution agreement, the distributor still has its customer base (provided no alternative arrangements were made between the supplier and the distributor regarding the transfer of customers or customer base). An agent works for and enters into agreements on behalf of its principal. After termination of an agency agreement, the agent is left with nothing (while he or she may have built a huge client base for its principal from which the principal can profit in the future, making a compensation for an agent reasonable).

So it is not that termination compensation for a distributor would be forbidden under Dutch law, it is just not common practice and the distributor has no statutory right to ask for such compensation (save for certain exceptions on the basis of the above-mentioned principle of reasonableness and fairness).

Dutch Franchise Act

On 1 January 2021, the Dutch Franchise Act came into force. The Dutch Franchise Act will be applicable to all contracts that meet the legal definition of a Franchise Agreement as set out in this Franchise Act. In such a case, the contract will be subject to the mandatory legal framework of the Dutch Franchise Act. The intention of the parties when entering into the contract will not be decisive when assessing whether the contract qualifies as a franchise agreement. If a contract falls within the scope of the Dutch Franchise Act, the position of the franchisee (eg, distributor and/or dealer) will be strengthened towards the position of the franchisor (eg, manufacturer). The Dutch Franchise Act includes provisions on information and compensation rights of the franchisee (eg, the distributor and/or dealer) in relation to the franchise formula and on goodwill and the permitted non-compete clauses. It is likely that legal disputes will be initiated to try to receive (declaratory) judgments on the qualification of the dealer and/or distribution agreements in this respect.

Mergers, acquisitions and joint ventures

5 | Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Generally, there are no major differences in the way in which automotive M&A transactions are handled in the Netherlands in comparison to the way in which transactions are handled in other European jurisdictions. Considering, however, that the automotive market is rapidly changing and that new entrants enter the market who have a completely different background, such as IT companies, internet companies and other major technology companies, topics that require specific attention during the due diligence process (when entering into M&A and JV transactions) include (among others) the reliability of customer and supplier relations, environmental issues, product liability, insurance coverage, IP rights and regulatory compliance (including compliance with emission standards).

Incentives and barriers to entry

6 | Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

According to the Rai Association, there is a wide variety of subsidy and incentive schemes in the Netherlands to which the players in the automotive industry can subscribe. Both the national government as well as the local governments incentivise innovation and sustainability in different ways. This may be at the level of vehicles or technics for cleaner vehicles, for instance, by providing subsidies or incentives when purchasing and using electric vehicles (often through the payment of individual purchase premiums) or by granting individual tax advantages, but it may also be at the level of business processes or innovation. An actual overview of all subsidy and incentive schemes, including an explanation, can be found at the website www.ondernemersplein.nl (subsection Duurzaam ondernemen).

There are also no special barriers to enter into the automotive market in the Netherlands. It is a rapidly changing industry sector though. Although the industry sector has long been ruled by the rules set and developed by the traditional (foreign) automotive players (mostly original equipment manufacturers), new companies entering the automotive market have started challenging these established rules and common practices by applying new rules and practices, also because the focus of all competitors is rapidly shifting from traditional automotive into connectivity and mobility.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 | What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Regulation (EU) 2018/858 introduces market surveillance measures for vehicles already on the market. Similar to the Framework Directive, Regulation 2018/858 does not include substantive technical requirements that vehicles have to comply with, but refers to the requirements of specific regulatory acts, such as Regulation 715/2017 regarding emissions and Regulation (EC) 661/2009 regarding general safety of motor vehicles. Next to the EU Regulations, the Road Traffic Act and the Vehicles Regulation lay down (further) rules on safety and environmental matters.

In principle, non-compliance with applicable law requirements is punished with both administrative and criminal sanctions. A violation of the requirements laid down in articles 29, 30, of the Road Traffic Act constitutes an economic offence under Dutch Law. These articles entail, among other things, a prohibition to use defeat devices, to withhold information or to forge test results. Next to criminal enforcement, The National Vehicle and Driving Licence Registration Authority (RDW) – as type approval authority – and the Human Environment and Transport Inspectorate (ILT) – as the market surveillance authority – are authorised to impose administrative penalties for violation of different provisions.

Under the new Regulation (EU) 2018/858, a manufacturer is obliged to take corrective measures (such as a recall) in the case of non-conformity of the vehicle and when the type approval is granted on the basis of incorrect data. A recall constitutes an obligation for the manufacturer and not the car owner. The Dutch legislator plans to impose an obligation on the vehicle owners to respond to the recall. If the vehicle owner repeatedly fails to respond to the call to repair the vehicle, he or she will be prohibited to drive the vehicle on the road.

In the case of a serious risk a manufacturer is obliged to provide to the approval authorities and market surveillance authorities detailed information on (1) the risk and (2) any measures taken in relation thereto. Regulation 2018/858 refers to both safety and environment related risks. For the qualification of a serious risk the Regulation refers to Regulation 765/2008.

> *The decision whether or not a product represents a serious risk shall be based on an appropriate risk assessment which takes account of the nature of the hazard and the likelihood of its occurrence. The feasibility of obtaining higher levels of safety or the availability of other products presenting a lesser degree of risk shall not constitute grounds for considering that a product presents a serious risk.*

Furthermore, under the new Regulation the market surveillance authorities of all EU member states (ie, the ILT) have the discretion to evaluate vehicles if there are sufficient reasons to believe that it poses a serious risk to the health or safety of persons or presents a serious risk of non-compliance. If the ILT concludes that the vehicle presents a serious risk to the health or safety of persons, it shall require that appropriate corrective measures are taken by manufacturer to ensure that the vehicle no longer presents that risk.

The RDW may refuse granting a type approval if it considers that, albeit in conformity with all the type approval requirements, the vehicle constitutes a serious risk to road safety, public health or the environment.

Product liability and recall

8 | Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability law

The European Product Liability Directive 85/374/EEC has been implemented in the Dutch Civil Code. A manufacturer is strictly liable for damages caused by a defect in his product. A product is defective when – in short, the product does not meet the expectations regarding product safety. The burden of proof rests on the consumer. He or she has to prove the existence of the damage, the defect and the causal relationship between the two. The consumer can claim damages up to three years as from the moment he or she has knowledge of the damage, the defect and the identity of the manufacturer. The right to compensation lapses 10 years after the day on which the product was brought into circulation. Next to the strict liability framework, a consumer can also bring a claim under contract or tort law.

If defects have been detected in vehicles, the manufacturer must notify the competent authorities, inform the consumers and recall the products. In some cases, such recall is geared towards repairing or replacing the defected product in the vehicle. In other cases, such recall may consist of a software update. These obligations are based on requirements of Directive 2001/95/EC. In this regard, the RDW is responsible for informing the public and for supervising the process. The RDW keeps a product recall register online that contains information about the product, the defect, the (possible) hazard and the required measures.

Class actions

In the Netherlands, there are three main collective redress mechanisms available for injured parties.

Dutch assignment model

Multiple injured parties (sometimes hundreds) assign their claim to a claim vehicle. The claim vehicle starts proceedings in the Netherlands against the defendants, thereby acting in its own name.

Collective settlement of mass damages claims on the basis of the Class Action (Financial Settlement) Act

Sometimes a party allegedly causing damages and an association or foundation representing the interests of a group of injured parties have concluded a collective settlement. Parties can request the Amsterdam Court of Appeal (by submitting a joint application) to declare this settlement binding on all injured parties falling within the scope of the settlement agreement. The injured parties can be either known or unknown and residing in the Netherlands or abroad. If interested parties do not want to be bound, they have the option to opt out.

Collective action on the basis of Mass Claim Settlement in Collective Actions Act

Until the end of 2019, a claim foundation or association could claim a declaratory judgment regarding liability on behalf of injured parties but could not claim damages. The Mass Claim Settlement in Collective Actions Act (WAMCA) entered into force on 1 January 2020. This new regime enables interest groups to file a lawsuit on behalf of the injured parties and claim damages directly. Another significant change under the WAMCA is the introduction of a system with an exclusive representative. An interest group must register a copy of the writ of summons to the central register for collective claims. Other interest groups can also file a writ of summons with the register within three months. After this, the judge will designate an exclusive representative who will act on behalf of all injured parties. After the designation, Dutch injured parties can opt out and foreign injured parties can opt in within one month. The WAMCA is currently being amended due to Directive (EU 2020/1828 on representative actions for the protection of the collective interests of consumers.

As a result of the *Dieselgate* incident, multiple claim foundations have been established. Volkswagen Car Claim foundation is, for example, litigating under the former legislation, whereas, Stichting Diesel Emissions Justice has issued several writs of summons and is litigating under the new legislation.

DISPUTES

Competition enforcement

9 | What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

In the previous update reference was made to proceedings initiated by two claimants (Stichting Tesla Claim and the Bios-groep) at the end of 2020. In these proceedings consumers and taxi drivers demanded compensation from car manufacturer Tesla. These two claims involving at least 220 claimants (Stichting Tesla Claim) respectively 70 claimants (Bios-groep) have been brought forward against Tesla. Tesla would not fulfil its promise that the cars manufactured by Tesla would be virtually maintenance free. The complaints are that, despite the promise of a virtually maintenance free car, they have never experienced more (maintenance) issues than they experienced with Tesla. The spokesperson of the Bios-groep states that, besides the maintenance malfunctions, also the aftersales service and support is below standards. Back in 2019, a group of four taxi drivers sued Tesla for similar reasons. They demanded the full repayment of the purchase price of the Tesla. The district court Midden-Nederland (29 July 2020, ECLI:NL:RBMNE:2020:2845) denied this claim on the basis that, among other things, the claimants failed

to prove that the maintenance issues already existed at the time of purchase. The claim of Stichting Tesla Claim against Tesla was, in line with the aforementioned judgment, rejected by the Dutch District Court in first instance. It is unclear whether Stichting Tesla Claim is appealing the judgment in first instance.

Furthermore, the Dutch Authority for Consumers and Markets (ACM) informed the Dutch automotive industry for electric chargers that more transparency is required regarding the prices for charging electric vehicles. At the beginning of 2020, members of the parliament suggested that a maximum price should be implemented. The Minister of Environment and Housing stated that (for now) no maximum price is necessary. The ACM is currently monitoring whether the operators of electric chargers are more transparent regarding the prices and encourage consumers to report any unclear display of prices.

The Dutch jurisdiction is a favourable jurisdiction for follow-on civil litigation for antitrust damage claims. Under Dutch law it is possible to start collective claims on the basis of an opt-out mechanism for Dutch customers (ie, a procedure in which a claim is brought on behalf of the entire class of potential claimants without the need for them to proactively choose to participate). One of the recent cases where follow-on civil litigation is present relates to the well-known *Dieselgate* case involving Volkswagen and more recently Daimler as well. Several claim vehicles represent different customers who seek compensation. The claim vehicles consist of ad hoc vehicles, but also established claim vehicles and representative bodies.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

No specific preference for litigation or arbitration has been observed in the Dutch automotive industry. If parties agreed on arbitration in their contract the Dutch courts will declare themselves not competent to hear the case. It is possible to request preliminary injunctions in the Dutch courts. Preliminary measures available in arbitration proceedings, if Dutch law is applicable and the parties chose to be bound to the arbitration rules of the Netherlands Arbitration Institute.

Claims for damages based on defected products developed and delivered by either the OEMs or the suppliers are common disputes (article 6:185 DCC et seq). Other common disputes are those in connection with the termination of the supply contract. Especially in light of the events in relation to covid-19, contractual disputes came up, more particularly on the question of whether contracts could be terminated or altered based on either force majeure clauses or unforeseen circumstances. If these are not included, parties are dependent on Dutch law and how it is interpreted. Whether parties may invoke the contractual or statutory provisions needs to be determined on a case-by-case basis.

Furthermore, the Dutch Franchise Act came into force on 1 January 2021. It is likely that distributors and dealers (and the respective representative associations) will initiate proceedings against the manufacturers to argue that their contracts fall within the scope of the (new) Dutch Franchise Act. If a contract falls within the scope of the Dutch Franchise Act, the position of the counterparty (eg, distributor and/or dealer) will be strengthened towards the position of the manufacturer. The Dutch Franchise Act includes provisions on information and compensation rights of the franchisee in relation to the franchise formula and on goodwill and the permitted non-compete clauses. The dealer associations of PSA initiated court proceedings against Stellantis Netherlands in relation to this new Dutch Franchise Act. The dealer associations argue that the dealer contracts fall within the scope of the Dutch Franchise Act and therefore the respective dealers can rely on the rights of a franchisee.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

First of all, the general rules of Dutch insolvency law also apply to the automotive industry. No specific provisions exist that allow for a different treatment of distressed suppliers in this industry.

Currently, the Dutch Bankruptcy Act (DBA) provides in three procedures for distressed suppliers. If a supplier foresees that it will become distressed it can request for suspension of payments. The suspension of payments aims to help debtors in financial distress to financially restructure their business and restart such business (post suspension of payments). The suspension of payments provides temporary financial relief, because it prohibits ordinary (unsecured) creditors from forcing the debtor to pay the claims when they fall due. Only the distressed supplier (debtor) may file for a suspension of payments.

In the case suspension of payments is requested too late or is not requested at all, creditors or distressed suppliers should request for a declaration of bankruptcy at the Dutch courts. The distressed supplier may be declared bankrupt at its own request or at request of its creditors. There are two criteria for such declaration of bankruptcy (article 6(3) DBA): the given circumstances summarily prove the debtor has ceased to pay its debts; and the claims of the creditors are summarily proven if the declaration is requested.

The second criterion includes a plurality requirement. A single creditor cannot request a declaration of bankruptcy. To that extent, if the debtor stopped paying a specific creditor, this creditor is considered to have other legal measures to get its claim paid. Therefore, a single creditor who is requesting for a bankruptcy of its debtor should accompany this request with supportive claims of at least one other creditor who has been left unpaid. The claims need to be sufficiently certain. If the debtor has reasonable grounds for disputing these claims, a declaration of bankruptcy will not be given. If the above-mentioned criteria are met, the distressed supplier will be declared bankrupt and a receiver (curator) will be appointed. The distressed supplier loses the power to dispose of its assets. This power is transferred to the receiver.

The third option came into force on 1 January 2021, the Dutch Act regarding Pre-Insolvency Restructuring Proceedings (WHOA). This new act allows debtors (or their creditors) to compromise certain debts and therefore prevent a possible insolvency. The new process, also referred to as the 'Dutch Scheme', is inspired by and based upon the experience of composition plans in the UK and the US. It will enable debtors to force dissenting creditors within the scope of the composition plan to comply with the plan, provided that the majority of the creditors have approved the composition plan.

A composition plan will only be approved by the court if it meets certain criteria, including that (1) the debtor is in financial distress, (2) it is reasonably expected that without the plan the debtor will become insolvent, and (3) the outcome of the composition plan is the avoidance of a possible bankruptcy of the debtor. However, the composition plan cannot put creditors in a substantially worse position than they would have been in on the debtor's bankruptcy.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The Netherlands is a frontrunner in developing technologies for the automotive industry. Its automotive industry ranges from original equipment manufacturers (OEMs) and component manufacturers to dealerships and commercial vehicle manufacturers. The companies

active in those areas seem to attribute great value to collaborations throughout the automotive sector.

Traditionally, disputes mostly related to the collaboration (eg, performance under distribution or supply agreements), confusion regarding the origin of the collaboration (eg, the distinction between a commercial dealer and a specialist in certain brand of cars) and origin of parts (eg, OEM versus non-OEM). The latter two types of disputes mostly involved the enforcement of trademark rights.

These days, the government in the Netherlands is actively endorsing the development of smart mobility solutions, such as electronic, autonomous, connected, shared vehicles that can be easily updated and upgraded to satisfy customer demand. For example, truck platooning (ie, a group of trucks travelling safely and automatically in convoy, a short distance apart) is high on the agenda to satisfy increased logistic demand in an environmental responsible way.

Smart mobility solutions require innovators to go beyond traditional boundaries and explore the integration of technology from other fields. For example, some manufacturers already use mobile networks to warn their own cars about congested roads or accidents. Future developments will include standardised technology such as low latency machine-to-machine communications, which makes it possible to share sensor data, control information to allow vehicles to drive in close formation, saving road space, and to exchange vehicle trajectories to prevent collisions.

In doing so, they rely on technology developed in the telecoms sector. This is an area where much patent litigation was seen in the Netherlands in recent years between network infrastructure developers and handheld manufacturers. These disputes related to patents covering standard essential technology (ie, common protocols to ensure interoperability among devices).

An increase of patent cases in the automotive industry is expected, for example, owing to the implementation of (standard essential) technology historically not linked to the automotive industry, such as the 4G and 5G telecom standards. While the telecom industry has developed best practices to negotiate fair, reasonable and non-discriminatory terms, it remains to be seen how this will work out in the automotive industry. For example, the business model of handheld manufacturers (ie, relatively low purchase price, high percentage of profit per device) appears to be quite different from car manufacturers (ie, relatively high purchase price, low percentage of profit per vehicle), which, no doubt, will have an impact on the licensing framework and related negotiations. The strategy traditionally seen in the automotive industry to collaborate could shift towards more aggressive strategies as seen in the telecom industry, in particular in issues involving non-practising entities having acquired intellectual property (IP) rights (also known as trolls).

The Netherlands provides several useful possibilities for an IP owner to successfully and quickly take action against infringements of IP rights. Especially, preliminary injunction proceedings and ex parte injunction requests provide exceptionally quick mechanisms for acting against infringements. Another important aspect is that courts in the Netherlands are prepared to grant an injunction even in the situation that no infringement has occurred yet, but there is serious threat thereto. Also, Dutch courts are, depending on the circumstances, prepared to grant cross-border injunctions.

The owners of IP rights can initiate preliminary injunction proceedings when becoming aware of an infringement, or a threatened or potential infringement, of their IP rights. Preliminary relief proceedings are available to get injunctive relief quickly. Provisions judges of district courts are sometimes willing to also grant ancillary orders, such as a recall, rectification, account of profits and an advance payment for the damages. There is an urgency requirement in preliminary injunction proceedings, but this requirement is often easily satisfied. There is no rule that the IP owner must bring preliminary injunction proceedings within a specific time frame, but the IP owner should act in a sufficiently expedited manner. A hearing in which both parties are heard usually takes place within a few weeks of service of the writ of summons and a decision is usually rendered two to four weeks later, thus making it often possible to obtain a preliminary injunction within six to eight weeks. In very urgent cases, a preliminary injunction can even be obtained in a matter of days. The provisions judge will render a decision on the basis of his or her preliminary findings and will normally issue a preliminary injunction if he or she is satisfied that the IP right is valid and infringed. Depending on the facts, the preliminary injunction may have cross-border effect. The party that is successful in the case will normally be awarded payment of reasonable costs that it has made in relation to the proceedings. Preliminary injunction proceedings should be followed in good time by proceedings on the merits. Otherwise, the preliminary injunction will lapse. A decision in preliminary injunction proceedings is normally provisionally enforceable notwithstanding appeal.

Ex parte measures are also available in the Netherlands. In very urgent matters, especially if there is a threat of irreparable harm for the IP owner, the IP owner can request the provisions judge to render an ex parte injunction. This is a preliminary injunction that is rendered by the provisions judge upon request of the IP owner without the alleged infringer being heard. The alleged infringer can protect him or herself against a possible ex parte injunction by submitting a protective letter with the district court of the relevant districts. Some, but not all, district courts in the Netherlands accept such protective letters.

Various types of seizures are also available to the owners of IP rights. One of the options is to file a petition to conduct a seizure for the surrender of infringing goods at the premises of the alleged infringer or elsewhere in the Netherlands. Another type of seizure that is available to the IP owner is the customs seizure with the customs authority in the Netherlands. If granted, the customs authority will undertake to search for infringing goods during its regular customs inspections and inform the applicant if infringing goods are found. If infringing goods are retained by the customs authority, the IP owner can examine the retained goods, confirm that the goods are infringing goods and decide whether he or she wants to have the infringing goods seized and destroyed in a simplified procedure or whether he wants the retention confirmed by initiating court proceedings. If no proceedings are timely initiated and no settlement is reached, the goods will be released. If the seized goods are declared by a court to be infringing goods, the customs authority can proceed to destroy the goods. Another attractive type of seizure is the seizure for the preservation of evidence. The petition for such a seizure is normally assessed and decided ex parte by the court. The evidentiary seizure is to be conducted by a civil bailiff who can, upon request, be accompanied by an independent expert (eg, a patent attorney or an IT expert). The evidence obtained can be in the form of actually seized goods, documents, materials or machinery, or a detailed description or sampling thereof. It should be noted that preserving evidence and getting access to the preserved evidence is a two-stage process. Once the evidentiary seizure has been made, the party levying the seizure must file a claim with the court for the inspection of the preserved evidence. Evidentiary seizures can, inter alia, be made against companies established in the Netherlands that infringe an IP right abroad, for the purpose of submitting the evidence in proceedings abroad. Seizures can also be conducted against foreign companies if the alleged infringing goods are located in the Netherlands. Alleged infringers of IP rights can protect themselves against a potential evidentiary seizure by filing a protective letter, as outlined above.

The owners of IP rights can also initiate proceedings on the merits, in which definitive relief can be obtained. In proceedings on the merits, is usually takes 12 to 18 months after service of the writ of summons before a decision is rendered. Besides a permanent injunction, the owner of IP rights can also obtain ancillary orders, such as declaratory judgment, recall

of infringing products, rectification, information with respect to distribution channels, account of profits, destruction of infringing goods or materials for the production of infringing goods, publication of the decision, payment of damages or surrender of profits and payment of reasonable legal costs. In exceptional situations, courts are sometimes prepared to grant a moratorium (ie, an order for an infringer to refrain from dealing in the infringing product for a certain period of time after expiry of the IP right), to prevent the infringer from benefiting from the infringement.

The District Court of The Hague, the competent court in patent cases in the Netherlands, has a special accelerated regime in patent cases. In such accelerated proceedings on the merits, the District Court sets a time schedule for serving the writ of summons, the filing of the pleadings and the date of the oral hearing. Several weeks after the hearing, a decision will be rendered and a decision is usually obtained within nine to 12 months of the date of service of the writ of summons.

The importance of trade secrets is also recognised, also during legal proceedings. For example, the Netherlands has implemented the European Trade Secrets Directive, which not only ensures the effective protection of trade secrets in the field but also enables the use of confidentiality clubs (ie, a mechanism to rely on confidential information without jeopardising the confidential nature of the information) during legal proceedings. Practice shows that confidentiality clubs are not only used in trade secret cases but also in other cases in relation to IP rights.

Finally, alternative dispute resolution is also available to easily resolve IP disputes, such as arbitration or mediation.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

The Netherlands is acquainted with trade unions and work councils. In fact, both trade unions and works councils play an important role in Dutch labour law.

Trade unions and works councils have different rights pursuant to Dutch (labour) law. The major differences are as follows.

Trade unions

First of all, employers are, in principle, obliged to comply with collective labour agreements that they have made with the unions that are party to the collective labour agreement. A trade union that is a party to a collective labour agreement can, as a contracting party, on its own behalf demand compliance with the obligations as set out in the collective labour agreement. Employers that are not members of an employer's organisation are not (automatically) affected by a collective labour agreement. From a legal point of view, they fully retain their freedom to act. This will only change if a collective labour agreement is declared generally binding. In this case, the relevant collective labour agreement will be mandatory for all employees and employers in the relevant industry, regardless of whether or not they are members of one of the parties to the collective labour agreement.

Moreover, it is possible that a company concludes its own company collective labour agreement and requests dispensation at the Ministry of Social Affairs and Employment from the mandatory application of the collective labour agreement.

One of the most important collective labour agreements that applies in the automotive industry is the collective labour agreement for the metals and electrical engineering sector (1 December 2020 until 30 November 2023). This collective labour agreement has (not yet) been declared generally binding for this period, but has mostly been declared generally binding in the past.

In addition, trade unions play a special role in the context of collective redundancies. An employer that intends to terminate the employment contracts of at least 20 employees, working in one working area, at one or more times within a period of three months, must notify the concerned trade unions and the Employee Insurance Agency in writing for timely consultation (article 3, paragraph 1 WMCO). The consultation should at least concern the possibilities of preventing or reducing the number of collective redundancies and of the possibility of mitigating their consequences by taking social counselling measures (WMCO article 3, paragraph 2).

Trade unions can also play a role in the context of mergers and acquisitions. Pursuant to the Social and Economic Council (SER) Merger Code of Conduct, trade unions must be informed in time about the merger or acquisition plans by the companies or organisations involved. The trade unions must still be able to exert a substantial influence on the consequences for the workers involved. In principle, the SER Merger Code of Conduct applies to companies established in the Netherlands in which 50 or more persons are working and to companies involved in a merger or acquisition that are part of a group of companies when 50 or more persons work together in the companies established in the Netherlands.

The SER Merger Code of Conduct may also be declared applicable to other companies by a collective labour agreement.

Collective actions (initiated by trade unions) are also not uncommon in the automotive industry. A collective action can (partially) be prohibited by an employer, if this is from a social perspective urgently necessary. The following factors play a role in this assessment:

- the nature and duration of the action;
- the proportion of the action and its intended purpose;
- the nature of damages to the employer or other third parties as a consequence of the action; and
- whether the action is used as the last resort and whether there has been a timely notification.

VDL, for example, successfully prevented a strike initiated by the trade unions in 2019, because of the risk that BMW would terminate the contractual relationship as a consequence of the planned strike (Court of Maastricht, 9 January 2019, ECLI:NL:RBLIM:2019:381).

Works councils

Works councils have various rights under the Dutch Works Council Act (WOR). Special rights that Dutch law grants to a works council are advisory rights and rights of assent.

Pursuant to article 25 of WOR, the works council has an advisory right with regard to a number of decisions that can have major consequences for employees. Examples include decisions relating to restructuring, mergers and acquisitions and major investments. Unless the entrepreneur's decision is in accordance with the advice of the works council, the entrepreneur is obliged to suspend the implementation of the decision until one month after the day on which the works council was notified of the decision. The works council can lodge an appeal with the Chamber of Enterprise in Amsterdam within these 30 days. The Chamber of enterprise assesses whether the decision made is reasonable.

The works council has a right of assent with regard to establishing, changing or withdrawing personnel regulations (WOR article 27), such as regulations for working hours, working conditions, training, performance reviews and sick leave. Consent is not required if the matter in question has already been arranged in a collective labour agreement or a working conditions regulation established by a public law body (WOR article 27, paragraph 3). If the entrepreneur has not yet obtained an approval from the works council for the intended decision, he or she can ask the sub-district judge authority to take the decision. The latter

will only grant permission if the works council's decision not to give consent is unreasonable, or if the intended decision of the entrepreneur is required for compelling business-organisational, business-economic or business-social reasons (WOR article 27, paragraph 4).

Other rights that are granted to works councils are: the right to a consultation meeting with the entrepreneur (WOR articles 23 and 24), the right of initiative (WOR article 23, paragraph 3), the right to education (WOR article 18), the right to information (article 31 WOR) and the right to expense allowance (WOR article 22). The Works Council also has a right of advice in the event of a proposed decision to appoint or dismiss a director of the entrepreneur (WOR article 30).

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

The Netherlands is widely recognised for its readiness for automated and autonomous driving. One of the latest major developments is that the Netherlands enacted the 'Experimental Law on Self-driving Vehicles'. This new legislation enables it to conduct public road tests involving self-driving vehicles.

The Netherlands has already allowed vehicles with automated functions on the road for quite some time. These automated functions include driver aids such as adaptive cruise control, automatic parking and lane-keeping systems. Also, large-scale testing was already allowed for self-driving vehicles on Dutch public roads, thus allowing field operational tests with automated driving on all public roads in the Netherlands provided that a driver is present in the vehicle.

The Experimental Law on Self-driving Vehicles brings the development of autonomous vehicles to the next level. It enables driverless vehicle experiments with automated driving systems in traffic without having to have an actual driver inside the vehicle. Supervision by a human takes place remotely (ie, outside the vehicle). For example, experiments can include remotely operated self-driving minibuses and moving motorway roadblocks with remote drivers.

Experiments in relation to truck platooning are high on the agenda. The goal is to accelerate the development of truck platooning by implementing platooning into real-life logistics operations for different use cases running at different participating companies. According to the government, the outcomes of these experiments will be used to review current legislation whether it sufficiently accommodates the cars and transport of the future.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

The Dutch government indicates that the Netherlands 'is paving the way for the traffic management system of the future. A future in which vehicles communicate with one another and with roadside systems'. This endorsement quite clearly expresses the ambitions of the Netherlands on intelligent transport systems and smart mobility.

The Netherlands is a unique testing ground for smart mobility solutions. The government is supporting the development of smart mobility solutions in many ways, from providing testing facilities to adjusting rules and regulations.

Road traffic is highly regulated in the Netherlands and elsewhere throughout Europe. The Netherlands recognises that harmonisation of the legal framework for an automated and autonomous vehicle is of vital importance to mitigate the risks for all traffic users in public spaces and to achieve a joint development approach. The Netherlands recognises the importance of harmonising the legal framework for testing and placing automated and autonomous vehicles into the market. Key legislative areas include road safety, liability issues, data processing and protection, and infrastructure. In addition, also ethical questions regarding artificial intelligence are recognised, such as respect for human dignity and freedom of choice by self-driving vehicles.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

Due to the global coronavirus pandemic and all covid-19 related effects such as, among other things, the subsequent lockdowns, production and assembly lines halts or slowdowns, disruptions in supply chains, the scarcity of semiconductors, increasing inflation and the war in Ukraine, the automotive industry sector has been continuously facing substantial challenges since 2020, which will probably continue into 2022.

Despite the challenging market conditions, the automotive industry sector remains one of the key drivers of Polish industry, and automotive manufacturing is one of Poland's largest industrial sectors accounting for, depending on sources, approximately 9–10 per cent of the total value of the country's production (in recent years). In terms of production sale value, automotive manufacturing ranks second after food manufacturing, surpassing all other manufacturing industry sectors, as well as many important industry branches such as mining and quarrying, energy, oil and utilities. In the recent pre-pandemic years, the growth in Poland's automotive production has mostly been driven by extensive investment outlays. Among the many factors that make this sector attractive for investment are the qualified workforce, the number of offered business-incentives and the support for hiring particular employees in Poland.

Polish automotive manufacturing is almost entirely export-oriented; therefore, the sector's shape depends heavily on the economic situation of foreign markets.

In the first three quarters of 2021, the export value of the Polish automotive industry amounted to €23.93 billion (compared to €28.58 billion throughout 2020.

In 2021, Germany was Poland's main export market (making up 34.22 per cent of the Polish automotive industry's total exports). Other key export markets in 2021 were France (7.28 per cent), Italy (6.66 per cent) and the Czech Republic (5.74 per cent).

For many years, parts and accessories, along with passenger and cargo-passenger vehicles, have been the most important export sub-sectors in the Polish automotive industry. In addition to parts and accessories, passenger and cargo-passenger cars are the second largest export sub-sector in the Polish automotive industry. In 2020, the export of lithium-ion batteries (as used in electric cars) increased greatly and amounted to €3.99 billion, almost twice as much as in 2019.

With respect to the Polish internal market, approximately 446,600 passenger cars were registered in 2021 (428,300 in 2020).

There are currently a number of regulations in Poland that are being implemented aimed at stimulating the growth of electromobility. These regulations introduce new definitions for the terms associated with vehicles and their infrastructure, and determine the general principles guiding the usage of alternative fuels in transport, as well as introducing incentives for vehicles using these alternative fuels. The trend for developing alternative fuel vehicles has already been seen on the market, but still, in relation to other European countries, the number of electric vehicles in Poland remains considerably lower.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The regulatory framework applicable in Poland comes from EU legislation.

Type approval

The general system for type approval in Poland is set out in the Act on Road Traffic of 20 June 1997, and in the Decree of the Minister of Transport, Construction, and Maritime Economy of 25 March 2013 on the approval of motor vehicles and their trailers, and of the systems, components and separate technical units intended for these vehicles. The above Acts implement Directive 2007/46/EC of 5 September 2007 and follow its provisions.

The Act on Road Traffic sets out the general system for EU-type and UN/ECE approval. The Decree contains administrative provisions, samples of required documents and the general technical requirements for the approval of all new motor vehicles and their trailers, and of the systems, components and separate technical units intended for these vehicles. It sets out the procedures that need to be followed in order to obtain approval.

The Act on Road Traffic (article 70d) imposes the obligation on original equipment manufacturers (OEM) of any new type of vehicle, component, or separate technical unit to obtain approval before placing a product on the market. An OEM is exempted from the need to obtain approval under Polish law if this approval has already been granted by the relevant authority of another member state and has been accepted by the Polish authorities.

According to article 70d, an OEM is responsible for all aspects of the approval process and for the conformity of production, regardless of whether the OEM directly participates in all of the production stages of the vehicle, component, or separate technical unit.

Apart from the technical requirements stemming from Polish law, an OEM should also comply with the directly applicable EU law

regulations, namely Regulation (EC) 715/2007 on the type approval for motor vehicles with respect to emissions ranging from light passenger to commercial vehicles (Euro 5 and Euro 6), as well as on the access to vehicle repair and maintenance information, and Regulation (EC) No. 661/2009 of the European Parliament and of the Council of 13 July 2009 concerning the type approval requirements for the general safety of motor vehicles, their trailers and the systems, components and separate technical units. An exhaustive list of EU documents applicable to EU type approval is provided in Annex II to the Regulation (EU) 2018/858 of the European Parliament and of the Council on the approval and market surveillance of motor vehicles and their trailers, and of the systems, components and separate technical units intended for these vehicles.

The approval is granted by the Polish authorities once the vehicle, component or separate technical unit concerned complies with all the applicable provisions mentioned above. The approval is granted by the Director of Transportation Technical Supervision.

Registration requirements

Purchasers of new and used vehicles have the obligation to register said vehicles within 30 days of purchase. Breach of this obligation can entail a fine of approximately €250. This obligation also pertains to distributors (dealers) with respect to the vehicles used by them for demonstration purposes (on the contrary, no registration obligation exists for vehicles remaining in a dealer's stock).

According to article 72 of the Act on Road Traffic, registration requires, among other things, the vehicle's compliance with an approved type. For EU type-approved vehicles this is confirmed by the certificate of conformity. According to article 70(s) of the Act on Road Traffic, an OEM must provide each vehicle that belongs to an approved type with a certificate proving its conformity.

Insurance requirements

Directive 2009/103/EC of 16 September 2009 relating to insurances against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against this liability is essentially transposed in the Polish Act of 22 May 2003 on Compulsory Insurance, the Insurance Guarantee Fund and the Polish Motor Insurers' Bureau.

According to article 23 of this Act, vehicle owners have the obligation to insure their vehicles.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The structure of development, manufacturing and supply in the Polish automotive sector is similar to that in other European countries since OEMs are global businesses. OEMs use a supply chain structure including Tier 1 suppliers (which supply directly to the OEMs), Tier 2 suppliers (which supply Tier 1 suppliers), Tier 3 suppliers, and so on. Supply relationships are often based on the application of an OEM's general terms and conditions. Development and design are generally carried out internally; however, cooperation and partnership agreements between OEMs have recently been observed in relation to new technologies.

The usual contractual arrangements include agreements between OEMs and auto parts manufacturers (supply agreements), agreements between OEMs and local importers or distributors (importer, distribution or commission agreements), and agreements between local importers or distributors and dealers (dealership agreements). Financing agreements with banks that act as an OEM's subsidiary providing financial support for local importers or distributors and dealers are also common.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

New vehicles are usually distributed by dealers acting on the basis of written contracts with local importers or distributors that are subsidiaries of OEMs (as a rule) or are independent (in a few cases). The market of second-hand vehicles is not controlled by OEMs, importers or distributors.

There is no specific legislation enacted in Poland in relation to importers, distributors, dealers or dealer networks. The general provisions of Polish anti-monopoly and contract law apply in this respect, in particular, the provisions of the Polish Civil Code relating to sales and supply. Moreover, EU legislation is also relevant, in particular, Regulations Nos. 330/2010 and 461/2010, and Supplementary Commission Guideline No. 2010/C 138/05.

Issues relating to restructuring and termination are, as a rule, regulated by the parties at the contractual level. In the case of a lack of specific contractual clauses, the general provisions of Polish civil law apply.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Generally, there are no specific issues for M&A or JV transactions relating to the automotive industry in Poland in comparison to transactions in the automotive industry in other European countries. The most important areas that should be investigated and covered in the transaction documentation include the contractual relationships with distributors, dealers and suppliers, employment issues, environmental issues, real estate, subsidies, intellectual property rights and compliance or regulatory issues. Owing to recently introduced legislation, it needs to be verified whether the automotive entity owns any agricultural real estate since in this situation, depending on the type of transaction, the National Centre of Agricultural Support will have a pre-emption right to the real estate or shares in the company. It also needs to be confirmed whether the transaction is subject to merger control by the European Commission, the Competition Authority or an authority from any other EU member state. Last, but not least, it also needs to be verified whether the new regulations on foreign investments in Poland adopted to protect the domestic market against hostile acquisition by entities taking advantage of the covid-19 outbreak do not apply to the transaction.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no specific incentives for investments in the automotive market in Poland. However, potential investors in the automotive sector might take advantage of various forms of public support. These are as follows.

- Obtaining tax exemption (corporate income tax (CIT) or personal income tax (PIT)): this aid is intended for companies carrying out new investments on publicly as well as privately owned properties. The new investment might take the form of the establishing of a

new enterprise, increasing the production capacity of an existing enterprise, diversifying the production of an existing enterprise through the introduction of products that previously were not manufactured in this enterprise, or fundamentally changing the production process of the existing enterprise. The decision on granting support is issued upon the entrepreneur's request by the management of a special economic zone (acting on behalf of the Minister of Development) for a definite period of time (no shorter than 10 years and no longer than 15 years). To obtain a tax exemption, the entrepreneur must meet certain quantitative and qualitative criteria. The maximum amount of state aid in the form of CIT or PIT tax relief is determined on the basis of the regional aid map for 2021–2027 and varies from 10 to 50 per cent. Support for medium-sized and small or micro enterprises is increased by 10 and 20 percentage points respectively. The tax exemption is only applicable to income generated from business activities carried out as part of an investment covered by the support decision. Therefore, if the entrepreneur simultaneously conducts activities that are not covered by the support decision, then the supported activities must be organisationally separated, and the level of exemption should be determined on the basis of the data (revenues and costs) of the separated activity. The above mechanism is relatively new (the law was adopted in May 2018) and aims to replace the aid for establishing a business within the territory of a special economic zone (the aid granted to investors within the old special economic zones will remain in force until 2026).

- Obtaining a real estate tax exemption: this aid can be granted by a municipal council. The local authority can, by way of a resolution, decide to exempt an entrepreneur investing in its territory from real estate tax. This aid has an automatic character (ie, an entrepreneur is automatically entitled to exemption after fulfilling the conditions set out in the resolution of the municipal council). This aid is considered to be public aid falling under the scope of the de minimis Regulation. Therefore, this aid should not exceed €200,000 over a period of three financial years.
- Obtaining support for research and development (R&D) initiatives: since 1 January 2016, entrepreneurs can benefit from additional tax relief for R&D activities, by granting an additional deduction from the tax base of part of the expenses incurred on R&D activities, previously already included in the tax deductible costs.
- Obtaining grants for investments of 'strategic importance' for the Polish economy: investors creating new jobs in business services centres and the research and development centres in Poland can apply for a cash grant from the state budget for each new job created. In addition, investors rolling out new investments meeting the criteria of a 'strategic investment', 'innovative investment' or an investment in an R&D Centre can benefit from cash grants amounting from 5 per cent of the investments costs (for investors that are large enterprises) up to as much as 25 per cent of the investment costs (for investors that are still developing, medium-sized enterprises, or small or micro enterprises).

There are no specific barriers to entry to the automotive market in Poland. However, Polish automotive manufacturing is almost entirely export-oriented. As a result, it is heavily dependent on the situation in foreign markets, which tends to make it more vulnerable to any potential changes in these markets (mainly western European countries).

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The most relevant regulations concerning safety and environmental issues at the EU level are Regulation (EU) 2018/858, Regulation (EC) 661/2009 and Regulation (EC) 715/2007. Polish law generally follows the EU legislation and sets out the procedural rules required for the enforcement of these provisions. However, the Polish government announced that it is working on a new law specifically dedicated to the systems of approvals for vehicles and their equipment, in order to fully align the Polish legal regime with the requirements of the above-mentioned EU Regulations (in particular Regulation (EU) 2018/858). The draft of this new law is due to be published and is subject to public consultations in mid-2022.

Additionally, automotive-related products are covered by the general system applicable to product safety as set out in Product Safety Directive 2001/95/EC and implemented into Polish law by the Act of 12 December 2003 on the General Safety of Products. The provisions of this Act are only applicable to those products that are intended for use by consumers.

According to the Act of Road Traffic, which complies with the relevant EU provisions:

- the Director of Transportation Technical Supervision can refuse to grant EU-type approval if it finds that a vehicle, component or separate technical unit, although in compliance with the required prescriptions, presents a serious risk to road safety or seriously harms the environment or public health (article 70p(3)); and
- the Director of Transportation Technical Supervision can revoke the EU-type approval granted in Poland (upon a prior demand to the manufacturer to remedy a non-compliance) if an inspection shows the non-conformity of the production of the vehicle, component or separate technical unit, or the installation of a liquefied petroleum gas system with the required standards (article 70r). The Director of Transportation Technical Supervision can initiate an inspection if it obtains information on any non-conformity (article 70w).

As far as the obligations of an original equipment manufacturer (OEMs) to which EU type approval has been granted are concerned, the OEM must immediately inform the Director of Transportation Technical Supervision if it discovers that a vehicle could cause road safety danger or damage to the environment (article 70u). The OEM must additionally undertake actions required to remove this danger or damage. To remove the danger or damage, the OEM must prepare a schedule of planned corrective actions, agree on a plan with the Director of Transportation Technical Supervision and inform the owner of the vehicle about the necessity to inspect the vehicle. The costs of any corrective actions are covered by the OEM.

Apart from the requirements stemming from the specific provisions applicable to car manufacturers, OEMs are covered by the general system on product safety. An OEM is obliged to immediately inform the Polish Competition Authority as soon as it has obtained information that a car is unsafe. Failure to fulfil this obligation can result in a financial penalty imposed on the OEM of up to 100,000 zlotys.

The Polish Competition Authority will initiate proceedings and decide on a case-by-case basis as to what steps should be taken towards a specific product. Before issuing a final decision, the Polish Competition Authority might render a temporary decision in which it prohibits the further supply of the product (for a maximum of 90 days),

until a final decision has been reached. This decision can only be issued if the initial assessment provides grounds for a claim that the product might be unsafe.

If, in its final decision, the Polish Competition Authority claims that a product is unsafe, it can order a specific corrective action (eg, a recall, or an obligation to inform consumers on the possible dangers caused by the product). In general, it is advisable for the manufacturer to cooperate with the Polish Competition Authority within the proceedings and propose specific corrective actions to mitigate any potential legal or financial risk.

In the second quarter of 2017, the Polish Competition Authority conducted a broad inspection of the components and separate technical units available on the Polish market. The objective was to determine whether the products possessed the required approval certificates. The inspection revealed that the majority of products had the appropriate certificate, and only 3 per cent of the products were questioned by the Polish Competition Authority.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Depending on the circumstances of a given claim, product liability claims can be pursued as contractual or pursued under the tort law system (which also includes the strict dangerous product rules).

Contractual claims encompass all of an OEM or supplier's potential breaches of an agreement (in terms of product quality), as well as any customer's warranty claims. A violation of an agreement claim is usually aimed at a payment relief, whereas a warranty allows for a wider scope of remedies: the customer might demand to have the vehicle part rectified or replaced, to have the product price reduced, or to withdraw from the agreement and claim back what has already been paid.

The tort law, in turn, allows for an OEM or a supplier to be held liable regardless of whether any agreement is in force. As a rule, the general tort liability requires the customer to demonstrate that the OEM's or supplier's actions leading to the damage were intentional or, at least, accidental, but still attributable to it. Therefore, a more favourable solution for a person (usually a consumer) harmed by a product is to seek damages under the strict Polish dangerous product rules.

Under this system, an OEM (or a supplier should the OEM, as a producer, be unidentified for any reason) can be sued if the product does not reach the level of safety expected from this product. The claimant can win the case even though the damage occurred for reasons not attributable to the OEM or supplier. Basically, the OEM or supplier can be released from liability only if the unsafe features of a product were revealed just after it was placed on the market (unless they resulted from features previously inherent in the product), or if the unsafe features could not have been foreseen at that time in light of scientific or technical knowledge.

The amount of damages for personal injuries that can be sought in accordance with these strict dangerous product rules is unlimited. In turn, compensation for damage to property can only be awarded if the destroyed or damaged property is ordinarily intended for personal use, and the total actual loss exceeds €500 (this sum cannot include damage to the vehicle part itself, or any benefits the party could have gained in connection with its use). Liability under this Polish strict dangerous product liability law cannot be contractually excluded or limited.

Polish law allows that basically all product liability claims can be pursued through class action proceedings if they have been raised by at least 10 people. The sought claims need to be of the same kind and be based on the same or identical facts. Group proceedings, however, are not commonly recognised in Poland as a normal means to claim damages within the automotive industry. There have been very few such class action cases in Poland, mostly unrelated to product liability. The largest class action in the automotive industry in Poland are the ongoing proceedings against Volkswagen. The action was dismissed for lack of domestic jurisdiction, since the courts of the first and second instance ruled that the manufacturer should be sued in Germany. However, the case is now pending before the Supreme Court, and its decision could be contingent on the Court of Justice of the European Union's ruling. According to this ruling, consumers would not be obliged to sue the manufacturer in Germany, but would be able to sue the corporation in national courts instead. In the case of a favourable ruling for consumers, we can expect an increase of importance of class action in litigation in the automotive industry.

Concerning recalls, while the automotive industry is not one that is highly affected in Poland, it does raise certain concerns and the number of notifications is increasing. While in 2020 only about 4 per cent of all the alerts registered in the Rapid Alert System referring to Poland concerned the automotive industry, in 2021 this rate rose to approximately 13 per cent. Therefore, product recall cases might be considered as relevant in the context of the automotive sector.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

In the past, the Polish Competition Authority's main focus within the automotive industry was purely concerned with consumer issues (specifically relating to product safety). However, recent developments suggest that this particular sector has now become one of its priorities when it comes to competition law enforcement. In 2019 and in the first half of 2020, the Polish Competition Authority instigated three proceedings pertaining to arrangements made between the distributors of trucks in Poland. In 2022, the Authority issued two decisions against the dealers of DAF's trucks for illegal market sharing, price-fixing and bid rigging. The total value of fines imposed in these two decisions amounted to approximately 110 million zlotys. In addition, separate fines (between approximately 13,000 zlotys and 500,000 zlotys) were imposed on seven managers who the Authority found to be personally responsible for this breach of competition law rules. In addition to this, in 2021 the Authority raided the offices of four dealers of KIA cars under the suspicion of market sharing, price-fixing and bid rigging. This case is currently still pending before the Authority.

When it comes to the private enforcement of competition law, damage claims are, as of yet, still quite uncommon in Poland. However, this situation is slowly changing and the follow-on claims related to the European Commission's decision concerning truck makers (decision AT.39824 – Trucks, dated 27 September 2017) could change the situation in this respect. Polish companies that might have suffered losses as a result of this alleged cartel are currently bringing follow-on claims, often by joining class action lawsuits, before the German or Dutch courts.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Disputes in the automotive industry concern antitrust, automotive finance, intellectual property or insolvency matters. A significant part of the disputes in the automotive industry arises regularly along the supply chain. Supply chain disputes in the automotive industry sector usually result from the following situations:

- customers' claims for damages based on defects of the product developed and delivered by the supplier, including warranty claims, claims for damages based on disruption of the supply chain, or claims for compensation for late delivery;
- OEMs or suppliers' claims for payments; and
- claims relating to the termination of a supply contract that involve, among other issues, the termination rights and duties to compensate a supplier for frustrated investments.

The aforementioned contentious matters usually arise out of B2B relations. They concentrate on demonstrating whether a particular irregularity has indeed occurred, and to which party the irregularity can, in the end, be attributed.

Mediation or negotiation in these types of cases is not usually a common solution. These matters relatively often go to arbitration; however, many entrepreneurs still prefer to resolve their disputes before the state courts. Claimants usually seek monetary claims. Unlike in certain other jurisdictions, in the Polish system it is not possible to enforce the continuation of supply. Therefore, it is highly recommended that, in the course of the contract negotiations, customers should ensure that an adequate contractual penalty for any increasing delay is determined in order to discourage OEMs or suppliers from any supply disruptions.

In addition to the types of disputes specific to B2B relations mentioned above, litigation matters also involve claims pursued under product liability rules; however, they do not normally refer directly to B2B relations and are usually brought by ultimate consumers. Defective products can trigger liability for the OEM (or a supplier should the OEM, as the producer, be unidentified for any reason). This can be pursued under general Polish tort law or under the Polish product liability rules which are more favourable for the injured party. These product liability litigation cases are resolved before the Polish state courts.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

Suppliers facing a lack of financial liquidity usually request relatively high advances and afterwards delay delivery of the ordered parts. These warning signs should encourage customers to thoroughly verify a contractor's financial condition. This can be done by checking the company's financial statements that are publicly available, checking the public registers of debtors, or even checking information in the media. The results of these examinations can provide grounds to consider actions that could protect the customer from any potential losses. This can mean the renegotiation or even the termination of a contract and the transfer of the supply relationship to a second source. It is critical, however, that these undertakings be first consulted with a lawyer who will point out the risks related to their potential subsequent ineffectiveness, especially in the face of possible bankruptcy proceedings.

A distressed supplier might have no choice but to launch a court-directed restructuring process or commence bankruptcy proceedings. The goal of the former option is to allow for the further operation of the company thanks to arrangements with its creditors, as opposed to the latter option, which aims at the liquidation of the company. In both cases, the contractual position of customers significantly differs from that which results from the concluded contract.

In the case of a restructuring processes, the supplier offers arrangement propositions. These might include different solutions in order to restructure its position. The distressed supplier might propose the postponement of the delivery date, earlier payments or (higher) advances, a reduction in the quality of the product, or limits to the warranty or guarantee claims. Ultimately, any arrangement propositions are voted on by the council of creditors.

In turn, in the case of a bankruptcy, as of the day of the declaration of bankruptcy, the supplier's obligation to deliver the ordered products automatically becomes a cash debt. The customer is then entitled to submit its claim (if any) in the course of the bankruptcy proceedings. If it is acknowledged, the claim is satisfied from the bankruptcy estate proportionately with the other claims falling under the same category. The decision as to whether the claim is justified is firstly vested in the bankruptcy receiver who examines its grounds. The decision is subject to challenge, which is resolved by a judge-commissioner and, finally, by a bankruptcy court. It happens less often that, instead of making the supplier's obligation a cash debt, the bankruptcy receiver decides to continue to perform the obligation, and to serve the ordered part in exchange for remuneration.

Under Polish law, contractual provisions allowing a customer to revise or to terminate a contract in the event of a supplier's bankruptcy or restructuring process is invalid. Additionally, in these cases, any obtained security can also be considered ineffective even if it had been granted by the distressed supplier within the previous few months. Therefore, it is advisable that any risky contract should be specifically protected by, for example, a bank guarantee issued by the parent company.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

In recent years, automobile manufacturers' interest in intellectual property (IP) in Poland has focused mainly on trademarks. Most of the cases are those between automobile manufacturers and unauthorised distributors, or between OEMs and producers of spare parts. Disputes connected to other IP rights, such as patents, designs or copyrights, are still rare.

IP is well protected under Polish law. National laws contain comprehensive provisions concerning copyrights as well as industrial property rights such as trademarks, patents, industrial designs and utility models. Polish law also stipulates the rules for fair competition that are relevant for the protection of IP and are often used to support claims concerning the infringement of these rights. Since Poland is a member state of the European Union, European Regulations on EU trademarks and Community design are directly applicable.

Since July 2020, IP matters have been heard by IP courts, that is, separate chambers in civil courts dealing solely with IP issues. There are five district IP courts (in Warsaw, Katowice, Poznań, Gdańsk and Lublin) and two appeal IP courts (in Warsaw and Katowice). The district court in Warsaw has exclusive jurisdiction to hear cases concerning, among other things, computer programs, inventions, unity models and business secrets of a technical nature. In 2020, Poland also introduced new rules of proceedings in IP matters, including separate rules for securing evidence and the request for providing information. Oppositions and cancellation matters are generally heard by the Patent

Office of the Republic of Poland in the first instance and can be appealed to the administrative courts.

Proceedings before courts and the Patent Office last approximately one year in each instance. In a significant number of disputes between automobile manufacturers and IP infringers in Poland, it is possible to reach out-of-court settlements, mostly owing to the small size and lack of bargaining power of the infringers.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

There are no specific automotive sector labour regulations in Poland. The minimum labour standards are laid down in the Labour Code, which specifies the rights and duties of the parties to an employment relationship irrespective of the industry or sector. Some of the most important aspects of Polish labour law are:

- national minimum wage (in 2022 this is 3,010 zlotys gross per month, in the case of a full-time employee);
- minimum standards of sick pay, annual holiday leave and statutory notice periods;
- minimum standards of working time (the working period cannot exceed, in general, 40 hours per week, within a five-day working week);
- obligatory social security insurance (health, sickness, pension and disability); and
- minimum statutory severance payments due in the case of redundancies.

Employers are obliged to implement employee capital plans (Pracownicze Plany Kapitałowe) that are an additional system for collecting pension savings for employees; however, employees can opt out. The statutory contributions for PPK amount to: (1) 2 per cent of the employee's gross remuneration – financed by the employee, and (2) 1.5 per cent of the gross remuneration of an employee – financed by the employer.

In Poland, work can be provided under an employment contract or a 'civil law contract'. Civil law contracts are not regulated by the Labour Code and are more flexible than employment contracts. They include contracts of mandate where an employer wishes to hire a worker to perform a particular action without entering into an employment contract, or contracts for specific work that are structured around and remunerated for the completion of this specific work. The provisions of the Polish Labour Code do not apply to persons employed under civil law agreements (eg, contracts of mandate, contracts for specific work or managerial contracts, etc) since they are legally not considered to be employees. However, Polish law guarantees them the national minimum wage (in 2022 this is 19.70 zlotys gross per hour).

The automotive industry commonly uses external personnel employed by temporary work agencies. Temporary personnel cannot be employed in the same company for more than 18 months and their employment terms and conditions cannot be less favourable than those of employees employed directly by the company.

The automotive sector is quite unionised in Poland. Trade unions are voluntary and self-governing organisations of individuals who provide paid work. Apart from employees hired under employment contracts, the individuals who provide paid work on a civil law basis also have the right to create and join trade unions and to benefit from certain trade union privileges. Trade unions are founded to represent and protect employees' rights, as well as their professional and social interests. Trade unions also have the right to conduct collective negotiations and enter into collective labour agreements. In addition to trade unions, in companies with more than 50 employees, employees have the right to establish a works council. Employers are obliged to inform the works council about the economic activity of the company and any expected changes in the employment situation or organisation of the work. A work council can issue its own regulations, resolutions, standpoints and opinions.

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NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

One of the most important developments concerning automotive technological and mobility advances is an amendment to the Polish Act on Road Traffic, which introduces a legal basis for testing autonomous cars on public roads in Poland. The amendment, which came into force in February 2018, contains a definition of an autonomous vehicle – a car equipped with systems controlling its movement and enabling its movement without the intervention of a driver, who remains able to take control of the vehicle at any time.

Testing autonomous vehicles in road traffic on public roads, in particular for the use of autonomous vehicles in collective transport and the implementation of other public tasks, is possible provided that the safety requirements have been met and a permit for carrying out these tests has been granted. The permit is issued by way of a decision by the traffic management body on the road where the tests are to be conducted.

Poland is considering introducing further changes to this law that would allow for the development of autonomous driving. However, works on these changes are at a preliminary stage.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

The most significant legal development for the automotive industry in Poland is the entry into force of a new emission standard – Euro 6D ISC-FCM – in the territory of the EU on 1 January 2021. The emission standard replaces the temporary standard that has been in force since 2018 – the Euro 6D Temp standard.

Under the new European emission standard, passenger car manufacturers have two new obligations. The first is to maintain the standard level of emissions not only during homologation testing but also during the subsequent usage of cars on roads. The other obligation is that from 1 January 2021, each new car must be equipped with a device monitoring the fuel consumption or use of electrical energy (in cars with electric engines). Cars without such a device cannot be registered in the European Union.

What is more, as of 2021, a new average emissions target standard of 95g/km applies across the EU, which has been drastically reduced compared to previous years – from 120g/km in 2020 and 130g/km in 2019. The average standard does not have to be met by every passenger car manufacturer. However, this is taken into account when calculating the individual standards for each manufacturer (in addition to, for example, the average mass of the vehicles produced). Therefore, lowering the average emissions target will obviously lower the individual standards of each manufacturer. If a manufacturer exceeds its individual standard, it will be required to pay a fee. The fee is €95 multiplied by the number of cars sold and the excess emissions over the individual standard.

There are no other current developments, emerging trends or pending legislation that should be noted.

* *This chapter was co-authored by Mateusz Mazurkiewicz, who has since left the firm.*

South Korea

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry in Korea has played a significant role in the Korean economy. Compared to 2020, Korea maintained its position in 2021 as fifth in country production rankings (after China, the US, Japan and India), and exported approximately 2.04 million units, which represents an increase of 8.2 per cent. Due to such increased exports, Hyundai Motor Group jumped from ranking sixth to third in the global market after Toyota and Volkswagen. The domestic sales volume of the five domestic automobile manufacturers in Korea (Hyundai Motors, Kia Motors, GM Korea, Renault Samsung and SsangYong Motors) decreased to approximately 1.7 million units in 2021, while domestic sales revenue increased by 1.8 per cent to 69.6 trillion won.

At the same time, imported vehicles reported record-high sales, posting an increase of 2.3 per cent year-on-year of approximately 300,000 units. Imported vehicles accounted for 32 per cent market share, which is further broken down as 70.5 per cent European, 15.8 per cent US, and 6.8 per cent Japanese. The cumulative sales of Hyundai and Kia in 2021 Q3 increased by 15.8 per cent and 24.6 per cent respectively compared to the previous year. However, Ssangyong's sales continued to decrease by 13.8 per cent compared to the previous year. Overall, the assembled vehicle production level is similar to that of the previous year. Recently, more SUVs and environmentally friendly type vehicles (hybrid and electric cars) have been sold, whereas the sales ratio of diesel vehicles has decreased.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Major government agencies regulating automobiles and automobile parts in Korea are the Ministry of Environment (MOE), the Ministry of Land, Infrastructure and Transport (MOLIT), and the Ministry of Trade, Industry and Energy (MOTIE).

Homologation

First, to manufacture or import automobiles in Korea, the manufacturer or importer must first obtain emission certification under the Clean Air Conservation Act and noise certification under the Noise and Vibration Contract Act for the subject automobiles from the MOE. The specific certification standards are similar to the US or EU standards. Currently, diesel vehicles are subject to the EURO 6 standards and test methods in a similar manner to the EU. Also, automobiles and their parts must satisfy the Korea Motor Vehicle Safety Standards (KMVSS) prescribed by the Motor Vehicle Management Act (MVMA). While similar to the EU type approval regime, emission and noise certification must be obtained in a formal application process, whereas the safety standards under the KMVSS must be complied with in a self-certification process similar to the US self-certification regime. On the other hand, if emission or noise-related changes occur, such changes must be declared and modified or reported before importing the affected vehicles. This specific procedure is different from the EU/US and unique to Korea.

Registration

Pursuant to the MVMA, automobiles must be registered prior to being in operation, and any changes in the ownership of the automobiles must be registered to be effective.

Insurance

Pursuant to the Guarantee of Automobile Accident Compensation Act, in principle, an automobile owner is required to purchase a liability insurance policy. Without purchasing this liability insurance policy, the automobile owner is not allowed to operate the automobile on public roads.

Other regulatory schemes

Fuel efficiency must be filed with the Korea Energy Agency, a sub-institution of the Ministry of Trade, Industry and Energy. Also, the MOE limits the contents of hazardous substances (eg, lead) in automobiles and automobile parts within a prescribed level (corresponding to the Restriction of Hazardous Substances regime in the EU). In certain cases, automobiles and automobile parts that use radio waves, which may interfere with other devices, may be subject to conformity assessment regulations under the Radio Waves Act. Finally, to those automobiles manufactured in the countries that enter into certain free trade agreements (FTAs) with Korea and imported to Korea, beneficial provisions of the applicable FTA (including exceptions from specific safety standards under Korean law) will apply.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Some Korean automobile manufacturers have their own steel and automobile part companies as affiliates. Thus, Korean automobile companies manufacture a considerable portion of automobile parts on their own, or procure them through original equipment manufacturers (OEMs). They also import a large number of parts from automobile part companies in various countries, including Germany and Japan. It is common for OEMs

to enter into a part supply agreement with parts suppliers and receive parts from them. If a new part development is necessary, it is common for OEMs to enter into a part development agreement with suppliers and share the newly produced IP rights.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Automobiles manufactured in Korea are sold in Korea or imported from foreign countries. In Korea, foreign automobile manufacturers import and sell automobiles manufactured in foreign countries by designating one or multiple distributor companies responsible for sales. In cases where the foreign automobile manufacturer established a subsidiary in Korea, it generally conducts its business by importing automobiles into Korea through its subsidiary, which then sells such automobiles to the designated dealer companies that sell them to customers in Korea. However, there are also cases where Korean dealer companies directly import automobiles to sell them to end consumers without dealing with any Korean subsidiary separately established by the foreign manufacturer. Also, most dealer companies operate repair centres for the automobiles they sell in Korea. Meanwhile, vehicles manufactured by domestic manufacturers are sold directly or through mega dealers.

It is common for both vehicles manufactured by domestic manufacturers and imported vehicles to be sold by dealers unless they are sold directly. As the Fair Trade Law applies to the contractual relationship with such dealers, arbitrarily terminating the contract or changing the terms of the contract unfavourably is subject to strict review. Therefore, in general, contracts with dealers are executed on a fixed-term basis, and the term is extended with an automatic renewal clause, but if termination is necessary, automatic renewal is refused.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no M&A or JV transaction-related regulations specifically applicable only to the Korean automobile industry. However, companies may be mindful that the Korean automobile industry has a significant impact on the overall Korean economy and employment. If a company intends to conduct business in Korea, it should carefully examine the labour issues related to the Korean automobile industry. In addition, because certain technologies are subject to export control, regulations may be applicable to the establishment of a JV with a Korean company that possesses such technology or the acquisition of a company that exports such technology.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no incentives or barriers specifically applicable only to the Korean automobile industry. However, the Korean government provides certain incentives to foreign invested companies in Korea. In particular, companies established in the designated areas such as free economic zones or industrial complex may benefit from deregulation and other incentives such as rent reductions, tax exemptions or cash grants. Further, the Korean government implements policies that support R&D of certain technologies, such as electric cars, hydrogen fuel cell cars and autonomous cars. While the barriers to entry into the automobile industry may differ depending on the type of business, the requisite compliance with regulatory standards such as homologation-related rules and regulations including the KMVSS may essentially function as a de facto barrier to automobile manufacturers and importers. If a new entrant emerges in the industry, its competition with pre-existing companies may be further intensified.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The Motor Vehicle Management Act provides that manufacturers and importers of automobiles and parts must self-certify the compliance of automobiles and parts with the Korean Motor Vehicle Safety Standards (KMVSS). Failure to do so may result in imprisonment of up to one year or a criminal fine of up to 10 million won, and an order from the Minister of Land, Infrastructure and Transport to suspend manufacturing, assembling, importing or selling such automobiles or automobile parts. If the automobiles fail to meet the KMVSS, they must be recalled. Generally, most provisions of the KMVSS are harmonised with international standards. For automobiles in violation of environmental standards such as the permissible emissions standards, emission certifications may not be issued, or the certifications previously issued may be revoked, which may lead to criminal sanctions, imposition of administrative surcharge and recall.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Under the Product Liability Act, a consumer may claim damages if he or she suffers a damage to his or her life or body or property due to a product's design, manufacturing or labelling defect. As the cause of action under the Product Liability Act is the occurrence of damage, it was difficult for consumers who did not actually suffer damage to file a claim. In addition, since punitive damages have not been acknowledged yet, consumers would not benefit from filing such lawsuits. In addition, because there is no genuine class action in Korea, collective action (which should also include occurrence of damage) is the only practical way to achieve volume litigation. Thus, most of the lawsuits have been filed by individual consumers on a small scale.

Meanwhile, the Korean 'lemon law', which benchmarks the US lemon law, has been introduced. According to the Korean 'lemon law', an automobile owner may seek a replacement or refund for a defective vehicle from the vehicle manufacturer within two years of delivery of the vehicle under certain requirements, while a defect discovered within six months of delivery of the vehicle is deemed to have existed at the time of the delivery, shifting the burden of proof as to the cause of the defect to the manufacturer. In addition, such request can be filed with the Ministry of Land, Infrastructure and Transport in the form of arbitration, which has the same effect as a final and conclusive judgment of a court, without having to file a lawsuit. Out of 170 arbitral awards resulting from 1,454 applications filed in the period between 2019 and

2021, only one case (0.6 per cent) resulting in replacement of a new vehicle due to a defect two cases (1.2 per cent) resulted in refunds, and 11 cases (6.5 per cent) resulted in a settlement, while 156 cases (92 per cent) were dismissed.

Defects contained in automobiles or parts may raise product liabilities. However, Korea has no formally established class action system similar to that in the US. Around 1999, civil lawsuits were instituted in multiple cases against Korean automobile manufacturers seeking damage compensation caused by unintended acceleration. However, the court did not acknowledge the liabilities of such manufacturers. In principle, the Korean product liability regime is based on continental law, compensating actually incurred damage. However, in the wake of recent high-profile product safety incidents and public calls for a strengthened product liability system and enforcement, a new punitive damages regime was introduced in 2018, under which a manufacturer may be sanctioned up to three times the actual damages if it had knowledge of a defect in its product but failed to take necessary remedial measures and the defect caused death or serious injury. The new punitive damages regime, coupled with the statutory presumption of causation between the alleged defect and harm, is expected to significantly increase manufacturers' product-related risks across all industries.

In some of the recent cases in which an alleged product defect was found to cause wide-scale harm to consumer health and safety, not only did the defendant manufacturers face civil liabilities but their senior managers faced criminal liabilities in some cases. This trend imposes greater burdens on product manufacturers and distributors and heightens the need for stricter monitoring and compliance. Depending on the specific facts and circumstances, there may be cases where consumers seek additional compensation other than the recall for the manufacturing defects.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Competition and antitrust issues relevant to the Korean automobile industry may include price fixing, intervention in management activities such as requesting financial information of the other transacting party, stealing technology of the transacting party by requesting its technical information and issues arising from the unilateral termination of OEM agreements. With the recent amendment to the Monopoly Regulation and Fair Trade Act, a simple 'exchange of information' is categorised as a type of collusion. In particular, in relation to an alleged cartel, the Korea Fair Trade Commission (KFTC) investigated and sanctioned (1) certain commercial vehicle manufacturers and importers and (2) automobile parts suppliers, respectively. Interestingly, a 2016 Supreme Court case held for issue (1) that it cannot be deemed that the purpose behind the information exchange was to jointly determine sales prices or that the information exchange was used as a means to fix prices, and that even where companies increased prices at similar times, the foregoing could be explained by a different reason and thus, it could not be deemed that there was external alignment that substantiated an alignment of intent among companies regarding pricing decisions. Another major competition statute relevant to the automobile industry is the Fair Transactions in Subcontracting Act, in particular where automobile parts have been supplied based on an OEM contract. The Fair Transactions in Subcontracting Act prohibits, among other things, unreasonable cancellation of entrustment, unreasonable return of goods, reduction of the subcontract consideration, such as prices fixed at the time of the entrustment of manufacturing without justifiable grounds, and unfair requests for economic profits. Competition cases may involve follow-on litigation, some of which may develop into collective actions. Competition issues may also arise under the Fair Labelling and Advertisement Act (FLAA). Recently, in cases where the Ministry of Environment found that certain vehicle models were equipped with a defeat device, the KFTC decided to investigate whether advertisements or labelling on the concerned vehicles constituted 'unfair' labelling or advertising under the Fair Labelling and Advertisement Act and imposed administrative sanctions, which were recently confirmed by the Supreme Court. Further, criminal proceedings and civil actions filed by consumers for cancellation of contract based on fraud or misunderstanding or compensation for damages due to (1) tort (ie, fraud or illegal acts), (2) violation of the FLAA for false advertisements, and (3) breach of warranty, resulting in a decline in the resale value of the vehicle, were pursued and are still pending.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Disputes in the automobile industry may arise between manufacturers and automobile parts suppliers and between manufacturers, importers and consumers. Such disputes usually are resolved by legal proceedings rather than arbitration. However, with the recent introduction of the Korean 'lemon law', most of the disputes between manufacturers or importers and consumers have been attempted to be resolved through arbitration. They may also be settled upon agreement among the parties without legal proceedings. Upon filing for legal actions, the parties may seek interim remedies in parallel, such as preliminary seizure or injunction, which are in fact pursued rather frequently.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

As automobile manufacturers and automobile parts suppliers tend to form a long-term, mutually cooperative business relationship, manufacturers may support distressed parts suppliers through price adjustments and financial assistance. Also, manufacturers may invest in or acquire the parts suppliers in financial difficulties. Such decisions are made by the relevant parties as, in principle, the government does not intervene in this process. However, if a financial crisis at large manufacturers or parts suppliers has the potential to cause a serious impact on regional employment such as mass unemployment, the government may choose to intervene to the extent necessary.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

For IP disputes, it is difficult to conclude that Korean courts are rendering decisions that are pro-IP owner, particularly since there have not been many Korean IP disputes in the automobile industry. However, there are occasional trade secret infringement disputes between competitors, instead of conventional IP disputes such as patent litigations. There were also some disputes where OEMs or higher-tier parts suppliers, who were in a superior position within a vertical relationship, demanded excessive technical materials from lower-tier parts suppliers. In the latter case, the Korea Fair Trade Commission, as the competent authority, implemented and enforced strong regulations.

Other IP disputes are also not easily resolved. In particular, as criminal penalties are also set for trade secret infringement, it is often fiercely disputed. IP protection is a significant issue in the automobile industry. Utilising its superior position, the automobile manufacturer may request a parts manufacturer for its technical information to steal its technology. In one case, an employee was caught while attempting to leak automobile development technology to a foreign competitor. Further, an R&D employee leaked and transferred core technology to a competitor. In Korea, any person who steals technologies or leaks trade secrets may be subject to criminal penalties and compensatory damages. However, owing to the particular nature of IP, the damage caused by leaked IP is irrevocable. Thus, providing ex post facto remedies for such damage may be ineffective. Therefore, interim remedies such as preliminary injunctions may be more effective.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Labour unions in Korea are organised at the company level or regional or industrial level. A majority of the automotive companies join a federation of labour unions at the industry level, where the industrial level federations in turn are affiliated with federations of labour unions at the national level. Owing to these characteristics, labour unions in the Korean auto industry tend to possess stronger bargaining power as regards company management than other industries, which is frequently translated into collective bargaining and wage agreements containing various restrictions on management prerogative over personnel matters, among other things.

In the face of the current economic environment, with the covid-19 pandemic creating significant economic difficulties for automotive companies in all major markets, it is anticipated that restructuring will become a key challenge for automotive companies in Korea. Also, the structural transition of the entire industry to electric vehicles adds to such difficulties. In this regard, depending on the provisions of their collective bargaining agreements entered into with labour unions, automotive companies may encounter limitations when they seek to implement restructuring (including workforce reduction) or introduce changes to the existing production regimes or work arrangements (eg, shift regimes).

Automotive companies may also experience business interruption owing to industrial action, such as strikes, which frequently occur during negotiation over the collective bargaining and the wage agreements. Given the strict limitation imposed on strike replacement under labour law, automotive companies should prepare contingency plans in advance if they anticipate difficulties in labour relations.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

Korea has a growing interest in new automobile development technologies such as autonomous cars, connected cars, electric cars, hybrid cars and hydrogen fuel cell cars. In this regard, the Motor Vehicle Management Act introduced a legal definition of autonomous cars in August 2015 and separately provided procedures to obtain temporary driving permits for autonomous cars intended for tests and research. In addition, Korea was the first in the world to enact safety standards for Level 3 autonomous vehicles.

Meanwhile, the Motor Vehicle Management Act prohibits Over the Air (OTA) updates that are not provided at repair shops for repair services. Recently, however, the Ministry of Trade, Industry and Energy temporarily allowed OTAs through regulatory sandboxes. Therefore, OEMs that applied for such regulatory sandboxes can implement service campaigns or recalls with OTAs. For new automobile technologies as above, legal developments are expected to continuously unfold in the future.

On the other hand, very rigid regulations apply to shared and transportation services. Basically, car sharing is not subject to significant regulations. However, if a passenger transportation service similar to a taxi is to be operated through car sharing, a very strict licence, which is difficult to obtain, is required, and any violation thereof is subject to criminal punishment.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

As a general note, Korean consumers have become more sensitive to automobile defect issues. Under the Product Liability Act, a manufacturer could be subject to treble damages if the manufacturer knew of a defect in its product but failed to take necessary remedial measures and the defect caused death or serious injury. The new punitive damages system, coupled with the statutory presumption of causation between alleged defect and harm, is likely to significantly increase manufacturers' product-related risks across all industries. This trend imposes greater burdens on product manufacturers and distributors and heightens the need for stricter monitoring and compliance. The Korean 'lemon law' allows consumers who purchase a new vehicle and experience a defect to seek a replacement or refund from the manufacturer and provides related standards and procedures. Further, for non-compliance with

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the Korean homologation-related regulations, the Korean authorities tend to strictly impose a variety of sanctions such as revocation of certification, recall order, administrative surcharges and criminal sanctions. In particular, the customs authority pays more attention to the case of importing automobiles without proper certifications or modification certifications, which may be subject to criminal sanctions. The Guarantee of Automobile Accident Compensation Act provides the principle of driver's liability and insurance company's right to seek remedy and a new obligation to install autonomous driving data recording device, while a new autonomous-driving vehicle accident investigation committee is established by the Ministry of Land, Infrastructure and Transport to identify the cause of accidents by collecting and analysing the data from the autonomous driving data recording device and investigate the relevant accident. Since the foregoing only applies to level-3 autonomous-driving vehicles, it is expected that laws and regulations governing Level 4 autonomous driving vehicles or higher will be introduced in the near future. Generally, given that automobile manufacturing is one of the key issues on the agenda for the negotiations on the amendment and the discussions on the implementation of the free trade agreements with Korea, it would be prudent to pay attention to such results. Finally, Korean large companies in the automobile industry, such as Hyundai Motors and Kia Motors, pay more attention to the development in global ESG standards and request suppliers in the supply chain to ensure compliance.

Spain

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry is a strategic and significant sector in Spain. It is, alongside other strong industries (such as tourism, chemicals, and agriculture and food), one of the important sectors of the Spanish economy. Spain is ranked second among European automotive manufacturers, and ninth globally. According to recent figures from industry associations, the automotive industry represents roughly 10 per cent of GDP, and more than 87 per cent of all cars and components manufactured in Spain are exported abroad, representing 19 per cent of total Spanish exports.

Spain is the fourth largest producer of automotive components in Europe. Moreover, Spain's production plants are among the most efficient and automated in Europe, having 1,000 industrial robots for every 10,000 employees.

All major automotive companies have manufacturing units in Spain, with 17 plants currently generating significant activity and direct and indirect employment. In some cases, automotive plants have prompted the creation of 'hubs', which have attracted numerous component suppliers and service companies in their vicinity.

A highly skilled workforce, significant research and development, modern technology and a strategic geographic location continue to make Spain an attractive country for the automotive industry.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Type approval

Pursuant to section 1 of the General Regulation on Vehicles (passed by Spanish Royal Decree 2822/1998 of 23 December 1998), the distribution of vehicles requires prior authorisation. This takes the form of type approval (homologation), granted by the Spanish Ministry of Industry, Trade and Tourism.

Vehicle type approvals are governed by Regulation (EU) 2018/858 of the European Parliament and of the Council of 30 May 2018 on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles.

Regulation (EU) 2018/858 regulates a harmonised framework containing the administrative provisions and general technical requirements for approval of all new vehicles within its scope and of the systems, components and separate technical units intended for those vehicles with a view to facilitating their registration, sale and entry into service within the EU. According to section 13(2), the vehicle's manufacturer is responsible for all aspects relating to the type approval process and for ensuring conformity of production, whether or not such manufacturer is directly involved in all stages of the vehicle's production.

In addition, there are other EU laws regulating type approvals relating to specific aspects on vehicles: (1) Regulation (EC) 661/2009 of 13 July 2009 concerning type approval requirements for the general safety of motor vehicles, their trailers and systems, components and separate technical units intended therefor (on 6 July 2022 this Regulation will be repealed by Regulation (EU) 2019/2144); and (2) Regulation (EC) 715/2007 of 20 June 2007 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) and on access to vehicle repair and maintenance information, supplemented by Regulation (EU) 2017/1151 of 1 June 2017, which ensure that new car models pass new and more reliable emissions tests under real driving conditions.

Regulation (EC) 661/2009

Regulation (EC) 661/2009 sets out the requirements for the type approval of motor vehicles, their trailers and systems, components and separate technical units with regard to their safety.

Pursuant to sections 4 and 5, manufacturers shall demonstrate that the following are type approved in accordance with its provisions: (1) vehicles, systems, components and separate technical units; (2) all new vehicles sold, registered or put into service within the EU; and (3) all new systems, components and separate technical units sold or put into service within the EU.

Regulation (EC) 715/2007

On the other hand, Regulation (EC) 715/2007 establishes common technical requirements for the type approval of motor vehicles with regard to their emissions. In this respect, manufacturers are obliged to fulfil all the type approval requirements provided for in the same. These obligations include meeting the emission limits set out in Annex I (Euro 5 and Euro 6 emissions limits and emission limits for the evaporative emissions test).

Furthermore, manufacturers shall ensure that type approval procedures for verifying conformity of production, durability of pollution control devices and in-service conformity are also met.

Registration requirements

Pursuant to section 4 of Spanish Royal Decree 750/2010, manufacturers wishing to type-approve vehicles, systems, components or separate technical units under the scope of application of the Decree shall be registered with the Manufacturers Registry.

Following the granting of type approval, vehicles and their trailers and semi-trailers shall be duly registered with the vehicles registry

managed by the relevant traffic authority. The traffic authority will depend on the autonomous region where the vehicle's owner, lessee with a purchase option or long-term lessee has its legal domicile. In this sense, and as it infers from the latter, the registration request must be undertaken by the owner, lessee with a purchase option or long-term lessee. Additionally, the Vehicles Registry, in general terms, aims at identifying, among other aspects, the vehicle's holder, the vehicle's technical characteristics, the inspections conducted, compliance with the applicable insurance requirements and compliance with other legal provisions.

Insurance requirement

Insurance requirements apply to the use of vehicles for private or professional use, but the Spanish requirements are not materially different from those that can be found in other European countries.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The contractual arrangements and structuring of the development, manufacturing and supply in the Spanish automotive sector do not differ substantially from what occurs in other European countries. Some particularities may apply in the case of the Canary Islands (which enjoys a specific tax regime to protect investment and consumption in that overseas region and represents a challenge in terms of operational and transportation costs), but other than that the situation in Spain is similar to that in neighbouring countries.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

As in many other European jurisdictions, vehicles are distributed through networks of 'concessionaires' or authorised dealers that represent the car manufacturers across the Spanish territory. There is, however, no specific distribution law in Spain (unlike in other countries, such as Belgium) and, therefore, general rules of contract law apply – in some cases in combination with franchise regulations, commercial agency rules or other specific subsets of Spanish contract law depending on how the relationship with a particular dealer is organised. There have been legislative efforts in recent years to introduce a new Commercial Code, including specific rules for distribution (which would encompass automotive wholesale and retail distribution), but it is not likely that a distribution law will be passed in Spain in the mid to long term.

Legal disputes between car dealers and manufacturers typically focus on the renegotiation or termination of distribution contracts, while disputes involving suppliers normally relate to purchase levels or price renegotiation (particularly with key suppliers that make ad hoc components for specific car models or agree on particular pricing based on minimum purchase volumes). We understand, however, that these types of disputes are not specific to Spain and can be found in most other European jurisdictions as well.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

The structuring and implementation of M&A and joint ventures in the Spanish automotive sector do not differ from what can be seen in similar transactions in the industry in other European countries.

In comparison with M&A and joint ventures in other sectors, it is worth mentioning that the global microchip shortage and the effects of the global supply logistic chain slowdown have added new layers of uncertainty especially with respect to valuation and also in terms of price negotiations.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

According to the data released by the Spanish Association of Vehicle Manufacturers (ANFAC), in 2021, due to general economic crisis derived from the pandemic and the microchip shortage, vehicle manufacturing decreased in 7.5 per cent with respect to 2020 (2,098 million units produced in 2021). If the comparison is run against the figures of 2019, the last pre-covid-19 year (where 2,822 million vehicles were produced), then the decrease would be 25.6 per cent). In terms of registrations of private vehicle, in 2021 there was an increase in relation to 2020 (1 per cent), while in comparison with 2019, in 2021 the reduction was of 32 per cent.

In June 2020, the Spanish government approved the vehicle renewal programme Plan Renove 2020, endowed with €250 million. The aim of this programme was to provide incentives for the purchase of new vehicles to replace older vehicles with cleaner and safer ones, while incorporating environmental and social criteria. Access to this programme ended on 31 December 2020.

On 9 April 2021, the Spanish government presented the programme Plan Moves III to boost sustainable mobility. This programme consists of direct aid up to €7,000 to private owners and self-employees and small business to acquire new electrical vehicles and includes a call for proposals for the installation of new electrical vehicle charging points, which will be funded by the Next Generation Funds.

In July 2021, the Spanish government launched the programme MOVES Singulares II with €100 million in aid to incentivise technological development projects and innovative experiences in electric mobility that serve to promote the technological leap towards electric and fuel cell vehicles, promoting the development of projects by Spanish companies, to reach the technological maturity that facilitates its commercialisation.

Likewise, on December 2021, the European Commission approved the Spanish aid scheme of €3,000 million for the recovery and economic transformation (known as PERTE) of the electric and plug-in car. The programme provides support for investments in research, development and innovation, environmental protection and energy efficiency throughout the chain of this industry. The scheme was formally put in place in March 2022 and is being financed in part by the Next Generation Funds.

In terms of market entrance, there are no substantial legal barriers other than the usual requirements involving the establishment of a business or manufacturing plant in Spain; nor are there any particular restrictions on foreign investment (except in the case of investors from countries that are affected by international trade sanctions or embargo regulations or in the event that the regime for foreign direct investments is triggered).

The automotive industry is immersed in a profound process of transformation that will completely change the shape of this industry as we understand it. The main drivers of this change are decarbonisation (new energies); new paradigm in terms of mobility (car sharing, pay per use, etc; internet of things; and autonomous driving. These changes will generate numerous opportunities for new and existing players.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The most relevant safety and environmental rules relating to automotive compliance are envisaged in Regulation (EU) 2018/858, Regulation (EC) 661/2009 and Regulation (EC) 715/2007, supplemented by Regulation (EU) 2017/1151.

Pursuant to Regulation (EC) 661/2009 and Regulation (EC) 715/2007, respectively, manufacturers shall (1) ensure that vehicles are designed, constructed and assembled to minimise the risk of injury to vehicle occupants and other road users, and (2) equip vehicles so that the components likely to affect emissions are designed, constructed and assembled so as to enable the vehicle, in normal use, to comply with Regulation (EC) 715/2007.

Against this backdrop, the Spanish General Regulation on Vehicles provides for the following:

- registered vehicles may be cancelled from the Vehicles Registry in the event that the relevant competent authority, owing to wear or deterioration of the vehicle's mechanical elements, certifies that said vehicle constitutes an obvious danger for its occupants or for traffic safety in general (section 35, paragraph 2 of the General Regulation on Vehicles); and
- in the course of procedures relating to the declaration of nullity, loss of validity or expiry of administrative authorisations for the traffic of vehicles, the competent authority is entitled to suspend the applicability of the relevant authorisation if it poses a serious danger to traffic safety (section 51, paragraph 4 of the General Regulation on Vehicles).

CO_2 emission performance standards for new passenger cars and for new light commercial vehicles are set out in Regulation (EU) 2019/631 of the European Parliament and of the Council of 17 April 2019. This Regulation sets EU fleet-wide CO_2 emission targets applying from 2020, 2025 and 2030 and includes a mechanism to incentivise the uptake of zero- and low-emission vehicles. As for automotive-related product recalls in Spain, these are subject to the general product safety rules, which are based on the General Product Safety Directive 2001/95/EC.

Pursuant to Act 7/2021, of 20 May 2021, on Climate Change and Energy Transition, national, regional and local authorities shall take measures to ensure that from 2050 passenger vehicle fleet and light commercial vehicles do not generate direct CO_2 emissions; no new non-commercial vehicles emitting CO_2 shall be marketed by 2040; and all municipalities with more than 50,000 inhabitants shall adopt sustainable mobility plans that shall provide for low-emission areas similar to those that are already implemented in Madrid and Barcelona.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Spain does not have a strong tradition in product liability litigation, and there have been no major automotive-related product liability disputes in recent years. This does not mean that there have been no product recalls in the sector. The automotive industry has suffered several product recall cases in Spain, some of them particularly relevant. However, the main consequences of these product recalls have been solved between the parties without judicial actions being filed to that end. On the other hand, the Spanish Procedural Act of 2000 established a completely new system of class actions, giving consumer associations a major role in these proceedings. However, to date these actions have been used in a very small number of cases, and rarely with regard to the automotive industry. It is yet to be seen whether the Class Action Directive will change the landscape.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

EU Regulation No. 461/2010 on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector, as well as its accompanying supplementary guidelines, is also applied by competition authorities in Spain to cases decided under either EU or Spanish competition law.

The main recent investigation and sanctioning proceedings conducted by the National Commission on Markets and Competition (NCMC) in the Spanish automotive sector include the following.

- In July 2015, the NCMC imposed a record combined fine of €171 million on 21 car manufacturers and distributors and two consulting firms for an alleged cartel consisting of exchanges of commercially sensitive information relating to motor vehicle distribution and aftersales services. The sanctioned companies represented more than 91 per cent of the Spanish market for car distribution. The investigation by the NCMC was triggered by a leniency application filed by one of the automotive manufacturers in Spain.
- Between 2015 and 2016, the NCMC imposed fines totalling roughly €53 million on a significant number of car dealers of different OMS distribution networks in Spain – as well as some consultancy firms and trade associations for their role as cooperators – on grounds of their participation in several cartels, through which they fixed prices or other commercial conditions and exchanged commercially sensitive information.
- In June 2016, the NCMC imposed a fine of €638,770 on a Spanish car-wash equipment manufacturer (which also provides repair and maintenance services itself and via appointed third parties) for alleged anticompetitive conduct consisting of a refusal to supply spare parts and technical data to independent repairers.
- More recently, in November 2021, the NCMC launched an investigation (including dawn raids) on possible anticompetitive practices, consisting of agreements for the manipulation and distribution of tenders issued by the Ministry of Defence, in relation to the supply, maintenance and upgrade of military equipment, in particular military vehicles. That investigation resulted in the opening, in

December 2021, of sanctioning proceedings against a number of companies.

As regards follow-on litigation, in recent years there has been a significant increase in private actions for damages suffered by victims of cartels in Spain (ie, civil law damage claims before the courts following administrative law sanctioning proceedings before the NCMC). It is expected that this trend will increase now that major developments regarding civil damage claims have been introduced into the Spanish legal system by Royal Decree-Law 9/2017. This regulation, which implements EU Directive 2014/104/EU on certain rules governing actions for damages for competition law infringements, aims to ensure that parties affected by cartels in Spain are effectively compensated by bringing specific private actions for damages.

This increase in damages actions is having a particular impact in the automotive sector. Following the recent Supreme Court rulings confirming the sanctions imposed by the NCMC on car manufacturers, distributors and car dealers, a relevant amount of damage claims is expected in the coming months. This mass litigation, which depending on its outcome, could have a significant impact on the Spanish automotive industry, is being widely reported in the Spanish press, with some law firms announcing mass litigation processes and encouraging consumers to file claims for damages, promising high compensations. The effective economic impact of these claims remains to be seen as, even in follow-on actions such as this one claimants are required to prove the actual damage suffered and demonstrate the causal link with the infringement.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

While class actions and litigation around recalls or product safety are rare, dispute and claims proceedings do affect the Spanish automotive industry. A great percentage of these disputes are related to distribution agreements, termination thereof and claims for compensation. Also, there has been a relevant number of supply chain disputes and insolvency related disputes.

In general, the Spanish system provides claimants with the possibility of obtaining quick and provisional solutions through interim injunctions, which are especially useful in cases of supply chain disruptions.

More recently, since 2015 a number of players in the automotive industry have been involved in antitrust litigation proceedings. Arbitration is not very common in automotive-related litigation.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

Distressed situations and insolvency proceedings are complex. The way the automotive industry should deal with suppliers facing such circumstances must be determined on a case-by-case basis, depending on the factual circumstances at hand, by seeking securities and guarantees to guarantee fulfilment of suppliers' obligations – and by considering not only the legal implications but also the economic impact that the relationship with the automotive manufacturer may have on a supplier's overall performance and business continuation.

One particularity of Spanish insolvency law is that the mere declaration of insolvency of a company is not a valid cause for termination of agreements entered into by that company. This means that a car manufacturer cannot terminate a supplier agreement only on grounds that the supplier has gone into insolvency; the contractual relationship will continue unless other reasons for termination appear such as a material breach of the supplier's duties.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Intellectual property (IP) and related unfair competition disputes in the automotive field in Spain are rather significant, in view of the number of cases that the Spanish courts have handled in the last few years, which show an increasing trend, although they are still less common than in other industries (eg, pharmaceutical and TMT industries). IP disputes and joint unfair competition claims are heard by several commercial courts specialising in IP matters across the country, which helps guaranteeing consistency in judicial decisions and, therefore, predictability. The most common venues are the Barcelona and Madrid Commercial Courts, as well as the EU Trademark and Design Courts located in Alicante, which handles all EU trademark and designs claims on an exclusive basis. Section 15 of the Court of Appeals of Barcelona and section 28 of the Court of Appeals of Madrid, as well as the EU Trademarks and Designs Court of Appeals, are the most reputed tribunals for IP matters in Spain, whose decisions have a great impact in the development of IP case law in our country.

The prevalence of trademark and trade names proceedings in the automotive field is remarkable. Disputes in this sector mostly involve trademark/trade name infringement actions for likelihood of confusion (eg, CICAR vs ZIPCAR or PARKIA vs PARKVIA) where defendants usually bring counterclaims seeking the invalidity or cancellation for non-use of the enforced trademarks. In a relevant number of cases, the claims involve the use by workshops or car sellers of well-known car brands. Case law shows that courts tend to be protectionist towards IP rights holders and have admitted the majority of the trademark or trade name infringement claims issued in the past few years.

It is also relatively common that trademark or trade name infringement claims are jointly brought with unfair competition-related actions, with claims mostly based on acts of confusion, unfair exploitation of a third party's reputation and misleading acts. Courts are less prone to uphold unfair competition actions brought by plaintiffs, not the least since IP rights holders are typically not entitled to enjoy double protection based on their IP rights and the protection granted by the unfair competition law against the same behaviour by defendants.

Patent, utility model and design infringement claims in the automotive field are still scarce. Although design cases have been traditionally upheld, in the majority of patent infringement cases the courts either dismissed the claims or declared the patent to be invalid. Looking ahead, patent disputes involving standard essential patents and FRAND licensing discussions related to mobile telecommunications technologies, which are brand new to the courts in Spain, are expected not only for the telecommunications companies, but also in the case of players in the automotive sector. This will certainly be a hot topic for the automotive industry in the near future.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

As in other European countries, in Spain the legal relations arising from an employment relationship are governed by legal provisions and agreements emanating from national and international legislative bodies (international treaties, local laws and regulations), the will of the parties (collective bargaining agreements, employment contracts) and the customs and practices of the company itself (company agreements, company practices).

Most of the employment regulations established in the laws apply to all companies, without any specific regulations regarding specific industries or sectors (except regulations on health and safety, which may vary depending on the business activity concerned). This applies, for example, to working time, minimum wages, severance payments in case of dismissal, types of contracts, election and activity of workers' councils and unions, etc.

Having said the above, in Spain it is possible to enter into collective bargaining agreements (CBAs) (ie, agreements that have been negotiated and concluded by employers and employee representatives and which are applicable to a more or less broad sector at both a national or provincial level, as well as, on a smaller scope, those applicable to a company or work centre).

However, most of the relevant companies in the automotive sector that operate in Spain have negotiated their own CBA at company level or have side agreements with their employees.

The pressures arising from the fierce competition in a highly globalised sector such as the automotive sector are transferred within companies, affecting labour costs and working conditions. In Spain, the automotive sector is characterised by the existence of large groups, mainly multinationals, with several activities in our country and with a dispersed CBA format. Some larger companies have their own CBA at company level, while the smaller ones are attached to regional CBAs.

It is also important to point out that automotive companies in Spain are highly unionised. They have not only works councils, but also national unions involved in relevant decisions. Likewise, in the case of renowned automotive companies, political involvement is also common when relevant decisions are taken (such as investments, divestments and restructurings); the scope of the political involvement (regional or even national) will depend on the company affected, its economic or social impact in the area, and the type of measure to be taken.

Finally, we must note that trade unions have played a key role in the automotive sector in recent years. This past two and a half years with the covid-19 and chip crisis, the automotive sector has been shaken by numerous redundancy plans that affected thousands of people in this industry. In this regard, trade union negotiation with companies has been an important factor in tackling this crisis.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

In the field of autonomous intelligent driving, on 20 December 2021, by means of Act 18/2021, various sections on automated vehicle driving were introduced into the recast text of the Act on Traffic, Circulation of Motor Vehicles and Road Safety, passed by Royal Legislative Decree 6/2015, of 30 October 2015.

Sustainable mobility-related policies have triggered some important developments relating to electric and hybrid vehicles. For instance, certain cities (eg, Madrid) have passed local mobility regulations that allow drivers of electric and hybrid vehicles to access areas restricted to other vehicles.

Also in this field, Royal Decree 266/2021, of 13 April 2021 was passed. This Decree grants direct aid for the implementation of incentive programmes linked to electric mobility (MOVES III) in the framework of the European Recovery, Transformation and Resilience Plan. Certain incentive programmes for electric mobility are also approved by said Royal Decree, such as the programme to promote the purchase of electric vehicles or the programme to support the deployment of charging infrastructure, both within the general framework of the Recovery, Transformation and Resilience Plan.

With regards to the provision of energy recharging services for electric vehicles, the approval of Royal Decree 184/2022, of 8 March 2022 should be noted. This regulation applies to electric vehicle charging point infrastructures that are located on public roads or, if not located on public roads, are accessible to all electric vehicle users, such as public and private car parks, service stations or shopping centres.

UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

In the field of intellectual property, the Spanish Patents and Trademarks Office (SPTO) is aware of the emerging trends in the automotive industry and has been publishing, on a quarterly basis, free, schematic newsletters on the new developments regarding electric vehicles and smart car systems, where updated news and new patent applications published within these fields are listed.

One of the main factors consumers take into account when acquiring a vehicle is sustainability. More than 80 per cent of the consumers argue that sustainability and social responsibility matter more today than before the pandemic. Based on this fact, the dealer must offer the right products to customers, especially those who are more environmentally conscious.

Evidence of this is that TESLA, for example, has positioned itself as the world's best-selling electric vehicle brand. In 2021, it sold 970,000 units. The vast majority of sales came from the American market. In China, around 330,000 units have been sold and 170,000 more vehicles were sold in the European market.

These reports note that the electrification boom has been driven in large part by the global semiconductor crisis. In such reports, they point out that this situation has forced manufacturers to prioritise the most profitable models (electrics) by reducing production of petrol and diesel models.

Even though electrical vehicles' car registrations rose up in 42.1 per cent in 2021, up to 82,999 vehicles, it is estimated that 100,000 registrations of electrified vehicles should be exceeded by 2022 to be in line with the targets set for 2030, according to the National Association of Motor Vehicle Dealers, Repair and Spare Parts and the Business Association for the Development and Promotion of Electric Vehicles (CEAC). 'In the medium term, the evolution of the car market will be even more aligned with environmental sustainability,' say CEAC sources.

According to some reports made by one of the biggest car dealer associations in Spain, there are two different scenarios for 2022. The first one, the optimistic one is that in 2022, 968,000 units will be registered, meaning a growth of 13 per cent compared to the previous year. The second scenario is that the market situation is complicated due

to the new increase of the registration tax at the end of the temporary reduction applied in the second half of 2021.

The registration tax is a tax levied on new cars and is based on the certified CO_2 emissions (ranging from zero per cent to 14.75 per cent of the taxable base). To this, VAT must be added. The regulation provides for four tax brackets for the payment of this tax, depending on the CO_2 emissions. On the other hand, the registration of electric vehicles is not subject to this tax. Compared to 2021, this year brackets are lower so more vehicles are subject to this tax, which may discourage both their production and their purchase by consumers.

This means that 2022 will be a transition year where sales will not be as expected. Sales in 2023, on the other hand, will be of about 1.1 million vehicles, whereas in 2024, it is foreseen that the sale of vehicles will reach the number of vehicles sold before the covid-19 pandemic.

Finally, some reports foresee that the much more intensive use of vehicles and a substantial reduction in their average life will lead to a reduction in the stock of vehicles in some markets – Europe and the United States – and, at the same time, to a substantial increase in the number of registrations.

Specifically, in Europe, it is estimated that the number of registrations could grow by 34 per cent by 2030, from 18 to 24 million units. It could grow in the United States by 20 per cent, up to 21.6 million vehicles. In China, given its particular market situation with a significant increase in population and in the midst of urbanisation, an increase in both registrations is forecast – a 30 per cent increase to 35 million - and in the vehicle fleet, which will reach 275 million cars in 2030.

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Turunç

OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry is one of the most significant drivers of Turkish industrial production. With over ten producers, most operating under licence or as joint ventures, over 150 research and development centres, three automotive design and engineering centres, and a production capacity of over two million vehicles per year, Turkey is the 13th largest producer of motor vehicles in the world and the fifth largest in Europe, having grown steadily over the past decade. In terms of actual production, Turkey produced 782,835 cars and 548,808 commercial vehicles in 2021 for a total of 1,331,643 vehicles, of which 937,005 were exported.

As of the end of 2021, there were 25,249,119 vehicles in Turkey, of which 13,710,272 were cars and 11,538,847 commercial vehicles. Retail sales for the same year included 561,853 automobiles and 175,497 light commercial vehicles, which represented an overall decrease of 4.6 per cent compared with 2020. However, there was an increase in the sale of the light commercial vehicles, which is attributed to the expansion e-commerce and delivery services due to the high demand for courier services and logistic companies during the pandemic. A campaign led by public banks for low-interest financing of vehicles also supported the demand and contributed to the increase in sales.

Due to an economic recession, the overall production has decreased by 20 per cent on the first two months of 2022 compared to the first two months of 2021. Similarly, the overall market has decreased by 17 per cent and exports by 14 per cent.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The Turkish regulations on vehicle manufacturing have generally been drafted in accordance with United Nations norms and European Union legislation. The primary piece of legislation regulating motor vehicles and their registration is the Highway Traffic Law No. 2918. Pursuant to the Highway Traffic Law, all motor vehicles and their trailers intended to operate on highways are obliged to have a certificate of conformity granted by a certification authority.

For vehicles to obtain a certificate of conformity, the initial step is obtaining type approval. The Ministry of Industry and Technology has authorised Turkish Standards Institute to supervise the homologation process and grant type approval certificates. There are three regulations pertaining to the conditions for type approval based on vehicle categories: the Regulation on Type Approval of Motor Vehicles and Their Trailers and Type Approvals and Market Surveillance of These Parts, Systems and Separate Technical Units (AB/2018/858), the Regulation on Type Approvals and Inspections of Agricultural and Forestry Vehicles (AB/167/2013), and the Regulation on Type Approvals and Inspections of Two- or Three-Wheel Motor Vehicles and Four-Wheel Motorcycles (AB/168/2013). All three are drafted in accordance with applicable European Union Directives and Regulations of the United Nations Economic Commission for Europe. There are no specific or additional provisions regarding the manufacture of automobile parts. All three regulations on type approvals are applicable to automobile parts as well.

Once a vehicle obtains type approval, a certificate of conformity also needs to be received in order for the vehicle to be operated on highways. The terms and conditions for obtaining the certificate of conformity for highways are regulated by a comprehensive regulation applicable to all types of road vehicles, entitled the Regulation on the Manufacture, Modification and Assembly of Vehicles dated 26 October 2016.

Pursuant to the Highway Traffic Law, all vehicles are obliged to be registered with the traffic registry before they can be operated on highways. With new legislation that came into effect in early 2018, called the Regulation on Carrying Out the Sale, Transfer and Registration Services of Vehicles, public notaries are responsible for the registration of vehicles using an automated system (previously, registrations were undertaken by Traffic Registration Offices).

The Highway Traffic Law also requires that vehicles have compulsory automobile liability insurance to be registered and continue to be operated on highways.

The Regulation on Aftersales Services dated 13 June 2014 includes specific rules for the distribution of automotive parts. Pursuant to this regulation, manufacturers and exporters must continue to supply spare parts to customers.

In practice, the distribution of automobiles and automobile parts is undertaken through dealership agreements, which must be drafted in accordance with the Block Exemption Communiqué on Vertical Agreements in the Motor Vehicle Sector, No. 2017/3 (the Block Exemption Communiqué) issued by the Turkish Competition Authority.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The Turkish automotive industry is engaged in both the manufacture and import of vehicles and spare parts. Primary manufacturers sell vehicles directly or through dealers. On the other hand, importers normally establish a sales network, with key importers establishing both a distribution network for sale (quantitative selective distribution)

and aftersales services (qualitative or – if their market share does not exceed 30 per cent – quantitative selective repairer network).

Primary industry manufacturers in Turkey generally work with various sub-industry (parts) manufacturers for their procurement needs. There are several hundred sub-industry manufacturers for every key industry manufacturer. However, contractual relationships among primary industry manufacturers and sub-industry manufacturers tend to be trade-based only and often short term, mostly lacking any mutual R&D efforts or other deeper collaboration.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

In terms of the distribution of vehicles, there are no special rules for importers, distributors or dealers with the exception of sector-specific arrangements under competition legislation. Owing to the requirements of competition rules, importers/manufacturers choose the quantitative selective distribution system to sell vehicles.

In accordance with the requirements of the Block Exemption Communiqué, an agreement between a supplier (ie, manufacturer/importer) and a distributor may have a definite or indefinite term. An agreement with a definite term must remain valid at least five years and each party must accept a provision to notify the other party of its intention not to renew at least six months before the expiration of the agreement. For agreements with indefinite duration, the notice of termination period must be at least two years for both parties. The terms must also allow this two-year notice period to be reduced to no shorter than a period of one year when:

- the supplier is required by law or the agreement to pay appropriate compensation in case it terminates the agreement; or
- the supplier terminates the agreement owing to the reorganisation of a significant portion or the entirety of its distribution system.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

There are no special provisions required for M&A or JV transactions within the automotive industry, and there are no additional steps to be taken while preparing, negotiating or entering into a deal, with the caveat that competition laws play a significant role in the Turkish automotive industry.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

The incentives provided for investments in various markets are regulated by a Decree of the Council of Ministers entitled the Decision on Government Incentives for Investments, No. 2012/3305. Through a 2013 amendment to this Decision, the automotive sector was designated as a priority sector. Pursuant to this Decision, for an investment in the automotive sector to be entitled to receive an incentive, it must be no less than 200 million lira if for the main industry and no less than 50 million lira for sub-industries. Furthermore, if the investment is no less than 300 million lira, it will be entitled to receive top-priority incentives. Top-priority incentives provided include, among other things, value added tax and customs duty exemptions, social security support, (partial) corporate tax exemptions and allocation of land free of charge. Incentives are granted individually for each party fulfilling the criteria and new entrants do not affect the incentives that incumbents are entitled to receive. Through an amendment to this Decision dated 28 February 2019, the top-priority incentives mentioned above will be applicable until 31 December 2022.

Furthermore, a recent Presidential decree has accorded government incentives to a consortium called Türkiye'nin Otomobili Girişim Grubu (TOGG) for the domestic production of electric vehicles.

There are no barriers to entry into the automotive market, provided that the new party to the market fulfils all general criteria for investors to establish an industrial enterprise. To increase competition in the local market and in furtherance of Turkey's desire to become a major global competitor in the automotive sector, newcomers to the Turkish market are normally encouraged via the incentives described above.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

As part of Turkey's EU harmonisation process, new legislation on product compliance safety and the environment has been adopted to conform to EU legislation within the framework of the Turkey–EU Association Council Decision (ACD) No. 1/95 of 6 March 1995, which establishes a Customs Union among EU member states and Turkey. The primary goal of the applicable Turkish legislation is to protect consumers from potentially dangerous and harmful products, and to ensure that businesses place safe and compliant products on the market. The Ministry of Industry and Technology regulates compliance and conducts market surveillance through related regulations implemented by other relevant ministries. The most relevant automotive-related product safety and environmental regulation is the Market Surveillance and Inspection Regulation of Automotive Products dated 22 February 2018, which regulates automotive products through the Ministry of Industry and Technology within the scope of the Law on Product Safety and Technical Regulations, No. 7223.

In accordance with the new regulations brought by the Law on Product Safety and Technical Regulations, No. 7223, any importer or exporter who supply the market with products which are non-compliant with the safety regulations can face administrative fines of up to 681,000 lira, and they will also be liable for the damages caused by their product to any person or goods.

The Ministry of Industry and Technology is responsible for supervising and investigating technical compliance of vehicles with the Market Surveillance and Inspection Regulation of Automotive Products during the market distribution, import, export and assembly processes. While the Regional Directorates carry out market surveillance activities, the central unit of the Ministry of Industry and Technology deals with policy development, programming and monitoring of these surveillance activities. The most significant market surveillance activities carried out by Regional Directorates are product recalls.

Obligatory recall process

Pursuant to the Market Surveillance and Inspection Regulation of Automotive Products, within the scope of an obligatory recall, if a vehicle is determined non-compliant, the manufacturer must submit a corrective action plan to a Regional Directorate within 30 days and implement

such plan within one year if approved. If the plan is not approved by the Regional Directorate, or the manufacturer fails to submit an appropriate plan or fails to implement the plan, administrative fines of up to 231,540 lira may be imposed on the manufacturer. Extensions will not be granted for implementing the corrective plan unless the malfunction was not the manufacturer's fault.

Voluntary recall process

If a manufacturer detects non-compliance before an administrative authority does, a voluntary recall procedure must be implemented to avoid administrative fines, which can be substantial. In the event of a voluntary recall, the manufacturer will make a submission to a Regional Directorate including all necessary documentation and make an estimation as to how long it will take to conclude the recall process. The Regional Directorate may grant a maximum of one year for the finalisation of the recall transactions. Extensions will not be granted if the corrective plan's failure to be implemented on time is the fault of the manufacturer. The voluntary recall must be announced on the Ministry of Industry and Technology's website, and separate notices made to vehicle owners including detailed information on recall process, technical non-compliance of the vehicle and contact information of authorised offices. If a vehicle owner does not respond to the notice, a second notice will be made. If the owner fails to respond again, the notice shall be deemed to be duly served.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability issues constitute the largest number of disputes in this sector. Consumers who claim that a vehicle is defective may exercise the general rights they are afforded under the Turkish Law on Consumer Protection, No. 6502. If it becomes apparent that the vehicle is defective, the consumer may exercise one of the following rights:

- rescinding the contract and returning the purchased vehicle;
- requesting a discount from the sales price in proportion to the defect and keeping the purchased vehicle;
- requesting a free of charge repair with all expenses borne by the seller, if the repair does not require extensive expense; or
- requesting replacement of the defective vehicle with a defect-free one, if possible.

The legislation provides a warranty period of two years after the date of sale of a vehicle. If the vehicle contains a manufacturing defect, the consumer may assert the rights listed above, even if the warranty period has passed. Furthermore, certain spare parts may have different statutory warranty periods.

Although recall cases are not very common in Turkey, pursuant to the Market Surveillance and Inspection Regulation of Automotive Products, Regional Directorates of the Ministry of Industry and Technology conduct recall processes for vehicles deemed unsafe or non-compliant with technical regulations. Having said that, separate from the recall process, if a consumer claims that the vehicle is not in compliance with applicable technical regulations, the case is deemed a matter of product liability and examined by consumer courts within the scope of the Turkish Law on Consumer Protection.

Although the Turkish Civil Procedure Code allows a type of class action by associations or other entities on behalf of their members or groups whose interests they represent, in practice, class actions are not common for defective goods in Turkey.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Sector-specific rules

Since 1998, the Turkish automotive industry has been regulated by sector-specific rules, with the (latest) Block Exemption Communiqué released in February 2017. These sector-specific rules lay down the conditions to be met for vertical agreements in the automotive industry to benefit from block exemptions from the prohibition on the allocation of markets, interfering with sales conditions and exclusive dealing of article 4 (akin to article 101 of Treaty on the Functioning of the European Union) of the Law on the Protection of the Competition, No. 4054 (the Competition Law). The provisions of the Block Exemption Communiqué apply to vertical agreements concerning the purchase, sale and resale of new motor vehicles; the purchase, sale and resale of spare parts of motor vehicles; and maintenance and repair services.

As long as the market share of the parties to the vertical agreement does not exceed 30 per cent, exclusive distribution systems, quantitative distributions systems or qualitative distribution systems can be concluded. Vertical agreements in which the market share of the parties exceeds 30 per cent benefit from the block exemption only if they adopt the qualitative distribution system. The Block Exemption Communiqué aims to protect distributors from immediate termination by regulating the terms of their agreements and the notice periods for termination. Accordingly, to benefit from the block exemption, the agreement must have a duration of at least five years and both of the parties must accept a provision in the agreement to notify their desire not to renew at least six months before the expiration of the agreement, where the agreement is for an indefinite duration, the notice of termination period must be at least two years for both parties.

Hardcore restrictions

The Block Exemption Communiqué contains a list of hardcore restrictions applicable to the distribution of vehicles, spare parts and the aftersales market, and is supplemented by a sector-specific guideline. The main restrictions can be summarised as follows:

- restrictions on setting the distributor's resale prices, with the exception of setting maximum and recommended prices;
- restrictions related to the region or customers to which the distributor may sell, with the following exceptions:
  - in the case of an exclusive distribution system, restriction of active sales to an exclusive region or an exclusive customer group allocated by the supplier to itself or to another buyer, provided the restriction does not include sales by customers of the buyer;
  - restriction on sales to final users by a buyer operating at the wholesale level;
  - prohibition of sales by selective distribution system members to unauthorised distributors within the region allocated by the supplier for the operation of the system concerned; and
  - in the case of parts procured for assembly, prohibition on the buyer selling these parts to manufacturing competitors of the supplier;
- restrictions on active or passive sales by selective distribution system members operating at the retail level to final users. However, the supplier is entitled to prohibit a system member from operating at a location where it is not authorised. Furthermore, prevention of sales and purchases between members of the selective distribution system is prohibited; and

- restriction on an authorised service station's freedom to limit its operations to maintenance and repair services, and spare part distribution.

In its regulation of the distribution of spare parts, the Block Exemption Communiqué aims to ensure that authorised distributors, authorised spare part distributors, authorised service stations, independent spare part distributors, private service stations and end users are not forced to depend on the motor vehicle supplier for the procurement of the goods in question, and to allow other suppliers of such goods to be active in the market.

Non-compete obligation

Non-compete obligations are regulated separately under the Block Exemption Communiqué for the distribution of motor vehicles, for the distribution of spare parts, and for aftersales services. A non-compete obligation is defined as 'any direct or indirect obligation placed on the buyer forcing the buyer to make its purchases of the relevant goods or services in the relevant market, or substitutes thereof, from the supplier or from an undertaking designated by the supplier at a level of over 80 per cent in the new motor vehicle sales market and over 30 per cent in the aftersales market.

For the distribution of motor vehicles, non-compete obligations with a period of a maximum of five years are within the scope of the block exemption. However, the distribution of spare parts and aftersales services do not benefit from the block exemption.

Investigations in the automotive industry

The automotive industry, including the spare parts sector, is a relatively frequent investigation target of the Turkish Competition Authority (TCA). The first violation decision of the Turkish Competition Board (the Board), a part of the TCA, related to Renault's practices on vertical agreements in 2000. Renault was fined for non-compliance of its distribution agreements with competition rules, fixing the discount rates, prohibiting the use of matching-quality spare parts, and prohibiting fleet sales by authorised dealers to public entities. Two subsequent decisions of the Board against Doğuş Group, which imports and distributes Volkswagen Group brands into Turkey in 2001, and Peugeot in 2004 also related to vertical agreements that were not in line with the requirements of permitted block exemptions.

In its widest investigation of the industry, the TCA initiated an investigation of 23 undertakings active in the automotive sector (both passenger cars and light commercial vehicles) in 2009. The TCA alleged that the undertakings under investigation discussed future pricing policies, stock data, sales targets and sales strategies. According to the Board's decision in 2011, 15 undertakings under investigation violated article 4 of the Competition Law (article 4 is akin to article 101 of Treaty on the Functioning of the European Union). The Board imposed fines on these 15 undertakings totalling approximately 277 million lira. At that time, it was the largest fine ever imposed by the Board. In its decision, the Board emphasised that exchange of future prices or price strategies can be deemed a violation of competition rules. The Board indicated that unless otherwise proven by the investigated undertakings, it is presumed that the undertakings used the exchanged information to coordinate their actions in the market. Exchange of other information such as stock data, sales targets, sales amounts and sales strategies among the undertakings was deemed as complementary to the exchange of future prices and price strategies. The appeals process against the fines was concluded by the end of 2019. The Council of State dismissed the request of 15 undertakings to cancel the fines and approved the Board's decision.

A two-year investigation by the TCA, initiated in early 2020 against 24 car distributors, which included companies such as Ford Otosan, Mercedes, Volvo, Tofaş and Doğuş was in March 2022. The Board decided that there was no infringement by the undertakings and did not impose a fine.

The length of the appellate process for competition law violations often prevents claims for damages by private action because Turkish courts are unwilling to accept suits for damage claims before the final decision regarding the underlying infringement has been issued. Additionally, it is not possible to bring actions on behalf of multiple claimants in the form of a collective action. Although the Turkish Civil Procedure Code allows a certain type of class action, class actions are not used in practice, which can be considered as a barrier to damage claims by private action.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

The main types of disputes seen in the automotive industry are disputes arising from contractual relations and product liability.

Disputes regarding contractual relations usually arise among main industry manufacturers, sub-industry manufacturers, distributors and dealers. These disputes are usually resolved by litigation. If the infringement of a contract constitutes an emergency that may prejudice a party from exercising a right, such party may file for an interim injunction before filing a case, provided it posts a deposit. After obtaining the court's decision on an interim injunction, related legal proceedings must be initiated within two weeks. The parties are also free to include arbitration and other ADR clauses in their contracts, or agree to such procedures after the dispute has arisen.

Disputes arising from product liability can be divided into two groups: disputes between automotive companies and other legal entities, and disputes between automotive companies and consumers. While product liability disputes between automotive companies and legal entities are resolved by litigation through civil courts, specialised consumer courts oversee consumer disputes. Furthermore, if the claim is for less than 15,430 lira, consumers can apply to consumer arbitration commissions for expedited resolution of the dispute.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

There are no specific provisions for dealing with distressed suppliers in the automotive industry. Having said that, Turkish legislation in general aims to enable distressed suppliers to continue their operations and provide various incentives to improve their financial status. There are various incentives foreseen for small and medium-sized enterprises, from which sub-industry manufacturers can benefit. Such incentives include, but are not limited to, loans with a low interest rate, tax deductions, debt relief and reorganisation.

Furthermore, one of the primary goals of the Turkish Code of Obligations, at the time of inability to perform obligations, is to maintain the continuity of contractual relationships rather than immediate termination. Accordingly, the Turkish Code of Obligations sets forth that in a bilateral contract, if one of the parties is distressed, the other party may grant additional time or request a judge to do the same to enable the distressed party to perform its obligations. In such a case, a claimant can request compensation or termination only if the distressed party cannot fulfil its obligation in the granted time. Having said that, as a default rule, if the rights of a party to a contract are jeopardised due to the other party's inability to perform its obligation arising from the contract, especially if the non-performing party is bankrupt or collection

proceedings against it remain inconclusive, the jeopardised party may refrain from performing its obligations until the performance of the other party is secured without the necessity to grant additional time.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The most significant intellectual property disputes in the automotive industry have traditionally been due to alleged infringements caused by companies that are not original equipment manufacturers (OEMs), which constitute a majority of the market. The new Turkish Industrial Property Law, which entered into force in 2017, adopts a new method specifically for aftermarket and non-OEM parts. Pursuant to this law, if the intended use of a good is indicated, the trademark owner can no longer prevent third parties from using accessories, repair parts and non-OEM goods in good faith, within the natural flow of commercial life.

From a design aspect, protection of vehicle parts is examined in different groups: repair parts (must-fit parts and must-match parts) and equivalent goods. Must-fit parts (engine pistons and the like) are designed in an imperative shape and size for a specific function and cannot be replaced with a different shape. On the other hand, must-match parts (headlights and the like) are visible and mandatory for the original appearance of a design, but not the function. Designs of must-fit parts cannot benefit from protection over design rights and OEMs cannot pursue any claims over must-fit parts manufactured by non-OEMs arising from design rights.

On the other hand, must-match parts can benefit from protection of design rights, and the most significant intellectual property disputes arise from the manufacturing of must-match parts. An exception to this rule is that the use of a must-match part for repair purposes after the part has been in the market for at least three years does not constitute an infringement of design rights. This exception was adopted as a part of Turkey's harmonisation process with European Union legislation.

The Turkish Industrial Property Law also protects non-OEMs with respect to their production of equivalent goods to prevent intellectual property disputes between non-OEMs and OEMs. Pursuant to this law, the use for repair purposes of equivalent goods announced by the Ministry of Industry and Technology does not constitute infringement of design rights even for the first three years of the availability of the goods on the market.

There is no fast-track option for resolving intellectual property disputes. Disputes arising from the infringement of intellectual property rights are examined by specialised civil and criminal courts for intellectual and industrial property rights. The approximate trial period is one to three years, excluding the appeal process, which may take more than two years.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Pursuant to the Turkish Constitution, all employees have right to become members of trade unions without the necessity to obtain permission from their employers. In practice, trade unions actively operate with significant influence in automotive companies. Currently, there are three trade unions whose members include automotive sector employees (in addition to other sectors); namely, Türk Metal, Birleşik Metal-İş and Özçelik İş. These three unions have a total of approximately 289,315 members; of these, 215,174 are members of Türk Metal.

Provided that a trade union has at least 10 per cent of the employees of the sector as members and its members in the given automotive company constitute a majority of the employees, the union can apply to the Ministry of Labour and Social Security in order to be authorised to sign a collective labour agreement. If the authorisation is granted by the Ministry, a collective labour agreement will be implemented at the company. Collective labour agreements can be in force for up to three years. The negotiation process takes place between the trade union that has the majority in the given automotive company and the Turkish Metal Manufacturers Union, the major employers' union for the automotive sector, if the given automotive factory is a party thereto. If the automotive company is not a member of an employers' union, the representatives of the company take direct part in the negotiation process.

Turkish Labour laws clearly forbid employers to terminate employment relationships due to employees' membership of trade unions. In the event of a company's non-compliance, the employee will be entitled to claim compensation equal no less than one year's wages, in addition to any employment claims the employee is entitled to receive at the time of termination.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

Turkish legislation on the manufacturing of vehicles, and the automotive industry in general, is drafted in accordance with United Nations norms and European Union legislation. Furthermore, to ensure compatibility with technical developments in the automotive industry, there have been various recent amendments to Turkish legislation with respect to the manufacturing and repair of vehicles.

The manufacturing of vehicles was regulated by the 2008 Regulation on the Manufacturing, Modification and Assembly of Vehicles until late 2016, when it was replaced with a new regulation with the same name. With the new regulation, provisions relating to electric and hybrid cars were introduced for the first time.

Pursuant to the Motor Vehicles Law in force, electric cars are not subject to motor vehicles tax (MVT) because MVT is calculated based on the cylinder volume of the engine, which electric cars normally do not have. Having said that, pursuant to the Law on the Taxation of Motor Vehicles, MVT is applicable to electric cars too, at the rate of one-quarter of the MVT of gasoline engine vehicles within the same price range and with equivalent engines starting on 1 January 2019. On the other hand, MVT for hybrid cars is subject to the Motor Vehicles Law and is not specifically regulated in any legislation. There are also specific tax discounts foreseen for a special consumption tax for electric and hybrid cars to encourage the use of these new technologies. Although sales of hybrid cars and electric cars are increasing (49,493 hybrid cars and 2,846 electric cars were sold in 2021, compared to 24,431 hybrid cars and 844 electric cars sold in 2020), sales of such vehicles are still negligible in the overall market.

The operation of Uber and similar companies in Turkey was subject to great controversy for a long time in Turkey. To transport passengers in Turkey, a certificate for commercial passenger transfer must be obtained. However, pursuant to the regulation in force, only taxis and passenger vans (minibuses) with a certain number of seats are entitled to obtain this certificate. This created a legal gap and for a period enabled ride hailing companies to operate using commercially licensed vans without being subject to the high tax rates and taxicab licence (that regular taxis incur).

In response to a lawsuit filed by the Union of Taxi Drivers, an Istanbul court ruled in 2019 that the operations of Uber constitute unfair competition between the taxi drivers and Uber operators. Accordingly, the court terminated Uber's commercial activities and prohibited access to Uber services. Uber appealed the decision and in January 2021, the appellate court reversed the judgement. Following the reversal, the Information Technologies and Communications Authority unblocked access to Uber's services, and the company is currently operating in several cities, albeit essentially as a taxi haling app. Certain other taxi hailing services are currently operating in Turkey too.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

In November 2017, a consortium composed of five large Turkish companies, which later incorporated a company under the name of Türkiye'nin Otomobili Girişim Grubu (TOGG), announced a new project to manufacture a domestic car designed, engineered and manufactured solely in Turkey. In December 2019, TOGG presented prototypes of several passenger electric vehicles. TOGG announced that in the next 15 years, an investment of 22 billion lira will be made to establish a facility that can manufacture 175,000 cars a year. TOGG has stated that the company will start mass production and enter the market in the first quarter of 2023.

In September 2019, Volkswagen incorporated a subsidiary in Turkey for the purpose of setting up a factory in the Manisa province to produce Volkswagen Passat and Škoda Superb models. Volkswagen announced it was expecting to make an investment of around €1.4 billion in this factory. However, in October 2019, due to political reasons relating to Turkey's involvement in the Syria situation, Volkswagen announced that they had frozen the investment plan. In July 2020, Volkswagen announced that because of the recent developments due to the pandemic, it has decided to revise its investment plans and terminate its plans for expanding its production facilities. In December 2020, Volkswagen initiated liquidation process of its Turkish subsidiary. The liquidation has been completed and the Turkish subsidiary has been closed as of September 2021.

The Turkish Energy Market Regulatory Authority has recently published an extensive draft regulation on the establishment and operation of electric vehicle charging stations for the comments and evaluation of the public. Furthermore, the Union of Chambers of Turkish Engineers and Architects and the Chamber of Electrical Engineers are currently working on a draft regulation setting forth the conditions for the inspection of electric vehicles and charging stations. While these pieces of legislation are not in force yet, they are clear steps in the right decision for the synchronisation of Turkish legislation with technological developments in this area, and an indication that there will be important legal developments in the near future. It is estimated that the number of fully electric vehicles actively used in traffic is around 5,000 in Turkey, increasing from approximately 1,700 electric vehicles in 2020. However, to establish and operate a meaningful system of electric vehicle charging stations, the number of these vehicles must be increased significantly.

In March 2021, Turkish conglomerate Koç Holding and Ford Otosan announced that with an investment of around €2 billion, Ford Otosan plans to establish an integrated production facility to manufacture electric vehicles in Kocaeli. The factory is expected to start its operations in 2022 and to have a capacity of 650,000 commercial vehicles and a battery installation capacity of 130,000 per year.

The Law on Product Safety and Technical Regulations, No. 7223 entered into force as of March 2021, and with it the Law on Preparation and Implementation of the Technical Legislation on Products, No. 4703, was repealed. Although most relevant provisions have not been changed drastically, the new law has brought requirements for importers and exporters on product liability which holds importers and exporters liable for damages their product causes to any persons or goods. Further, importers and exporters that supply the market with defective products may face fines of up to 681,000 lira.

There is also an ongoing dispute among Turkish scholars regarding the rules to be implemented for autonomous driving and the responsibilities of vehicle owners in the event of accidents. Currently, there is no legislation on autonomous vehicles.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

According to research by Emirates NBD, the UAE is one of the largest automotive markets in the Gulf, second only to Saudi Arabia. The UAE relies heavily on imports, with nearly all cars being imported from manufacturing facilities abroad. Aside from a small number of factories that assemble components for trucks and buses, as well as factories that produce armoured vehicles and boutique high-performance sports cars, there is no significant large-scale, commercial automotive manufacturing activity taking place within the UAE.

The UAE's strong economic growth, household spending and relatively easy access to vehicle financing are likely to be the primary drivers for the automotive industry over the coming years. As the UAE's population continues to grow, the growth outlook for the automotive sector looks positive. The International Monetary Fund's World Economic Outlook estimated that the population of the UAE will grow to approximately 10 million between 2021 and 2025. Any increases in public spending on development projects and general infrastructure to support such an increase in population will generally bolster the automotive sector, through demand for trucks and other commercial vehicles required for such growth. Following a dip in new car sales figures of 17.8 per cent between 2015 and 2020, as a result of customers scaling back their spending, the market is forecasted to return to normal levels and, according to a *Gulf News* article in November 2021, obtaining enough stock to satisfy demand might even be an obstacle.

The impact of the covid-19 pandemic was felt in the UAE, with consumers nervous about discretionary spending and widespread restrictions on physical movement leading to the shuttering of car showrooms temporarily. However, demand did rebound, and UAE automotive industry experts remain cautiously optimistic about the future, citing easing lockdowns, the world-class rollout of vaccines in the UAE and on a more macro level, further infrastructure spending and economic development as reasons to be hopeful (including Expo Dubai 2020, which was held in October 2021). Nevertheless, the composition of the market for automobiles is changing. An article in the Abu Dhabi-based newspaper the *National* in May 2020 noted that the size of the used car market had surpassed the new car market in the previous 12 months, coming off the back of a decline in the number of new car sales in the previous four years. Data from the Roads and Transport Authority showed that the vehicle fleet of the UAE was getting older in comparison to previous years as consumers hold onto their cars for longer. A report produced by Ken Research predicts growth of 16.6 per cent in terms of revenue in the UAE used car market from 2020 to 2025, citing multiple factors including the covid-19 pandemic leading people to prefer to travel in private vehicles rather than by public transit.

The UAE is also becoming a hub and re-export centre for vehicle parts and components in the Gulf region. Abu Dhabi's government initiative to develop an 'Auto City' in the Mussafah area, southwest of Abu Dhabi, will potentially create a cluster of advanced workshops and service centres, attracting investment in automotive manufacturing and spare part logistics.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

All motor vehicles must be insured and licensed by the Roads and Transport Authority (RTA) before they can be driven on UAE roads. The process of obtaining insurance and licensing is straightforward and can be dealt with by auto dealers or car owners directly at any RTA outlet. Vehicles more than three years old must undergo an RTA safety test prior to each annual registration renewal.

In terms of the regulatory framework, all cars and buses entering the UAE must abide by the safety regulations issued by the Emirates Authority for Standardization and Metrology (ESMA) and the Gulf Standardization Organization (GSO). These regulations are primarily composed of a combination of European Union and US federal motor safety standards. By way of common examples:

- airbags for the driver and front passenger seats are compulsory for all passenger cars and buses with a capacity of up to 22 passengers;
- safety belts and anti-lock braking systems are required in all new cars; and
- all vehicles must have an alarm to notify the driver when the vehicle exceeds the speed of 120km/hour in cars and 100km/hour in buses.

In relation to homologation of new vehicles in the UAE, automotive manufacturers often conduct simulated tests at their factory facilities followed by local testing in the Gulf Cooperation Council (GCC) to confirm that prototypes of new vehicles are fit for driving in GCC countries and meet the standards set by the GSO and ESMA prior to any mass production taking place.

Certain tests are designed in part to ensure that new vehicles are capable of functioning properly during extreme heat conditions that are the norm for GCC countries, for example, between April and October in each year. The vehicle's durability, performance and stability are tested by representatives of the manufacturer driving it off-road and on highways at high speeds, and engines, transmission and other powertrain elements of the vehicle are tested through driving in standard city traffic, with an emphasis on relatively low speeds and frequent stopping and

starting. The other vehicle processes such as engine lubrication, electrical systems, braking, steering and air conditioning are all monitored during these tests to ensure that they perform to the required standards of each market. If any of these systems do not perform to the required standards, then the manufacturer's factory is notified to fix minor problems prior to mass production. In the case of substantial problems with prototype vehicles, the prototype will be sent back to the factory for investigation and a new prototype will be developed to undergo the same tests. Otherwise, the prototype is left with the local distributor to increase its mileage and measure wear and tear conditions.

In relation to certification, the automotive manufacturer will normally have a representative that is familiar with ESMA and GSO standards and confirm that the vehicle (or any parts) meet the requirements of these organisations. After the self-certification process takes place, the new vehicle's specifications are sent to the GSO for registration of the new vehicle, which is a requirement for customs clearance and further registration of the vehicle by any consumer.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

The majority of automotive manufacturers operating in the GCC have their regional head offices and logistic distribution centres located in Jebel Ali Free Zone in order to supply new cars and spare parts to their network of authorised distributors.

The contractual structure of automotive distributors or dealers may vary according to the policies of each manufacturer. However, in general terms, the operations are normally governed by dealership agreements covering commercial commitments and targets, in addition to legal terms and conditions in connection with the responsibility and obligations of each party. The lengths of such dealer agreements may vary, typically from one to five years, depending on the relationship between the manufacturer and distributor and any historic performance records in achieving annual commitments and targets.

Automotive manufacturers largely operate in the UAE by appointing local distributors pursuant to the UAE Commercial Agency Law No. 18 of 1981 (as amended) using local Emirati agents to sell products in the region; there are analogous laws in several other GCC countries. A recent amendment, by Federal Law No. 11 of 2020, has slightly widened the scope of who may be considered a commercial agent, but the relaxation of the requirement that agent entities must be 100 per cent UAE national-owned applies only where the agent entity is a public joint stock company (which must be 51 per cent UAE national-owned), or a private entity which is owned by a public joint stock company meeting that threshold.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Orders for new vehicles and parts are normally processed by the regional offices of the manufacturers. Weekly supplies of vehicles and parts are usually shipped from logistics centres by trailer within the UAE and GCC and by ship to other destinations in Middle Eastern and North African markets. Monthly stock orders may be shipped from factories abroad directly to importers and distributors in the UAE. The importers and distributors must have trading licences issued by the Ministry of Transport and renewed periodically by local authorities such as the Chamber of Commerce (each emirate has its own local regulatory powers and authorities).

Performance and metrics in relation to customer satisfaction are normally reviewed by automotive manufacturers and their distributors through regular meetings between senior executives from both parties. Any restructuring of a distribution arrangement is normally preceded by a number of warning letters and potentially by arbitration proceedings in accordance with the distribution agreement.

The Federal Commercial Agencies Law No. 18 of 1981 can cause significant issues for automotive manufacturers seeking to terminate their relationship with a local distributor. This was the case when a major international automotive manufacturer sought to terminate its distribution relationship in the late 1990s. The manufacturer was unable to terminate the relationship due to restrictions under the Agencies Law. The dispute that arose between the two companies proceeded before the courts of the UAE, and the manufacturer was unable to appoint a new distributor in the UAE until the dispute was resolved. The manufacturer was unable to sell its products in the UAE for several years as a result of this dispute with its local distributor.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Manufacturers do not have a significant direct presence in the UAE, electing instead to operate on an agency/distributorship model. Most M&A activity, therefore, tends to occur at the distributor level, rather than the manufacturer level.

Any M&A or JV transactions that result in a significant change in the ownership of a distributor should be reported to the Ministry of Economy (MOE) under MOE regulations. In addition, distribution agreements often contain change of control provisions that will require the distributor to notify the automotive manufacturer if such a change in ownership were to occur.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

The main barrier to entry into the market in the UAE is in company setup and licensing, including in relation to premises and importation; it is for these reasons, among others, that international manufacturers use authorised distributors in the UAE. In practice, this means that any new automotive manufacturer entrants into the UAE market will need to identify an appropriate distributor in the region to sell their vehicles and parts to consumers. Recent legal changes have permitted companies in most sectors established in mainland UAE to be 100 per cent owned by foreign nationals, in contrast to the previous requirement that at least 51 per cent of such companies be owned by UAE nationals, and we have not yet seen any impact of the legal changes permitting 100 per cent foreign ownership on the automotive industry.

Abu Dhabi's government initiative to develop 'an Auto City' in the Mussafah area is likely to lead to the creation of new production plants for cars, light vehicles and trucks, as well as assembly lines for manufacturing spare parts and vehicle accessories. This strategy could increase opportunities for automotive manufacturers and distributors in the UAE. More generally, the Dubai Chamber of Commerce and Industry has announced the formation of the Automotive Manufacturers Business Group, which will be tasked with developing and advancing Dubai's automotive industry.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

There are no specific product recall rules that exclusively apply to the automotive industry in the UAE. The general principles in relation to product recalls and compliance safety are therefore set out below.

Consumer safety and protection are regulated by the Ministry of Economy (MOE). The safety and quality of products are further standardised in the UAE by the Emirates Authority for Standardization and Metrology and local authorities such as the Department of Economic Development, the Dubai Municipality and Abu Dhabi Quality and Conformity Council. Together with the emirate-level authorities, the MOE has the power to investigate and enforce the recall of defective products based on consumer complaints and reports from international markets.

The main law relating to product recall is Federal Law No. 15 of 2020 on consumer protection (the New CP Law), which replaced Federal Law No. 24 of 2006. Executive regulations are due to be published alongside the New CP Law in due course, but until such time as these are published, the executive regulations issued alongside the previous law, Federal Cabinet Resolution No. 12 of 2007, will remain in force (to the extent that they do not contradict the New CP Law). The New CP Law and the current associated regulations state that a supplier of goods must immediately report any harmful defect discovered in any goods to the relevant UAE authorities and consumers. The Cabinet Resolution contains more detailed provisions regarding the notification and other procedures that must be followed by a supplier where a defect is found in goods. In practice, the notification is made to the UAE MOE Consumer Protection Department, and an advertisement of the recall is published in UAE newspapers to notify consumers. The notification to the Consumer Protection Department must be made within 14 days of the commencement of any product recall. It should be in Arabic (but can be accompanied by the home language of the supplier) and it must:

- state the name of the goods, the supplier and the country of origin;
- contain a colour photograph of the goods and the defective part;
- contain a detailed description of the defect and its causes;
- indicate the number of products sold and the quantity to be recalled;
- suggest the type and nature of probable damage to consumers;
- indicate procedures adopted by the supplier to recall the goods;
- provide the manner of announcing the recall (such as a newspaper advertisement), together with the duration and timing of such announcements;
- provide procedures to be adopted by the supplier in relation to the defective goods; and
- estimate the time frame expected to remedy the defect.

The supplier has a further obligation to notify the Consumer Protection Department with a report within 30 days of initiation of the recall, which must set out the following information:

- the quantity of the goods recalled in the UAE;
- the number of recalled goods either repaired (in which case providing details of the defective parts repaired), replaced or returned for a full refund; and
- the procedures to be adopted to avoid the defect arising, where possible.

The advertisement in local UAE newspapers is also quite prescriptive in that it must not be less than 15cm by 15cm in size and must contain the following information:

- the name and address of the supplier;
- the name of the goods and the country of origin;
- a description of the defect;
- the trademark of the goods;
- instructions that consumers should follow to avoid harm; and
- instructions that consumers should follow to have the goods repaired or replaced or to have the price of the goods refunded.

The responsibility to notify the authorities and consumer will lie with both the manufacturer and the distributor, but it is the distributor that will be found liable for any failure to do so. Penalties for non-compliance in connection with product recall rules include a fine of a minimum of 1,000 dirhams (with no maximum financial penalty stipulated) and referral to the Public Prosecutor for possible prosecution for commercial fraud, which may result in a prison sentence of up to two years, presumably for the manager of the establishment being prosecuted.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

There are no specific product liability laws or regulations that exclusively apply to the automotive industry in the UAE. We have therefore set out below the general principles that apply in relation to consumer litigation in product liability and product recalls.

A consumer can make a claim against a manufacturer or an importer under the UAE Civil Code if any products are defective and such defects are not covered by a warranty, or if the products do not fit their descriptions. Distributors can also be sued for misrepresentation in such cases. Additionally, consumers can bring claims for breach of contract against distributors under the Commercial Transactions Law No. 18 of 1993 if any vehicles are not fit for purpose.

In cases of 'gross cheating', the consumer can have the entire contract with the distributor invalidated. As a general rule, courts in the UAE only award damages for direct losses. Class actions do not yet exist in the UAE, and are unlikely to be introduced in the near future.

When claims are brought by consumers against distributors or importers, vehicle manufacturers may be required under the supply contract to indemnify such parties for the cost of remedying the defects in vehicles or spare parts.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

General principles of competition law under the UAE Federal Competition Law No. 4 of 2012 are applicable to the automotive industry in the UAE. For example, geographic division of markets and agreements between competitors to avoid soliciting each other's customers are considered to be anticompetitive. It is therefore unlawful, for example, for automotive distributors to allocate territories between them and agree not to market products in the territories allocated to the other distributor.

Similarly, abuse of a dominant position by a distributor or manufacturer, or any agreements between competitors aimed at reducing competition in the market, such as collusion in bids and tenders or agreements on the terms and conditions for goods and services, will likely be prohibited under the UAE Competition Law.

Consumers who are affected by anticompetitive agreements or conduct can complain to the Competition Regulation Committee at the Ministry of Economy. The potential for follow-on litigation is currently unclear on the basis that it is largely untested, but a finding anticompetitive behaviour will have a negative impact on the business of both the manufacturer and the distributor, in addition to resulting in potential criminal sanctions and fines ranging between 50,000 and 5 million dirhams for either abusing a dominant position or entering into an agreement that restricts competition in the UAE.

Notwithstanding the information above, the Federal Competition Law No. 4 of 2012 is stated to be subject to further regulations, some of which have not yet been published. The competition law of the UAE has therefore not been completely implemented, and it is uncertain and unclear how the courts will enforce competition law principles in the UAE.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

According to an article published in August 2016, 73 per cent of the disputes related to non-compliance with the terms of sales or service agreements, refunds or defective products, making it the third most complained about sector after services and electronics. The terms and conditions of vehicle warranty, insurance and sales and service agreements constitute most of the disputes in the automotive industry. In 2021, according to the Commercial Compliance and Consumer Protection (CCCP) sector in the Department of Economy and Tourism as reported by *Khaleej Times*, the automotive sector dropped to the sixth most common subject of customer complaints in Dubai, after services, electronics, e-commerce, clothing and shipping.

Several manufacturers and distributors are in the process of setting up bilingual customer care counters in their showrooms to comply with the standards set by the Department of Economic Development, to offer solutions and accelerate the customer satisfaction process and resolve disputes with customers prior to the commencement of litigation.

Disputes between automotive manufacturers and their distributors are relatively rare in the UAE because of the difficulty a manufacturer would have in terminating such a relationship. Disputes between principals and their registered agents are heard by a specifically constituted Committee of Commercial Agencies, which convenes to adjudicate on whether the distributor has fulfilled its duties as an agent, and has the power to strike an agency relationship from the register.

Registered agency relationships can be removed from the register either with the consent of the local agent, or by direction of the Committee of Commercial Agencies. It is therefore in the manufacturer's interests to resolve any problems with the distributor amicably, rather than attempting to terminate the distribution agreement prior to the end of its term, as the manufacturer will find the termination process difficult and time-consuming. More importantly, the automotive manufacturer will be unable to sell any products in the UAE during the period in which it is in dispute with its extant distributor.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

In practice, the distributor and the automotive manufacturer may seek to reach an agreement to extend the supply period by offering discounts to the distributor or shipping certain products free of charge to reduce damage caused to the distributor and to avoid complaints from customers.

Ultimately, the parties are reliant upon each other such that neither the automotive manufacturer nor the distributor is capable of selling products in the UAE without the other party's support. It is, therefore, in each of their best interests to support the other party during periods of distress.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Intellectual property disputes between automotive manufacturers tend to commence in international markets and are simply reflected in the UAE, rather than originating in the UAE. Disputes between distributors in the UAE are rare and have not historically related to intellectual property.

The principal intellectual property issues for automotive manufacturers and distributors in the UAE typically relate to branded counterfeit spare parts being imported or exported by non-authorised distributors and sold to consumers, which can potentially lead to safety concerns in addition to causing losses to the authorised distributors, which sell genuine but often more expensive spare parts.

To resolve this issue, a key consideration for automotive manufacturers and distributors will be how to efficiently implement anti-counterfeiting measures in the UAE. This process is likely to require extensive communication with customs authorities and the police in order to effectively implement such measures.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Employment law in the UAE is relatively basic compared to that in certain other jurisdictions. By way of example, trade unions and works councils are not permitted in the UAE. Employment agreements in the UAE (with the exception of those for employees within the Dubai International Financial Centre and the Abu Dhabi Global Market, each of which has its own employment regulations) must comply with Federal Law No. 33 of 2021 (the New Labour Law) and associated regulations and ministerial decisions. In accordance with the New Labour Law, employment agreements in the UAE are required to be of a fixed duration of a maximum of three years. Most employment contracts can be terminated on one month's notice unless otherwise agreed between the employer and the employee. On termination of an employment contract, an end of service gratuity may be payable to the employee.

Under the New Labour Law, any employee who has completed at least one year of continuous service is entitled to an end of service gratuity payment that amounts to 21 days' remuneration for each year of service for his or her first five years of service and 30 days' remuneration for each additional year of service, provided that the aggregate amount of the end of service does not exceed two years' remuneration.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

The Emirates Authority for Standardization and Metrology (ESMA) has prepared draft standards applicable to electric and hybrid vehicles being imported into the UAE, and these standards have been provided to the Gulf Standardization Organization (GSO) for consideration as the GSO is also seeking to develop standards in connection with these vehicles. The standards are still in draft form at the time of writing, and address: general requirements as to the performance and safety of electric vehicles; the responsibilities of manufacturers; the installation of charging ports and electricity supply; and how to deal with accidents. It will be important for cooperation between the GSO and the local standards bodies in each Gulf Cooperation Council (GCC) county (such as the ESMA in the UAE) to ensure that the final standards produced by each authority are aligned and automotive manufacturers are not required to make modifications to vehicles for each of the GCC countries.

It will also be important for these standards to be substantially similar to those used in other significant markets (such as the United States) to incentivise manufacturers to export their electric and hybrid vehicles to GCC countries in mass quantities. Uncertainty in the standards could potentially cause problems in the licensing of such vehicles as well as inconsistency of product quality, therefore frustrating the objectives of standardisation and objective to create a sustainable electric and hybrid market in the UAE.

The Dubai Green Mobility Initiative was established in 2015 by the Supreme Council of Energy as a strategy to achieve sustainable development and to create a low-carbon economy by promoting the use of hybrid cars and electric vehicles in Dubai. In addition, Vision 2021 was launched by His Highness Sheikh Mohammed bin Rashid Al Maktoum, the Prime Minister of the UAE and the Ruler of Dubai. One of the pillars of the Vision 2021 project was to create a sustainable environment and infrastructure, measured by a number of key performance indicators. The Vision 2021 site reports that many of the targets were achieved, including an Air Quality Index of 91.4 per cent and a 10.64 per cent share of clean energy contribution.

Shared transportation services continue to be a growing trend in the UAE; car-sharing service Udrive launched in Abu Dhabi in 2018 after finding popularity in Dubai the previous year. Users rely on an app to find cars in their vicinity, which can then be driven to a location and left behind. The covid-19 pandemic, however, has reduced the viability of these services; vehicles are still subject to maximum occupancy restrictions where the occupants are not from the same family or household.

Regulations and standards in relation to connected and automated driving vehicles are still under development at the time of writing, but it is expected that the UAE will continue to be progressive with its legal framework to enable such vehicles to enter the market in the UAE. Following the launch of the Dubai Smart Self-Driving initiative in 2016, it is anticipated that 25 per cent of all Dubai's journeys will be self-driving by 2030. Dubai began flight testing the world's first electronic autonomous passenger drones (autonomous air taxis) in 2017, with services planned to launch in 2023. Legislative and operational guidelines continue to be developed, and are expected to be the first of their kind worldwide.

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UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

There are no updates at this time, except for the potential changes to the foreign direct investment landscape in the UAE due to the removal of local 51//49 per cent foreign ownership requirements in many sectors. There may also be changes to the product recall process once the executive regulations in connection with the New CP Law are issued.

* *This chapter was co-authored by Ashley Connick, who has since left the firm.*

United Kingdom

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The automotive industry is a significant contributor to the UK economy, generating an annual manufacturing turnover of £60.2 billion in 2020 (a decrease on the 2019 figure of £78.9 billion). The industry employed some 797,300 people in the wider industry in 2019. Although 2017 saw the first decline in car production in the UK for nine years, overall the industry had remained strong. The covid-19 pandemic accelerated the material decline in production in 2020, with just over 920,928 cars built in the UK as compared to 1.3 million in 2019. In 2020, the industry accounted for 5.2 per cent of the UK's total export goods, with £27.24 billion worth of exported goods, and invested £2.9 billion in automotive research and development. Eighty per cent of total production in the automotive industry in 2021 was exported to more than 150 markets worldwide, with over half of those exports to the EU (53.5 per cent), followed by the US (17.7 per cent) and China (7.6 per cent).

However, the ongoing adverse effects of the covid-19 pandemic on both the UK economy and the global economy have had a significant effect on the automotive industry, severely impacting production and sales. Car production levels continued to fall in 2021, to around 859,575 cars built in the UK.

In terms of consumer behaviour, new car registrations remained at just over 1.6 million registrations in 2021, a decrease of 28 per cent from 2.3 million in 2019, but a slight improvement on 2020, which saw the lowest total since 1992.

In 2020, over half of car registrations were still fleet registrations, and this trend looks to have remained during 2021. With an increasing focus on car emissions affecting air quality, the demand for eco-friendly cars, particularly electric and hybrid vehicles, is ever increasing. As such, alternative fuel vehicle registrations have grown significantly between 2009 and 2021. In response, the decline in demand for new diesel cars continues. Consumers are looking to online marketplaces for competitive deals, and in 2021 more than 7.53 million used cars were sold in the UK. This figure is still below pre-pandemic levels, but shows a significant recovery from the reduced activity seen in 2020.

Brexit is still creating uncertainty in the UK's automotive industry, particularly as the EU automotive industry has historically been deeply integrated within the UK automotive industry. For example, in 2020, 78.1 per cent of cars imported to the UK were imported from the EU; 53.5 per cent of UK assembled car exports were to the EU; 81.5 per cent of imported components came from the EU; and 68.4 per cent of British-built components were exported to the EU. These figures illustrate that the maintenance of trade flows between the UK and the EU will be critical to support the continued success of the UK automotive sector, and the EU–UK Trade and Cooperation Agreement (the UK–EU TCA) (signed on 30 December 2020) will be central for managing the UK's trade relationship with the EU moving forwards.

Figures used in the above section are from The Society of Motor Manufacturers and Traders (www.smmt.co.uk).

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

Generally, to operate a vehicle on public roads in the UK, the vehicle must be registered and type-approved in the UK. The Vehicle Certification Agency (VCA), an executive agency of the Department for Transport, is charged with issuing vehicle type approvals in the UK.

There are now separate provisions for Great Britain and Northern Ireland as a consequence of the terms of the Northern Ireland Protocol, and Northern Ireland remains subject to EU type approval regulations. These approvals are known as UK(NI), which distinguishes them from EU member states' approvals. The UK type approval regulations cover both Great Britain and Northern Ireland, but apply differently in each area.

The regulations governing type approvals are:

- the Road Vehicles (Approval) Regulations 2020 (Statutory Instrument 2020 No. 818 (as amended));
- the Motorcycles (Type-Approval) Regulations 2018; and
- the Agricultural and Forestry Vehicles (Type-Approval) Regulations 2018.

New type approvals are available for all categories of vehicles under these regulations, in conjunction with:

- retained EU legislation in the case of UK approvals; or
- directly applicable EU Regulations in the case of UK(NI) approvals.

In making an application for type approval, a manufacturer's production processes will be subject to a conformity of production assessment. This will ensure that all vehicles will be manufactured in accordance with a particular approved specification. Pre-production vehicles will also undergo examinations to ensure that safety and environmental standards are met (including, where appropriate, destructive testing).

Where automobile parts are manufactured or sold separately, generally, they must be tested for compliance with the vehicle to which they will be fitted. However, certain component parts can be tested for compliance in isolation (for example, seat belts).

According to the VCA, the following rules currently apply for vehicle and component type approval in the UK as from 1 January 2021 (www.vehicle-certification-agency.gov.uk/vehicle-type-approval):

Existing vehicle and component type-approvals

- Vehicle manufacturers need a provisional GB type approval before placing their products on the UK market. EC type approvals will no longer be valid for this purpose, unless the vehicle was in the UK on or before 31 December 2020;
- UK and EU technical standards were aligned on 1 January 2021. As such, the UK will issue provisional GB type approvals, upon application, to manufacturers that can prove they hold valid EC type approvals. This administrative conversion of EC type approvals into UK type approvals avoids costly retesting and redesign for manufacturers, and ensures that products can continue to be sold and registered in the UK;
- the provisional UK type approval will be valid for two years from the date of issue. It will need to be converted into a full GB type approval during this period, or it will become invalid;
- until 1 January 2023, a valid EC type approval is acceptable for component, trailer and non-road mobile machinery (no provisional GB type approval is needed); and
- since January 2021, EC type approvals issued in the UK have not been valid for sales or registrations in the EU market. Manufacturers should, therefore, have a new EC type approval from a type-approval authority in an EU country. This process is set out in EU Regulation 2019/26.

New vehicle and component type approvals

- Manufacturers now need a UK type approval if they intend to place new vehicle models on the UK market. Manufacturers must follow the requirements of the Provisional GB type-approval scheme if they intend to get a UK approval on the basis of their EC type approval; and
- manufacturers wishing to place new products on the EU market need to follow the existing procedure for obtaining a new EC type approval. Full testing and certification must be done by an EU type approval authority and a technical service designated by that authority.

Registration

For use on UK roads or in UK public places, vehicles must be registered with the Driver and Vehicle Licensing Agency and hold a Vehicle Registration Certificate (V5C). The person named on the V5C is responsible for the vehicle as the registered keeper of the vehicle, and has a number of registration and licensing obligations. Without type approval, a vehicle cannot be registered or licensed by a person in the UK. A V5C is not evidence of ownership of the vehicle, and the owner and registered keeper are not always the same.

Insurance

Under current legislation, the UK has a compulsory motor insurance regime, under which a person using a vehicle (or causing or permitting the vehicle to be used on public roads or in a public place in the UK) must have insurance cover against third-party damage, although there are some exceptions for motor traders. For example, if a vehicle is between registered keepers or registered as 'in trade' with the Driver and Vehicle Licensing Agency, it is excluded from continuous insurance enforcement. This contrasts with the EU approach where, generally, the vehicle itself must be insured, not the individual person.

The Automated and Electric Vehicles Act 2018 (the AEVA) contains new insurance measures in light of advances in vehicle technology, which came into force on 21 April 2021. In particular, a new form of direct liability has been imposed on the insurer of a self-driving vehicle that causes an accident while driving itself. The single, comprehensive motor insurance framework allows a person who suffers damage in an accident, involving a self-driving vehicle with automated mode engaged, to have a direct claim against an insurer. Unlike the current third-party motor insurance framework, insured persons in the automated vehicle at the time of the accident will also be covered.

Drivers taking a UK-registered vehicle outside the UK may need to carry a Green Card depending on the destination country. The Green Card is an international certificate of insurance currently issued by insurance providers in the UK, guaranteeing that the motorist has the necessary third-party motor insurance cover for travel in the destination country. All UK vehicle insurance provides the minimum third-party cover to drive in the EU, as well as other countries including Switzerland, Norway and Iceland. Drivers taking a UK-registered vehicle to an EU or EEA state require valid vehicle insurance but are not required to carry a Green Card.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

As automotive companies are global businesses, the arrangements for the UK generally tend to mirror global or regional arrangements. Original equipment manufacturers (OEMs) generally have a supply chain structure of Tier 1 (supplying directly to OEMs) and Tier 2 (supplying to Tier 1 suppliers) and so on. For common parts, OEMs tend to be sourced pursuant to pan-EU arrangements, but will also often have specialist local suppliers located in close proximity to manufacturing sites. In the case of the UK, it is also not uncommon to see parts move across the border between the UK and the EU multiple times as part of the manufacturing process.

Arrangements with suppliers tend to be pursuant to purchase orders, which are governed by general terms and conditions established by an OEM. Typically, the commercial arrangements contemplate that the OEM will place orders for specific components supplied for particular vehicles over the life of a vehicle, but do not necessarily include minimum purchase quantities. Prices are negotiated with respect to each vehicle (often annually), and longer-term agreements may be subject to price adjustment mechanics. Larger suppliers and specialist suppliers for hard-to-source components can often have more bespoke arrangements reflecting their relevant bargaining power.

For major OEMs, design and engineering tend to be completed internally, although it is not uncommon to see licensing or collaboration arrangements between OEMs for the use of new technology.

The interconnectedness between UK and EU supply chains for parts and components, as well as finished goods, presents challenges in a post-Brexit world. The UK–EU TCA goes some way to help mitigate these challenges by providing for tariff-free trade for UK and EU originating products under the 'rules of origin'. However, even for products qualifying for preferential origin under the UK–EU TCA, there are added steps and costs associated with trading between the UK and the EU. Contracting parties involved in automotive trade between the UK and the EU should incorporate an agreed set of Incoterms in their contracts to establish responsibility and liability for the costs, procedures and risks associated with each step of the cross-border delivery of goods.

As the 12-month grace period has come to an end, electric vehicles (EVs) are one of a number of products to benefit from a phase-in period for rules of origin requirements to apply. EVs can benefit from an exemption on the tariff for vehicles manufactured outside the UK or EU until 2026, rather than the tariff being introduced immediately or over a shorter time frame. However, UK EV manufacturers will have to prove that at least 40 per cent of the value of parts in a finished EV that is

exported to the EU were produced in the UK or the EU (with no diagonal cumulation). The threshold for this originating content will increase to 45 per cent from 2023 until the end of 2026, and to 55 per cent from the start of 2027. The tariff exemption came about in part because batteries form a large proportion of the value inherent in an EV, and imposing tariffs on imported batteries (which are mainly imported from Asia or the US) would therefore stifle EV trade. The new rules of origin requirements further increase the need for domestic UK battery production, which will likely shape the cost-benefit analysis for EV manufacturers with plants in the UK. To keep its position as an attractive market for manufacturers of EVs, a material increase in the UK's domestic production of batteries will be required.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

In the UK new vehicles are generally sold through selective distribution networks, usually in the form of car dealerships. As such, manufacturers can control branding and sales processes, including aftersales relations. Owing to the nature of selective distribution networks, manufacturers can sell directly to consumer or fleet companies, but generally not to other dealerships outside of their selected network.

Competition law imposes particular requirements on selective distribution networks, especially with regard to the criteria for being an authorised dealer, and restrictions on trading within or outside the authorised network. Following Brexit, the UK competition rules are of primary relevance for businesses operating in the UK or importing into the UK, but EU competition rules remain relevant for UK-based exporters into the EU. Currently, the rules under each regime are largely the same, although there will be divergence over time now that the UK is no longer part of the EU. The changes to the Regulations are not expected to require significant changes to current selective distribution arrangements.

Relationships between manufacturers and approved dealerships in practice tend to be long-term arrangements (although typically they will be subject to termination on two years' notice), and the dealership will usually undertake warranty repairs as well as general vehicle sales services. Vehicle financing is increasingly common in the UK and takes a variety of forms, from manufacturers offering dealer financing for the dealership's purchase of vehicles for onward sale, to consumer car financing for purchase of new vehicles by individual consumers.

Fundamental issues across the distribution network (such as changes to a standard dealership contract) will usually be handled by the manufacturer dealer association, while localised issues with a specific dealer will usually be handled on an individual basis. In recent years there has been a consolidation of dealerships, creating larger dealers who have greater individual negotiating power outside a dealer association.

The UK's Motor Ombudsman (an automotive dispute resolution body) self-regulates the UK's motor industry through a number of Chartered Trading Standards Institute-approved Codes of Practice. These Codes of Practice cover accreditations for vehicle manufacturers, warranty product providers, franchised dealers and independent garages. While voluntary, compliance with relevant codes is frequently an obligation in contractual arrangements between manufacturers and dealerships or garages.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

At the time of writing, there are no issues particular to the UK automotive industry specifically that need to be considered in relation to the negotiation of an M&A transaction. However, Brexit and the covid-19 pandemic have generated much uncertainty in the industry, and the effects are yet to be fully observed. In addition, while UK law is at present largely aligned with EU law, over time there may be increased divergence between the legal regimes that could impact M&A transactions, for example, with respect to competition law.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are a number of significant UK tax incentives that apply to the automotive sector (although not exclusively) to encourage investment in capital and research-intensive activities, and in specific geographical locations. For expenditure incurred from 1 April 2021 until the end of March 2023, companies can claim a 130 per cent 'super deduction' (capital allowances) on qualifying plant and machinery investments anywhere in the UK. Further, the UK government has granted (or is expected to grant) the following areas freeport status: East Midlands Airport, Felixstowe & Harwich, Humber, Liverpool City Region, Plymouth and South Devon, Solent, and Teesside and Thames. In addition to some freeports being a customs duty and import VAT-free zone (until the goods enter the UK market), and benefitting from preferential treatment in respect of employer National Insurance contributions, freeports are expected to benefit until 30 September 2026 from:

- an increased (10 per cent instead of the usual 3 per cent) rate of Structures and Buildings Allowance on constructing or renovating non-residential structures and buildings;
- enhanced capital allowance of 100 per cent for companies investing in plant and machinery for use in the freeport. Unlike the 'super deduction', the enhanced allowance applies to both main and special rate assets;
- full relief against stamp duty land tax on the acquisition of land or property purchased and used within the freeport for a qualifying commercial purpose; and
- full Business Rates relief.

Tax reforms to encourage capital investment, including in respect of plant and machinery, are being considered by the UK government ahead of the end of the 'super deduction' in March 2023.

Other tax incentives applicable to the automotive sector include research and development (R&D) expenditure credit and R&D tax relief, to support companies that work on innovative projects in science and technology. Both of these incentives are available for large companies to reduce their taxable profits if they carry out qualifying R&D work. The UK government is considering reforms to aspects of the R&D regime, intended to take effect from April 2023. Where intellectual property is developed and exploited, a preferential Patent Box regime might apply. Although it has been amended to bring it into line with Organisation for Economic Co-operation and Development multinational requirements, the Patent Box offers an optional lower rate of corporation tax on eligible profits attributable to intellectual property. At the time of writing, the optional rate is 10 per cent.

Demand-side tax advantages are also available for ultra-low emission vehicles, to support demand in this sector. Fully electric, zero-emissions cars are exempt from VED (Vehicle Excise Duty or road tax), and also benefit from a 'plug-in' grant of up to £1,500, which is deducted from the cost of a new EV. The UK government has also committed to significant expenditure to support ultra-low emission vehicles (including in developing charging infrastructure), renewable fuels and connected and autonomous vehicles through the National Productivity Investment Fund.

While a number of incumbent OEMs are embedded in the UK market, new challengers are continuing to disrupt the UK market, from technology companies to mobility service providers. With the rise of self-driving vehicles, EVs and alternatively fuelled vehicles, we expect this trend will continue. Digital buying has already challenged traditional dealerships in the UK, as consumers spend longer researching and analysing information online. In response, many dealerships and retailers have adopted digital strategies to ensure consistency between online and offline consumer experiences.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The UK regime for the type-approval of vehicles is set out in the UK Framework Regulation (Regulation (EU) 2018/858 of the European Parliament and of the Council of 30 May 2018 on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles, amending Regulations (EC) No. 715/2007 and (EC) No. 595/2009 and repealing Directive 2007/46/EC (Text with EEA relevance) (legislation.gov.uk)) and the Road Vehicles (Approval) Regulations 2020 (SI 2020/818).

The UK Framework Regulation prescribes a series of technical standards (including requirements relating to vehicle emissions) for road vehicles and their component parts, systems and separate technical units intended for such vehicles, which must be met before type approval can be obtained. The UK type approval authority has powers to withdraw or suspend type approvals where vehicles are found not to conform to the approved type, or where the vehicle is found to present a serious risk to health, safety, the environment or other public interests. It can also refuse to recognise type approvals where it finds that a type-approval does not comply with the UK Framework Regulation.

Product recalls and other corrective actions are an important concern for the automotive industry in the UK. The competent authority, the DVSA, is an active regulator, and manufacturers carrying out corrective actions are often subject to ongoing reporting obligations. Recalls can be required under the General Product Safety Regulations 2005 (where the product is unsafe or dangerous) or under the UK Framework Regulation (where the recall is due to a non-conformity with the Regulation, including emissions requirements, or a serious risk to the health or safety of persons, the environment or to other aspects of the protection of public interests). The UK authorities have also published a Code of Practice on vehicle safety defects and recalls, and a manufacturer's guide to recalls in the automotive sector, which (while not strictly mandatory) are generally regarded as authoritative. A separate Code of Practice, and a Guide, exist for recalls in the vehicle aftermarket.

Despite the UK's withdrawal from the EU, UK authorities also continue to work closely with EU member state authorities in relation to type approvals and recalls. The UK Framework Regulation continues to require UK authorities to make notifications to other member states and to the Commission (all references to 'Member States' in the UK Framework Regulation are defined to include the UK). The scope of the UK's continued cooperation with EU authorities on safety and standards is set out in the Annex on Motor Vehicles to the UK–EU TCA.

Once a vehicle has been authorised for use on public roads in the UK, drivers must also comply with various vehicle safety provisions to ensure that the vehicle is operated in a manner that does not pose a danger to the general public (including the requirement for a driver to always be in a position to have full control of the vehicle, a full view of the road and traffic ahead, and a motor vehicle to be attended by a person who is licensed to drive it unless the engine is switched off and the parking brake is applied). Most vehicles are required to pass a Ministry of Transport test of vehicle safety, roadworthiness and emissions on a regular basis.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability cases in the UK automotive industry are generally brought by consumers under the Consumer Protection Act 1987, which implemented the EU Product Liability Directive 85/374/EEC.

Group litigation is also highly relevant and topical for the automotive industry, particularly in the context of consumer claims in respect of diesel vehicles that are alleged to have 'defeat devices'. Claims have been brought and are ongoing against a number of manufacturers, dealers and automotive finance companies.

The UK has an 'opt-in' collective action system for product litigation (rather than a US-style opt-out 'class action') and punitive damages are not available. However, group actions are still a considerable threat (and claimant firms are very active in the automotive sector, particularly around diesel claims and other product claims), so companies operating in the sector should be aware of this risk.

Developments in the automotive industry, such as the increasing prominence of hybrid vehicles, electric vehicles and connected vehicles, and the emergence of autonomous driving systems, will also impact the liability landscape in the UK.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Following Brexit, in substantive terms distribution systems in the UK automotive industry remain governed by the EU competition rules under the Vertical Block Exemption Regulation (330/2010/EU). This regulation has been carried over as a 'retained exemption' in the equivalent UK rules under the Competition Act 1998. This block exemption does not cover agreements relating to the purchase, sale or resale of spare parts for motor vehicles, or the provision of repair and maintenance services for motor vehicles, as these activities are covered by a separate block exemption, which came into force on 1 June 2010 (the Motor Vehicle Block Exemption Regulation (461/2010/EU)). This regulation has also been retained under the UK competition rules.

Over time, however, the UK rules will diverge from EU rules, since the post-Brexit UK regime under the Competition Act 1998 gives the UK competition authorities and courts greater scope to do so.

Both the EU Vertical Block Exemption Regulation and UK retained Vertical Block Exemption Regulation will expire on 31 May 2022 and be

replaced by a new Vertical Block Exemption Regulation and UK Vertical Agreements Block Exemption Order, respectively. The drafts of these new exemptions are similar in many respects but include some differences in approach to be taken by the EU and the UK.

The Motor Vehicle Block Exemption Regulation is up for renewal or reform on its expiry in May 2023. This is an obvious point at which the UK may adopt a different approach. The UK's Competition and Markets Authority has announced that it will launch a consultation on its proposed recommendation to the UK government on the Motor Vehicle Block Exemption Regulation in late spring/early summer 2022. The European Commission has already conducted its review of the Regulation.

In recent times, the UK competition authority has imposed significant fines on an original equipment manufacturer (OEM) and five of its commercial vehicles dealers for anticompetitive behaviour, including market sharing, price coordination and the exchange of commercially sensitive information. Following this, the authority issued an open letter to the motor industry warning against unlawful contact between competitors.

In addition, the Supply of New Cars Order 2000 (as amended) prevents new car suppliers from:

- discriminating on price between dealers and fleet buyers;
- providing bonuses and discounts to dealers on pre-registered cars; and
- imposing restrictions on price advertising on dealers.

The UK is currently a popular forum for private follow-on damages actions based on competition authorities' infringement decisions, including in the automotive sector. For example, there was recently a claim for damages before the UK Competition Appeal Tribunal (which is a specialist judicial body with cross-disciplinary expertise in law, economics, business and accountancy, that hears and decides cases involving competition or economic regulatory issues) against automotive bearings suppliers.

Dispute resolution mechanisms

10 | What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

The most common disputes in the automotive industry are supply chain disputes and disputes with dealers. These are usually settled out of court. The most common forum for resolving disputes with dealers and suppliers located in the UK is the English courts. The English courts have power to grant interim relief, including injunctions to compel performance. Where disputes concern international suppliers or joint ventures, it is common for the relevant contracts or joint venture agreements to provide for such disputes to be resolved through arbitration. Where arbitrations are seated in England and Wales, the English courts have the power to grant interim relief, including injunctions, in cases of urgency when the arbitral tribunal is unable to act.

There have also been an increasing number of technology licensing disputes as more technology companies enter the market.

There are procedures for group litigation in the UK. There is the potential for increased use of these procedures for collective redress, particularly in relation to claims by groups of consumers or distributors, or both.

Distressed suppliers

11 | What is the process for dealing with distressed suppliers in the automotive industry?

OEMs and their suppliers enter into long-term and highly symbiotic relationships. Tier 1 suppliers contract directly with the relevant OEM. Tier 2 suppliers' contractual relationships lie with the Tier 1 suppliers. In some cases, there will be additional links in the chain (for example, Tier 3 suppliers contracting with the Tier 2 suppliers and so on). The relationships are complex and interdependent on account of the high level of investment needed in new car models. Additionally, car models may be in production for a decade or more. Every model invariably requires bespoke tooling even though some aspects (for example, vehicle platforms) may be common among a number of models.

The need for collaboration between OEMs and their suppliers will become all the greater over the next few years, as the market adapts to continuing evolution in powertrain developments stemming from 'Dieselgate', which saw a number of vehicle manufacturers artificially reduce harmful emissions from their cars during tests, and its fallout. Particular examples are the development of new lean-burn engines, and hybrid or electric power plants. The result is that OEMs and their suppliers will often work together on the development of new models and their respective key components. Tooling and car parts are very often difficult to transfer between particular models and the supplier market. The result is that if a supplier encounters financial difficulty, it may take an OEM months (and occasionally a year or more) to 're-tool' and 're-source' from one supplier to another.

Production interruptions or delays may cause an OEM (and other supply chain members) daily and weekly losses wholly out of proportion to the financial worth or turnover of an individual distressed supplier. Those losses can quickly and easily run into significant sums of money. For that reason, major OEMs manage supply relationships closely. Where possible, they will dual-source (and on occasion even multi-source) components. In all cases, OEMs are likely to monitor the creditworthiness and ongoing financial viability of suppliers. OEMs' terms and conditions almost invariably also lay down approval procedures where suppliers change hands or, on a worst-case basis, encounter financial difficulties. Where problems arise, OEMs will therefore often be willing to provide ongoing finance to suppliers, negotiating priority arrangements with their bankers or other creditors. Such negotiations are likely to be combined with rights of access and inspection. In our experience, OEMs will also seek to secure access to intellectual property rights and the ability to remove tooling and finished parts, where a supplier gets into difficulty.

The relationship between the OEM's rights and insolvency practitioners can also be complex. Where a supplier goes into liquidation or administration, the supplier's administrator or liquidator will always seek to maximise recoveries from key OEM clients. In our experience, OEMs are frequently willing to fund production during an administration or liquidation in exchange for rights of inspection and the ability to influence (as a means of securing ongoing production) the identity of the purchaser of the business or assets of an insolvent supplier.

Intellectual property disputes

12 | Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Intellectual property (IP) disputes are significant in the automotive industry, and we anticipate this area of litigation will grow as technology from diversified fields is incorporated into vehicles.

IP disputes arise in the automotive industry in a variety of contexts. Automotive manufacturers have previously brought proceedings for

infringement of the design rights they hold over the appearance of their parts. These disputes typically occur between two parties within the automotive industry. A well-known example is in the context of wheel rims; the European Court of Justice held that the manufacture and sale of replica car wheel rims by a third party was permissible in certain circumstances, where the products are visually identical and the purpose is for repairs.

Patent disputes in the automotive industry are also expected to become more commonplace owing to the increasing connectivity incorporated into vehicles, which in turn has caught the attention of (commonly litigious) patentholders of cellular telecommunications patents. Unlike designs disputes, this will bring parties from different industries together in court. Patent litigation of cellular patents which are necessary to operate certain cellular standards (such as 4G or 5G, and known as standard essential patents (SEPs)) is already very common for mobile phone manufacturers. As vehicles begin to incorporate the same technology, the owners of large SEP portfolios are now approaching manufacturers for substantial licensing royalties to use their technology. Where licence fees can't be agreed, litigation (and with it the risk of an injunction preventing the use of the standard) can follow. A well-known recent example was between Nokia and Daimler, although this case resulted in settlement.

As to how well protected IP is, and how easy it is to resolve disputes, it is too early to reach a definitive conclusion. Design manufacturers may have been disappointed by the decision of the ECJ to permit the sale of replica components that do not contribute to a technical function of a vehicle under repair exemptions. As to how easy it will be to resolve disputes: SEP litigation, for example, can be complicated and expensive, and if history from mobile phone company disputes teaches us anything, they can last for several years and require multiple trials to determine different issues. Conclusion of licensing agreements is not always straightforward, given the high royalty fees SEP holders can command, many of whom are non-practising entities that have acquired their patents from other companies (commonly referred to as 'patent trolls').

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

There are no specific automotive sector employment regulations, or laws, in the UK. All basic UK employment laws and regulations essentially apply to employers in every industry or sector. Although the UK is arguably one of the larger economies when compared with the economies of the remaining EU member states, the UK is the jurisdiction with the lightest-touch employment laws. The UK still has far more 'employee-friendly' legislation, for example, when compared to the US.

The automotive sector is heavily unionised. The trade unions are strong, and usually represent a significant part of the workforce. There can often be more than one trade union recognised by a company. In the UK, there are no national, sector-specific or employer-association negotiated collective bargaining agreements (CBAs) of general application. Locally negotiated CBAs may apply within particular unionised UK employers. These are commonplace in the automotive sector.

A CBA will usually cover certain groups of employees, or 'bargaining units', at the workplace. In the automotive industry, a CBA usually covers, among other things, remuneration, working time (including overtime and overtime payments), disputes in the workplace (such as disciplinary matters) and security of employment. It is not uncommon to see restrictions regarding compulsory redundancies and agreed enhanced redundancy payments.

In addition to UK trade unions, large employers in the automotive industry are often part of multinational groups with EU works councils. This creates different levels of information and consultation obligations about issues affecting not just the UK workforce, but also those in other EU jurisdictions. After Brexit, whether UK employees continue to participate in EU works councils will depend on the wording of the relevant agreement, and any agreement reached between the employer and employee representatives.

Strong trade union presence can be coupled with political interest (and sometimes pressure) when there are perceived, and actual, threats to jobs.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

Key legal developments relating to automotive technological and mobility advances include the banning of sales of new petrol and diesel-based vehicles by 2030, and the development and use of autonomous vehicles.

Banning of sales of new petrol and diesel-based vehicles

The UK government is under increasing pressure to put in place measures to reduce air pollution, including pollution caused by vehicles. In response to this pressure, and in connection with the UK government's wider climate change strategy, in November 2020, the UK government announced that all sales of new petrol and diesel cars will be banned by 2030. The sale of some hybrid cars and vans will continue until 2035.

Data published by the SMMT show one in five car buyers in January 2022 purchased an EV. The primary driver behind the popularity of EVs is the possibility that such vehicles could provide CO_2 neutral mobility, if the electricity used to charge the vehicles is derived from renewable sources. According to a study carried out by Deloitte (2022 Global Automotive Consumer Study | Deloitte), after environmental concerns, the second most common motivation for UK consumers to purchase an EV is lower fuel costs. The commonality of EVs is also likely to rise with the increase in autonomous vehicles.

However, one of the primary challenges for the EV market is the lack of charging infrastructure across the UK, which is particularly significant due to rapidly increasing demand for EVs. The AEVA grants the Secretary of State powers to implement secondary legislation to improve the infrastructure in place for EVs, including to ensure provision of EV charging points at key strategic locations (such as motorway service areas and large fuel retailers), and require that charging points have 'smart' capability. Development of this infrastructure will be key, as currently the vast majority of EV owners charge their vehicles at home. The most common reasons cited for consumers who did not charge their EV at home were (1) that it was not possible to install a charger; or (2) that installing a charger was prohibitively expensive. This illustrates that charging a vehicle at home is not an option for all consumers, therefore a lack of charging infrastructure will be a limiting factor for growth of the EV market. Improvement of EV infrastructure forms part of a wider UK government strategy to encourage consumers to 'go green', building on similar initiatives that have been introduced (such as UK government grant schemes for new EVs or hybrid vehicles that meet certain criteria).

Investment by the UK government and the overseeing of the creation of a coordinated infrastructure, avoiding manufacturers and infrastructure providers working in R&D silos, will be vital for the widespread take-up of new EVs or hybrid vehicles.

Autonomous vehicles

The potential of connected and autonomous vehicles to enhance the lives and driving experiences of vehicle users is recognised and supported by the UK government and the UK automotive industry. According to the

SMMT, connected and autonomous vehicles will transform the lives of six out of every 10 people in the UK. The SMMT concluded that this new technology will offer freedom to some of society's most disadvantaged, including those with disabilities, older people and the young. In addition, the UK government has predicted that the British self-driving cars industry could be worth £41.7 billion by 2035.

The emergence of autonomous vehicles presents two critical legal challenges to the UK government, car manufacturers and drivers. First, at present the majority of road traffic laws in the UK assume that a vehicle will be controlled by a human driver who is engaged at all times and remains ready to resume control of the vehicle. Recently, the UK government confirmed planned changes to the Highway Code to accommodate self-driving technology, which clarify drivers' responsibilities in self-driving vehicles. Self-driving vehicles should be distinguished from the existing technology available on the market, which is 'assistive', meaning drivers must currently always remain in control and responsible. Although changes to the Highway Code are a major milestone, the government is continuing to develop a full legal framework for self-driving vehicles, which is expected to be in place by 2025.

The AEVA is part of the UK government's strategy to promote the development and deployment of automated vehicles, and (as mentioned above) contains new insurance measures in light of advances in vehicle technology. Under the AEVA, insurers can be liable for accidents caused by automated vehicles. This liability does not extend to loss suffered by the person in charge of the automated vehicle, and the insurer can bring a secondary claim against the person in charge of the vehicle. In most circumstances, the insurer's liability cannot be limited or excluded by the terms of the relevant insurance policy. Please refer above for further discussion of the role of insurance in this field.

In January 2022, the Law Commission of England and Wales and the Scottish Law Commission published a joint report on automated vehicles (Automated Vehicles | Law Commission). This report included a call for a new Automated Vehicles Act, due to the specific regulatory schemes required to regulate these vehicles. Other key recommendations of the report include writing the test for self-driving into law, a two-stage approval and authorisation process for automated vehicles and new legal roles for users, manufacturers and service operators.

Vehicles fitted with Automated Lane Keeping System (ALKS) technology could be the first example of self-driving technology, as long as they receive UK type approval and there is no evidence to challenge the vehicle's ability to self-drive. Designed for use on a motorway in slow traffic, ALKS enables a vehicle to drive itself in a single lane, while maintaining the ability to easily and safely return control to the driver when required. The technology controls the position and speed of a car in a single lane and it will be limited to 37mph (60km/h).

Once autonomous vehicles are more widely developed, it is likely there will be a shift towards intelligent transport systems (ITS). ITS allow communication between vehicles and infrastructure. For example, traffic lights and vehicles could communicate with one another, reducing road accidents, relieving congestion and reducing emissions.

The second challenge involves the collection and use of personal data. Collection and use of data using sensors and cameras in cars (to enable vehicles to make their own hypothetical driving decisions) is necessary for the development of autonomous vehicles. However, gaining consent for collection and use of that data, or relying on another legal basis, is a major challenge facing the car industry. The UK data protection regime includes a range of obligations that apply to any data collected from vehicles that can be linked to an identifiable living person. When designing vehicles, automotive manufacturers have to abide by the principle of 'privacy by design and by default', which requires that privacy issues be addressed throughout the design process.

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UPDATE AND TRENDS

Trends and new legislation

15 Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Traditional car ownership models are starting to be challenged by the development, and growing popularity of, schemes that provide alternative forms of access to vehicles. Online taxi platforms provide ready, convenient access to taxi services, and car subscription and car-sharing schemes are also on the rise. These business models will become even more economically viable with the rise of autonomous cars. As part of the gig economy, these activities will be under increasing regulatory scrutiny, including from an employment perspective. The reliance of these schemes on online platforms to operate also means that developments in online platform regulations are, and will continue to be, relevant.

A further trend that has been accelerated by the effects of the covid-19 pandemic is the decrease in consumer reliance on car purchases using the traditional car showroom. Online marketplaces offer increasingly competitive prices, and as consumer confidence and experience in buying all things online is increasing, so is the popularity of buying new cars online too. In response, many dealerships and retailers have adopted digital strategies to ensure consistency between online and offline consumer experiences. However, the first months of 2022, which signalled the lifting of covid-19 restrictions and the subsequent opening of car showrooms, have brought a 27.5 per cent increase in car registrations (compared to January 2021). This suggests many consumers still hold a preference for in-person purchases.

As in many other industries, the war in Ukraine has impacted automotive supply chains. Specifically, Ukraine produces approximately one-fifth of Europe's car harnesses, which hold together electric cabling within the car. As well as disruption to supply chains, rising oil and aluminium prices as a result of the conflict could discourage buyers from purchasing new cars. Automotive supply chains also continue to be impacted by semiconductor shortages as a result of the covid-19 pandemic.

* *The authors gratefully acknowledge the assistance of Christopher Hyde, David Haughan, James Gray, Joe Beautridge, Iris Karaman, Alice Russen and Johari Adjei in writing this chapter.*

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

The US automotive industry is massive. The US auto market is the world's second largest by number of vehicles produced. Over 250 million vehicles populate US roads.

Covid-19 delivered a vigorous economic shock to the US auto industry as it did on a global basis. New vehicle sales that were around 17 million for each of the few years before the pandemic were expected to drop precipitously. Some estimates forecasted sales at around 12.5 million units for 2020. Actual results were significantly better with total sales around 14.5 million units and around 15 million units for 2021. Demand has rebounded much faster than almost anyone expected. Continued supply challenges, largely due to limited availability of semiconductors but also due to new supply issues resulting from the invasion of Ukraine, lead many to forecast lower sales volumes for 2022, perhaps below 13 million units. More limited production paired with high demand produced strong sales prices in both the new and used car markets, which aided in profitability for original equipment manufacturers (OEMs) in 2021. The range of issues and challenges involved on a global scale make reliable predictions on sales and profitability difficult this year.

Given the magnitude of the US automotive industry, it is obviously of significance to the US economy as a whole and that is not expected to change. The industry's share of US GDP is often estimated to range between 3 and 3.5 per cent. Approximately 1.5 million people are directly employed in the industry. Projections indicate that around 7.25 million US jobs – about 3.8 per cent of total private sector employment – are to some extent dependent on the auto industry.

The scale needed to cost-effectively produce vehicles is large and resource-intensive. Major suppliers often locate facilities near to the manufacturing plants of OEMs so manufacturing hubs of substantial size tend to develop. As a result, the industry is typically an economic engine for local and regional economies where major production plants locate.

The impact of the industry extends to nearly every community in the nation as a host of businesses are required to sell new and used vehicles and to maintain and fuel those vehicles already on the road.

The transition to electric vehicles (EVs) is also impacting the US market. As discussed elsewhere in this chapter, emissions stringency is increasing, and companies expect a large volume of EV sales will be needed to comply with those rules. As President Biden's administration seeks to achieve environmental, labour and foreign policy goals, it wants to foster EV production in the United States and is proposing spending to fund EV charging infrastructure and sales support for EVs. These endeavours seek to significantly transform the automotive market in the United States.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

In the United States, new automobiles must be certified to both emissions and safety standards.

Emissions certifications are granted by the US Environmental Protection Agency (EPA) on an annual basis for all models sold in a given model year. The emissions certification is based on an application submitted by the manufacturer to the EPA and supporting emissions test results. The state of California has developed its own separate emissions certification and enforcement program for new vehicles sold in the state of California, which requires the submission of a separate application and test results to the California Air Resources Board (CARB) for vehicles sold in California. In recent years, a number of states, representing nearly one-third of vehicles sales, have adopted the California emissions programme, which historically has imposed more stringent emissions standards for certain pollutants including greenhouse gases (GHG) as well as targets for zero-emission vehicles (ZEV). New automobiles can only be sold in the United States after the receipt of Certificates of Conformity from the EPA and/or approving Executive Orders from CARB.

In the US, safety certification is done by the manufacturer through a 'self-certification' system. In this system, the National Highway Traffic Safety Administration (NHTSA) sets performance-based safety standards for a wide range of vehicle functions (from occupant crash protection to headlight performance), and manufacturers are required to self-certify, under penalty of law, that the vehicle meets all of the federal safety standards. Falsely certifying a vehicle subjects the manufacturer to substantial civil penalties and mandatory recalls at the manufacturer's expense for any and all non-compliances with safety standards. In addition to self-certification to safety standards, manufacturers are required to recall vehicles at no cost to the customer where defects that cause an unreasonable risk to motor vehicle safety are identified by either the manufacturer or NHTSA.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Globally and in the United States, the commercial terms with respect to distribution and supply arrangements tend to vary depending on whether the transaction involves an original equipment manufacturer (OEM) or aftermarket customer.

For OEMs, products are supplied through purchase orders that are governed by general terms and conditions established by an OEM. Typically, the commercial arrangements contemplate that the OEMs place orders for specific components supplied for particular vehicles over the life of a vehicle, but do not include minimum purchase quantities. Prices are negotiated with respect to each vehicle, but may be subject to adjustment for various reasons including commodity or foreign exchange escalation or de-escalation clauses and cost reductions achieved because of productivity improvements. Individual purchase orders are terminable for cause or non-performance and, in most cases, upon the supplier's insolvency and certain change of control events.

Suppliers manufacture and ship based on OEM customer release schedules, normally provided on a weekly basis, subject to variance based on cyclical automobile production or dealer inventory levels. Suppliers generally ship directly from a manufacturing location to the customer for use in vehicle production and assembly.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

The US legal environment is a challenging one for manufacturers and distributors. The distribution of motor vehicles is principally governed by 50 different state franchise protection statutes. Forty-five of the 50 states expressly prohibit OEMs from selling vehicles directly to retail consumers, and the remaining five place potentially onerous restrictions on direct sales. Notably, however, a growing number of states are granting statutory exceptions to new market entrants that (1) do not have existing dealer networks and (2) sell EVs only. Accordingly, vehicles are generally distributed to retail customers by independent dealers, with the exception of EV-only OEMs such as Tesla. While, as noted, the relationship between OEMs and their dealers is governed by statutes that vary from state to state, those statutes include a number of common elements. Chief among them are the following.

- The statutes are intended to redress an alleged 'imbalance in bargaining power' between 'large' manufacturers and 'small' retail dealers. As a result, each statute offers significant protection to the latter as against the former.
- Initially, the principal form of protection was against 'unreasonable' terminations and various forms of manufacturer 'coercion' (eg, against requiring dealers to accept product not ordered and not wanted).
- Most statutes have been amended multiple times over the years to add a host of additional protections and requirements. Among these include protections against 'unreasonable' refusals to recognise proposed transfers; restrictions on 'add-points' (ie, the addition of new dealer locations); regulations governing incentive programmes; regulations governing certain kinds of facility standards (eg, chiefly restrictions on the ability of manufacturers to insist that dealers sell exclusively one make of vehicle from a dealership location); mandates that franchisors pay 'retail' rates and prices for labour and parts used in warranty repairs; protection against unfair allocation of products; and restrictions on a franchisor's right to modify its standard form of dealer agreement.
- In addition to passing laws that are highly favourable to franchisees, many states have special administrative agencies ('dealer boards') to enforce the statutes and to hear and decide disputes between manufacturers and dealers.

Due to the substantial protections granted to dealers by these state laws, it is very difficult to terminate a dealer for poor performance and for most breaches of the franchise agreement. Dealers usually contest manufacturer attempts to terminate; the statutes provide for an 'automatic stay' of termination until the termination protest is fully litigated; and termination litigation can take years to complete. Restructuring a dealer network is extremely expensive: a manufacturer's need to restructure does not constitute good cause to terminate a dealer or to require a dealer to relocate under most state statutes, and, consequently, substantial settlement payments must typically be made to dealers to effectuate a restructuring.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

The US automotive industry has traditionally been highly regulated and likely more so today because of surges in disruptive technology and innovation driving change. Consequently, US automotive industry participants must carefully analyse national, state and local legal requirements in the formulation of strategic plans. While traditional automotive M&A and JV transactions involve due diligence and structuring issues with respect to competition, safety and environmental matters, the advent and adolescence of 'ACES' – vehicles that are automated, connected, electric and shared – and related technologies has resulted in new and expanded regulatory and business frameworks.

Technology-driven investments, new product entrants and growth in partnerships among industry participants (including erstwhile competitors), fuelled largely by a shift toward ACES, continue to challenge and reshape traditional US automotive industry models. OEMs and suppliers alike seek to expand their technological capabilities, as well as manage risk associated with supply chain disruption (including cross-industry disruption arising from the scarcity of semiconductors) from the fallout of the covid-19 pandemic, through a variety of legal arrangements including licences, investments, partnerships and full acquisitions of technology-focused companies and talent. While emerging technologies, evolving business models and continued access to capital markets in a relatively low interest rate environment provide deal-making opportunities globally, the United States is uniquely positioned as a home to traditional automotive industry participants such as the Big 3 OEMs in Detroit, centres of innovation and new market entrants such as Silicon Valley, as well as leading financial centres to support strategic developments both domestically and abroad. Further, the disruptive forces of new technology add additional complexities in the transaction context within the United States given that regulatory regimes developed over many decades need to be flexible to take new changes into account.

As an example of the evolving regulatory environment, while government regulation of autonomous vehicles remains a work in process, there is surging interest and investment in the application of autonomous vehicle technology, including to support supply chain logistics and specifically in last-mile delivery as the most expensive and time-consuming portion of deliveries to consumers. Consequently, from a transaction perspective, potential investors in targets developing and

utilising autonomous vehicle technology must develop a sophisticated understanding (and diligence) of the current federal and state regulatory environment as well as the target's compliance plans.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

There are no significant incentives targeted specifically at investment in the US auto market beyond various federal incentives for production of alternative fuel vehicles or the infrastructure to support them. For example, purchasers of electric vehicles currently may receive a tax credit of up to US$7,500 depending on the energy density of the battery. While this incentive flows to the consumer, it is essentially a pricing aid to manufacturers of qualifying vehicles to encourage the production of electric vehicles. Each manufacturer may use 200,000 of these credits. Some manufacturers have met those limits or soon will. Once that limit is surpassed, the sum of the credit reduces through a transition period before ending. There are legislative efforts in place both to revise the programme to extend the number of credits available and to end the entire programme completely. State governments in some cases may add additional incentives.

Various federal and state incentive programmes are in place that a manufacturer may take advantage of, but are not focused exclusively on the auto industry. For instance, those building manufacturing facilities may try to generate competition among states and local governments regarding the incentives offered to encourage them to build a plant in a given location.

Material practical barriers remain in effect for new OEMs entering the US auto market. Automobiles are highly regulated goods. The emission and safety rules are complex and challenging. State statutes effectively prohibit manufacturers from selling directly to retail customers, so building a network of dealers adds additional complexity in entering the market.

The most significant barriers to entering the US market are the depth and competitiveness of the market. While entering the US market requires careful planning and compliance with complex rules, staying in the market is even more challenging. A successful new OEM requires the resources to build a brand with a good reputation, as well as cars that capture the public's imagination and the praise of specialist reviewers. Those cars must remain serviceable over time and maintain value in the used market. A solid distribution network is crucial for success, as well as a good media team with a large budget to advertise the vehicles. Given the competitiveness of the market, profit margins can be small. A new entrant will need sufficient financial resources and resolve to stick with the investment when positive returns are unlikely for several years.

The most likely opportunity for new entrants in the US market comes from the prospect of electric vehicles (EVs) or autonomous-drive vehicles. Large and well-known technology companies with significant access to capital and established brand names continue to explore these new markets in addition to a host of companies interested in developing novel technology and production capacity. EV companies are also expected to evaluate entrance into the US market, in particular based on consideration of the value of emissions-related credits available to zero emission vehicles.

Mobility services utilising a fleet of vehicles would constitute a challenge of sorts to the business model of sales to individuals that has dominated the industry for decades. While it is difficult to evaluate exactly how such developments would impact market dynamics, many automotive manufacturers have explored these service options themselves. Ride-hailing and vehicle-sharing services were hit by covid-19. Early in the pandemic, some questioned whether perceived health risks would dramatically reduce demand for ride-hailing in the long term. Demand for ride-hailing services, however, has recently recovered and exceeds pre-pandemic levels. High fuel prices and challenges in getting drivers are current concerns for these services but there is no serious suggestion that these relatively new services are at risk of exiting the market.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

Environmental regulations

Pursuant to the Clean Air Act (CAA), the Environmental Protection Agency (EPA) and California Air Resources Board (CARB) have comprehensive regulations for passenger vehicles and light duty trucks that apply throughout the full useful life of the vehicle. Since the 1970s, the EPA has established mandatory emissions standards for 'criteria pollutants' (eg, NOx, PM, CO, HC) that have become progressively more stringent. Through a grant of a CAA waiver of pre-emption, the state of California can develop and enforce its own separate emissions requirements for vehicles sold in California. Over time, California has developed additional requirements for criteria pollutants and other emissions, and a number of other states, representing nearly one-third of all vehicle sales, have chosen to adopt California's emissions standards. Since the 1980s, EPA and the National Highway Traffic Safety Administration (NHTSA) have implemented and enforced fleet-wide standards for fuel economy. More recently, the EPA and CARB have been regulating greenhouse gases (GHG) through progressively more rigorous mandatory fleet-wide standards. Currently, California's GHG regulations are more stringent than the EPA's, which gives rise to a market for California GHG credits to facilitate compliance in California and the other states that have adopted California's GHG programme. In addition, California has established a zero emissions vehicle (ZEV) programme requiring manufactures' annual sales to include a certain fraction of electric or hybrid vehicles. Both the EPA and CARB have warranty requirements for emission-related components and require reporting and potential penalties or recalls for emission-related defects. EPA has recently enacted new, more stringent GHG emission requirements for Model Year 2023–2026 and is expected to propose new requirements for Model Year 2027 and beyond as early as next year. California has recently proposed new requirements for Model Year 2026–2035 (CARB GHG and ZEV), including more stringent ZEV mandates with the goal of 100 per cent new vehicles to be ZEVs by 2035.

Safety regulations

NHTSA maintains more than 70 federal motor vehicle safety standards covering the full range of safety-relevant vehicle performance parameters, from occupant protection to headlight illumination levels. Following the Ford-Firestone tire safety crisis in the United States, NHTSA also developed mandatory reporting requirements for potentially relevant safety information from in-use vehicles both in the United States and in foreign markets (pursuant to the Transportation Recall Enhancement, Accountability and Documentation (TREAD) Act enacted in 2000). The TREAD requirements require manufacturers to actively monitor warranty claims, customer complaints, death and injury claims, property damage claims, field reports and service measures, and report relevant data to NHTSA on a periodic basis. In July 2021, NHTSA issued a new Standing General Order requiring OEMs and operators

to promptly report incidents and accidents that occur while their vehicles are operating with Level 2 Advanced Driver Assist Systems and Level 3-5 Automated Driving Systems. This reflects NHTSA's increased efforts to regulate autonomous vehicles, and semi-autonomous vehicles, using its existing authority to mandate that manufacturers recall safety-defective vehicles and equipment at the manufacturer's expense. NHTSA has aggressively ramped up enforcement of all of its regulations and requirements in recent years, following major safety issues by a number of manufacturers. NHTSA has collected hundreds of millions of dollars in civil penalties for a wide variety of violations, including failure to recall safety defective vehicles and failure to comply with TREAD reporting requirements. In recent years, NHTSA has shifted its enforcement focus toward corporate conduct and process, and the bulk of civil penalties have been associated with gaps in corporate compliance structures and process.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

Product liability and class action litigation play a significant role in the US automotive market. Each year, consumers file numerous individual product liability lawsuits alleging that purported automotive defects resulted in bodily injury, injury, death or other damages. Consumers have also filed an increasing number of individual lawsuits seeking reimbursement for certain repair costs. (These are often referred to as 'lemon law' cases.) Consumers also file numerous class actions alleging that purported automotive defects (or alleged unfair business practices) resulted in economic damages, such as unreimbursed repair costs.

In some of these class actions, the consumer filing suit will not have incurred any repair costs or experienced the alleged vehicle malfunction. This type of class action is frequently referred to as a 'no injury' class action. In such class actions, a consumer frequently alleges that the automotive company concealed a supposed defect in the vehicle or its components and that, as a result, the consumer either paid more to purchase or lease the vehicle than intended or will recoup a lesser amount than expected upon resale. (This is also frequently referred to as a diminution in value claim.) Generally, a class action cannot be premised on the basis of bodily injury as there would be too many individual variations in class member claims.

A few trends are apparent in automotive companies' efforts to defend against individual and class action product liability claims. First, when facing class action allegations that a particular component is supposedly 'susceptible' to malfunction (but has not yet actually malfunctioned), automotive companies have argued that consumers have no standing to litigate, either individually or as part of a class action, because they have not in fact been injured. Second, US Supreme Court decisions issued in recent years have enabled more corporate defendants to raise personal jurisdiction defences. In limited circumstances, these decisions permit automotive companies (particularly foreign ones) to argue that courts have no authority to exercise personal jurisdiction over them. Third, automotive companies have investigated strategies for diverting consumer claims from the US court system to arbitration, which can often be a more efficient mechanism for resolving disputes. However, thus far, automotive companies have enjoyed only limited success in compelling the arbitration of claims by vehicle purchasers against automotive companies.

The advancement of autonomous vehicle technology also has implications for US litigation, including potentially reapportioning the liability of certain actors and the burdens of proof associated with particular claims. However, until new legislative and regulatory frameworks to address autonomous vehicles are developed, consumers are likely to continue to rely on traditional common law and statutory claims in lawsuits involving autonomous vehicles.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

While no special competition laws apply exclusively to the automobile industry, antitrust issues are pervasive in the sector. First, the Hart–Scott–Rodino Antitrust Improvements Act, 15 USC section 18a, requires parties to certain mergers, asset acquisitions and joint ventures to notify government enforcement agencies before closing. If notification is necessary, then the parties may not close the transaction until the statutory waiting periods expire. These statutes allow government enforcement agencies to review mergers, acquisitions, and joint ventures for competition-law concerns before consummation of the deal. Even transactions that are not subject to pre-closure review, however, may be challenged retrospectively under US antitrust law.

Second, automotive sector companies must comply with generally applicable antitrust laws. The Sherman Act prohibits agreements among two or more entities that unreasonably restrain trade. It also prohibits certain unilateral conduct permitting a firm to obtain or maintain monopoly power or threatening to allow a firm to do so. In particular, the Sherman Act flatly prohibits agreements between or among competitors to fix prices, rig bids, allocate customers or territories, and boycott suppliers, customers or competitors. Other agreements are judged under a fact-bound inquiry into their competitive effects. Under that analysis, if, on balance, the anticompetitive effects of an agreement outweigh its pro-competitive benefits, the agreement is unlawful.

In addition, the Robinson–Patman Act in certain circumstances prohibits differential pricing of commodities, which includes automobiles and automobile parts, and many states have special statutes protecting automobile dealers.

In the US, antitrust violations carry both criminal and civil penalties. In addition, private parties injured by antitrust violations may recover triple their actual damage and obtain injunctions against future violations. An active plaintiffs' bar regularly brings private actions. Antitrust actions are common in the automotive industry. In recent years, the US Department of Justice conducted a massive investigation into price-fixing and bid rigging in the automotive parts industry. A number of companies have pleaded guilty to criminal violations and received substantial fines. Individuals have also pleaded guilty and received prison sentences. Those investigations have also spawned substantial private civil litigation by automobile dealers and consumers. The Department of Justice also recently investigated whether four automobile manufacturers improperly entered an agreement concerning emission of greenhouse gases with the State of California. That investigation closed without action.

The Department of Justice has also recently been aggressive in investigating non-compete and non-solicitation agreements in the employment area. Although no investigation that has been made public directly implicates the automobile industry, contract covenants related to the solicitation or hiring of employees have become more common in asset sale or joint venture agreements in the automobile industry, particularly as manufacturers enter arrangements with non-traditional suppliers and partners for the development of electric vehicles and autonomous driving systems. These covenants should be reviewed carefully to ensure compliance with US antitrust law.

Dispute resolution mechanisms

10 | What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Original equipment manufacturers (OEMs) rarely have disputes with each other. Consequently, litigation among OEMs is rare.

Disputes are more likely along the extended supply chain in the auto sector. Even there, however, litigation between an OEM and a supplier is relatively rare. The nature of the economic relationship between the parties means disagreements are typically worked out through other methods of dispute resolution.

Disputes are not uncommon between manufacturers and auto dealers.

Disputes regarding intellectual property are a somewhat different situation.

Distressed suppliers

11 | What is the process for dealing with distressed suppliers in the automotive industry?

Traditionally, financial distress may arise from one or more of the following: (1) internal sources (eg, weak quality control, financial mismanagement or strategic missteps), (2) sources close to the supplier (eg, a defaulting upstream raw materials or sub-component supplier, a lender unwilling to renew or extend a line of credit), or (3) market-wide influences (eg, government regulation, technological change, commodity supply or pricing – or today, pandemics).

The growing trend, as 2020 approached, towards autonomous, connected, electric and shared vehicles (ACES) gave rise to concerns of potential distress for suppliers and other industry participants due to anticipated flat or depressed automobile sales and meaningful technological and other industry-wide advancements producing significant winners and losers.

In 2020, the covid-19 pandemic weighed heavily on automotive production, triggering several of the financial distress factors outlined above. However, as companies suffered from significant cash burn rates, they accessed a variety of financing alternatives to avoid full-scale restructurings, including CARES Act financing and other government support, decreasing working capital investment and extremely favourable debt and equity markets. As a result, automotive suppliers generally emerged with bullish projections premised on strong demand and normalised production in the second half of 2020, but, at the same time, increased leverage ratios.

Despite significant recent disruption (including from production limitations due to semiconductor and other raw material shortages), no major US automotive bankruptcies were filed in 2021, and that trend has continued into 2022. This has been due, in large part, to extended debt maturities and the enhanced liquidity noted above. However, the forecasts supporting the higher amount of leverage that contributed to this liquidity were premised in 2022 beginning with gradual relief in supply chain issues and steady progress towards a fully open economy that would result in a forecasted sales recovery and allow automakers to mitigate short-term supply chain constraints by improving product sales mix and raising prices. At the end of the first quarter of 2022, many projections were revised downward to reflect market uncertainty with world events, inflation and continued issues with supply chains. On one side, the industry is considering the extent of consumer demand destruction with higher gas prices and general cost of living inflation concerns. On the other side, manufacturers and suppliers are assessing how increased costs can be passed on. Wages and freight costs continue to increase, while commodity prices (including raw materials for EV batteries) have become more volatile. Not all suppliers will be able to navigate this environment equally and the risks must be assessed individually.

Further complicating matters is the accelerating demand for electric cars and the roll-out of electric vehicle (EV) models from legacy and start-up manufacturers. Incumbents are pivoting to include EV production alongside traditional internal combustion product offerings and favourable capital markets are funding new market entrants. This shift in the market with newer production platforms and market entrants is creating an additional set of variables for risk assessment. Not all suppliers will share equally in the changing market as global themes of electric vehicles vs internal combustion engines realign long-term production goals and supply chains.

Technological trends and volatile global supply chain dynamics are taking up most of the time in management discussions, which is a departure from previous distressed cycles. This is expected to result in significant strategic, operational, financial and transformation challenges for many suppliers, who have been and will be navigating through somewhat uncharted territory.

This dynamic industry backdrop provides a more complex environment for assessing financial viability and points of distress. Ideally, an OEM or top-tier supplier will identify a distressed supplier before the first delivery is missed or the supplier requests payment in advance to cover insufficient working capital. Obvious signs of supplier distress include, without limitation, failed refinancings, increasing leverage ratios, impending debt maturities, divestitures or sale-leaseback transactions, sharp drops in debt/equity security prices, management resignations, employment of advisers and deteriorating accounts receivable. While these signs of distress need to be monitored closely, the investigation of each of these criteria needs to be evaluated in terms of overall liquidity and strategic assessment within the currently changing industry environment.

Upstream customers must assess, through a close and open dialogue, how long it may be before a supplier's distress may affect them, and whether the supplier has the talent, ability, resources and time to cure its distress. These factors will inform a decision on whether to merely work with and monitor the supplier as it addresses a problem, or to move more aggressively to replace the supplier or consider other options, including:

- entering into accommodation agreements, under which the customer provides the supplier with commitments to continue sourcing parts balanced with customer protections, including collateral grants (including intellectual property rights) and facility access agreements;
- extending financing;
- providing operational support or facilitating changes in management; and
- acquiring the supplier.

The last option would not necessarily change the source of distress, but would provide the OEM or top-tier supplier with greater control to assess and fix its problems, and make necessary adjustments.

The US Bankruptcy Code permits the assets of bankrupt companies to be sold 'free and clear' of all liens and other liabilities, which could allow an OEM or top-tier supplier to obtain key unencumbered assets from the distressed business. An OEM or top-tier supplier may thus find that an acquisition of a distressed supplier (or key assets) is best accomplished within a formal bankruptcy proceeding, where the transaction is approved by a court and the chances of a post-closing challenge to the transaction terms are greatly diminished.

A distressed supplier may materially disrupt the complex and potentially fragile just-in-time inventory system upon which the automotive industry depends. OEMs and top-tier suppliers examine the financial health of prospective suppliers, but one that fails to continue

to monitor its suppliers, its competitors, or trends in its sector or region does so at its peril. It will be prudent for all stakeholders to frequently review potential signs of distress and associated risk mitigation strategies as largely unprecedented matters unfold.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

Intellectual property disputes, and in particular patent infringement actions, remain a significant issue in the automotive industry. Over the past several years there have been hundreds of automotive-related patent litigation cases, filed in US district courts and the International Trade Commission. Most of these suits have been filed by non-practising entities (NPEs or 'trolls'), often against multiple OEMs. This patent litigation continues to trend toward global disputes with high risk.

Many of these patent cases, however, do not focus on purely vehicle-specific technologies, but rather on such aspects as communication protocols in the infotainment, mapping and navigation systems, semiconductor or integrated circuit technologies used in auto parts such as battery power packs and radar systems, software algorithms used in autonomous vehicles, and connected car networking technologies incorporated into the vehicles. There also continues to be a clear trend towards disputes involving standard-essential patents (SEPs), particularly in the connected car space. Connected cars need to rely on existing infrastructure owned by telecommunication entities and others to access the internet, communicate with other devices, receive traffic information, provide in-vehicle entertainment, and enable control of vehicle systems via smartphones (eg, climate control, turning the car on and off). Using the existing telecoms infrastructure, however, requires using certain protocols, procedures, and data formats that are subject to industry standards set by standard-setting organisations whose members are telecoms companies, national administrations, universities, and research groups. Existing patents that cover these standards, such as Wi-Fi, LTE, 5G, 4G, 3G, UMTS, GSM, GPRS and WLAN, are referred to as SEPs. There is also an increase in SEP enforcement related to wireless charging standards. The owners of these SEPs are often the telecom or chip companies, although NPEs (including Nokia and Ericsson) are obtaining an increasing share often by purchasing patents from the innovators. SEP owners are also forming patent pools together (such as, Avanci), to attempt to license large patent portfolios relating to telecom standards. As vehicles implement more connected car technologies, including in 5G, the owners of SEPs in this space will continue their licensing campaigns and will file suits against automotive makers and suppliers when those licensing negotiations fail. These litigations will likely be on a global level and carry significant risk.

Resolution of intellectual property disputes varies, and may depend on whether the plaintiff is an NPE or an automotive company or supplier. When the plaintiff is an NPE or SEP holder, it is more likely that the dispute may be resolved for a licence fee, although the threat of an injunction still looms in jurisdictions such as Germany and the International Trade Commission, to create leverage in licensing pricing. Resolution of automotive patent litigation (and the amount and nature of such litigation) has also been impacted by *inter partes review* (IPR) proceedings filed by defendants in the US Patent and Trademark Office (USPTO) to challenge the validity of patents asserted in litigation. Defendants are having success invalidating patents, or forcing the patent owners to settle or drop lawsuits, by filing or threatening to file IPRs. The trend of filing IPRs in response to most patent lawsuits is expected to continue, although perhaps not with the fervour it did several years ago given the prior administration's propensity to enhance the protection and enforceability of patents. There is also a recent trend to ensure that IPRs are filed in advance of or at the start of lawsuits, as the institution of an IPR can be denied by the USPTO if the final decision in the IPR would come after trial or claim construction of the same issues.

EMPLOYMENT ISSUES

Trade unions and work councils

13 Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Any company interested in getting a deal done in the automotive industry must understand both US labour law and the state of labour relations in the industry.

US law does not provide for works councils and, in fact, severely discourages their existence by making dealing with employee groups that do not represent a majority of the employer's employees unlawful except for very limited purposes. Thus, works councils as formulated in Europe are non-existent. The way unions come to represent employees in the US is to demonstrate majority support among a group of employees, usually through a secret ballot election conducted by the National Labor Relations Board, a federal government agency responsible for regulating labour relations.

Although unions represent less than 7 per cent of the US private sector workforce, they have been making gains in organising certain sectors. The United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) is the union that has traditionally represented American automotive workers. It has been very strong in the Midwest, representing workers at Ford, GM and Fiat Chrysler (the Detroit Three) for decades, as well as a number of their suppliers. But it has struggled in the US South, where it has largely been unable to organise the foreign transplant original equipment manufacturers (OEMs).

An employer making a major investment, particularly a controlling interest, in an automotive manufacturer or supplier in the United States must consider dealing with a number of key questions:

- is the target unionised;
- if so, is there a collective bargaining agreement in place;
- does that collective bargaining agreement obligate the target to require a purchaser to assume the collective bargaining agreement; and
- is the transaction structured as an asset or stock deal?

If an acquirer purchases the majority of the stock of a corporation, the corporation remains subject to the terms of the collective bargaining agreement. If it simply purchases the assets, it will have to bargain with the union if a majority of the employees it employs come from the predecessor target. (The purchaser is not bound by law to hire the employees of a unionised target, but if it does not hire those employees because of their union affiliation, this would be an unfair labour practice.) Even if it hires the unionised workforce, the law requires the acquirer only to bargain with the union; it is not required to assume the collective bargaining agreement. However, many collective bargaining agreements require the employer signatory for a business to oblige an acquirer to assume the contract. If so, the seller will likely require contract assumption; otherwise it faces a damage claim by the union and the possibility of the sale being enjoined altogether. The bottom line is that a company considering buying a unionised operation must undertake careful due diligence. Issues to consider include whether the target is unionised, what kind of relations it has with the union, what are the provisions of the collective bargaining agreement, and whether it is possible to operate successfully under the agreement and whether it will it be required to assume the collective bargaining agreement. Mistakes can result in expensive litigation and strikes.

A major investment in a unionised OEM would be particularly complex. The UAW would carefully scrutinise a major investor and if it concluded that the investor would jeopardise its relationship with the OEM or have a negative impact in any way, the UAW would likely engage in significant efforts to block the deal. Again, a buyer should not consider such an investment without the most scrupulous due diligence and without a full understanding of the impact of the union.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 What are the most important legal developments relating to automotive technological and mobility advances?

The most important legal developments all revolve around the vast amount of technology coming into vehicles. Connectivity and accident-avoidance technologies have made the prospect of driverless cars a matter of extensive research and development not only by incumbent original equipment manufacturers (OEMs), but also by large global technology companies. These developments extend throughout an evolving supply chain.

Significant legal questions are developing around safety regulation. Federal safety rules are traditionally oriented around crash survivability but cars in the future will seek to avoid accidents. Safety rules also mandate certain structures such as mirrors that may be replaced by screens or a steering wheel and brake pedal that would obviously not be needed were the vehicle entirely autonomously driven. A host of rules will need re-evaluation as technology increasingly enters vehicles. The injection of advanced technology will also reshape the intellectual foundation for safety rules and lead to extensive changes over time.

The US Department of Transportation (DOT) continues to indicate the desire to facilitate these new developments and not over-regulate the industry in a way that inhibits development while still fostering safety. Guidelines issued by the Obama administration in September 2016 attempted to strike a balance between safety and technological development in a manner to encourage development and foster different solution pathways. The Trump administration issued in September 2017 its revision of these guidelines: Vision for Safety 2.0. These guidelines make it clear the safety assessments are 'voluntary assessments' that do not have to be submitted. Nevertheless, the DOT officials note they have extensive authority to address safety concerns and have stated that if those testing autonomous vehicles do not submit their assessments, the DOT will ultimately revise the guides in a more restrictive fashion. In October 2018, the Trump administration's DOT issued 'Preparing for the Future of Transportation: Automated Vehicles 3.0' (AV 3.0). This document further updated the administration's policy guidance and takes a multi-modal approach (applies not just to cars but to other modes of 'surface transportation'). In general, AV 3.0 affirmed the desire to use existing authority to advance and enable the technological development of the transportation sector. AV 3.0 provided updates on various initiatives related to autonomous vehicles and outlined a rulemaking agenda. Similarly, 'Ensuring American Leadership in Automated Vehicle Technologies: Automated Vehicles 4.0' (AV 4.0) was issued in January 2020 and continues to reiterate the administration's desire to revise existing regulations to remove barriers to automated vehicle technology while remaining technology-neutral and maintaining safety goals. In addition to DOT's four rounds of voluntary automated vehicle guidance, the National Highway Traffic Safety Administration (NHTSA) under the former Trump administration had undertaken numerous efforts to evaluate changes to the regulations needed to remove barriers for automated vehicle technology, including initiating advanced notices of proposed rulemaking as well as a new rulemaking for 'Occupant Protection for Automated Driving Systems' (the FMVSS 200 series). Under the Biden administration, NHTSA has recently finalised new rules amending the occupant protection-related FMVSS (200-series) to account for automated driving system (ADS)-equipped vehicles that do not have traditional manual controls associated with a human driver. We expect the Biden administration to continue developing a framework to address automated driving systems as well as similar efforts to incorporate safety standards for battery electric vehicles into the federal motor vehicle safety standards. Against this backdrop of required compliance with federal safety rules that do not yet accommodate automated technology, states continue to take varying approaches to the regulation of autonomous vehicles operating on their public roads.

With vehicles generating increasing amounts of data coupled with connectivity, privacy issues are of paramount concern. Automakers have issued industry privacy principles to follow for the protection of consumer interests in privacy. In addition, the California Consumer Privacy Act (CCPA), which became effective in January 2020, has a significant impact on OEMs and technology companies' handling of California consumer data. For example, while personal information shared between dealers and OEMs for recalls and vehicle repairs covered by warranties are excepted, other sharing arrangements between such entities that have been occurring for decades have been significantly affected by the CCPA because of its broad definition of 'sale' and corresponding consumer right to opt-out of the sale of personal information. In addition, a new ballot initiative that California voters considered in November 2020, the California Privacy Rights and Enforcement Act of 2020 (the Initiative), could further impact the industry. The Initiative will expand the CCPA, including through greater regulation of geolocation information, data that is frequently collected by today's vehicle technologies. Policymakers remain keenly interested in this area and additional laws or regulations could significantly impact how the industry handles data.

The extensive use of computer code in vehicles (estimates indicate modern vehicles already have over 100 million lines of code) and connectivity dictate that vehicle cyber resilience is a significant concern. The DOT recently issued guidelines in this area as well.

Fuel economy and vehicle emissions are aggressively regulated under a trifurcated and overlapping regulatory system with NHTSA regulating fuel economy and USEPA and California both regulating vehicle emissions, including GHGs. The current regulatory structure covers fuel economy and GHG emissions requirements, including four potential credit systems for electric vehicles and other low emission technologies, through Model Year 2026: (1) NHTSA CAFE, (2) EPA GHG, (3) California GHG, and (4) California ZEV credits. This year, the Biden administration has repealed and replaced the former Trump administration fuel economy and GHG emissions standards, effective for Model Year 2024 and Model Year 2023, respectively. In particular, EPA's Model Year 2023–2026 GHG emissions standards will be the most stringent GHG standards finalised to date and will continue to increase in stringency year-over-year (YoY) by 5 per cent in MY 2024, 6.6 per cent in MY 2025, and more than 10 per cent in MY 2026 (compared to 1.5 per cent YoY under the Trump rules). In addition, CAFE civil penalty amounts have been increased from US$5.50 to $15 per 0.1mpg by Model Year 2022. The increases in regulatory stringency as well as penalty amounts will undoubtedly impact the market for credits generated by EVs and plug-in hybrid vehicles.

UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

The trend toward a mobility system defined by autonomous, connected, electric and shared vehicles is technology driven and continues vigorously.

Public policy developments are having a significant impact on the industry. The administration of President Biden has environmental, labour and foreign policy goals that have led it to aggressively seek the development of a robust electric vehicle (EV) market with production of the vehicles and the batteries located in the United States.

New and proposed rules on vehicle emissions are, as expected, significantly more stringent and will essentially force a rapid shift to EVs by vehicle manufacturers. To facilitate market acceptance, the Biden administration seeks legislation that would fund EV charging infrastructure and support EV sales through incentives for consumers. The Biden administration has also revoked a rule issued by the administration of President Trump that eliminated a waiver under the Clean Air Act that allowed California and states that follow its lead (the section 177 states) to have their own rules on vehicle emissions. California has long sought to be at the vanguard of environmental stringency in the US, so the return of its regulatory capacity will further force OEMs to aggressively bring forward EVs as California is expected to aggressively enforce its own, more stringent GHG emissions programme and zero-emission vehicle (ZEV) mandate.

Governmental regulation does not, however, automatically lead to consumer acceptance. EV sales are approximately a small percentage of total vehicle sales in the US so a very dramatic change in consumer demand is needed for this desired transformation to EVs to occur. The sale of electric vehicles is, however, increasing and recent high fuel prices following Russia's war on Ukraine have increased consumer exploration into EVs.

The National Highway Traffic Safety Administration has taken tentative but significant steps to update regulations in anticipation of highly advanced vehicles. That nascent effort has a long way to go, but the formal start of the rulemaking process establishes an important process of regulatory change. These efforts have been in place during the administrations of Presidents Obama and Trump and are expected to continue further under the Biden administration. Notably, NHTSA has recently issued a first-of-its-kind final rule amending occupant protection-related Federal Motor Vehicle Safety Standards (FMVSS) to account for automated driving system (ADS)-equipped vehicles that do not have traditional manual controls associated with a human driver. The final rule updates the 200-series FMVSS in an effort to ensure that ADS-equipped vehicles meet the same standards for occupant safety and protection as traditional passenger vehicles, while also amending the standards to account for new designs and clarify applicability (and non-applicability) of specific standards.

Legislation to advance a mobility future, and autonomous vehicles in particular, has been introduced each of the past few years. While that legislation has led to Congressional hearings and negotiations nothing has found Congressional approval. No legislation in this area is expected to become law in 2022.

Sanctions rules in response to Russia's war on Ukraine have impacted the motor vehicle industry as they have many others. Further action on sanctions is dependent on how the war progresses.

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OVERVIEW

Market

1 Describe the significance of, and developments in, the automotive industry in the market.

Vietnam's automotive industry has seen significant growth in recent years to satisfy increasing customer demand. According to data compiled by the ASEAN Automotive Federation, Vietnam became the fourth-largest automobile market in Southeast Asia in 2020. In 2021, despite the difficulties caused by the pandemic and strict public health measures the Vietnam Automobile Manufacturers' Association recorded a 3 per cent year-on-year increase in automobile sales, with more than 300,000 units sold. The Ministry of Industry and Trade estimates that the growth in demand for cars will rebound in 2022, and increase by 16 per cent over last year. Industry analysts expect automotive sales to continue to increase in the coming years as Vietnam's young and growing middle class expands its appetite for cars. However, despite the increasing popularity and affordability of cars, for the time being Vietnam very much remains a country of motorbikes with approximately 58 million motorbikes registered and annual sales around 3 million. Vietnam is ranked as the fourth-biggest market for motorcycles after India, China and Indonesia according to statistics from MotorCycles Data.

Despite the increasing local demand for cars, Vietnam is largely an automobile-assembling, rather than automobile-producing, country. There are few local parts suppliers, meaning the vast majority of automobile parts used by in-country automobile manufacturers are imported. Imports of completely built units are also experiencing faster growth than domestically assembled units, and in recent years have represented approximately 30 per cent of total sales within Vietnam. Vietnam's tariff reduction commitments under the Association of Southeast Asian Nations Agreement on Trade in Goods, the EU-Vietnam Free Trade Agreement (EVFTA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) have opened the market to imports from regional car-producing countries such as Thailand and Indonesia, as well as from member countries of EVFTA and CPTPP.

Local real estate giant VinGroup JSC debuted Made in Vietnam cars under the VinFast brand in 2019, and its models have quickly become among the most popular in their segments. In March 2021, VinFast officially opened sales of its first electric car, with limited deliveries to consumers starting on 25 December 2021. VinFast has announced it will stop making gas-powered automobiles by the end of 2022, showing its determination to succeed in the global race of electric vehicles. Vinfast also recently announced that it will begin manufacturing vehicles abroad, with its first US factory complex planned for construction in North Carolina with a US$4 billion investment, and a potential plant in Germany.

COMMERCIAL OPERATIONS

Regulation

2 What is the regulatory framework for manufacture and distribution of automobiles and automobile parts, such as the homologation process as well as vehicle registration and insurance requirements?

The Vietnamese automotive industry is regulated and supervised by both the Vietnam Register, under the supervision of the Ministry of Transport, and the Ministry of Industry and Trade. The Ministry of Transport has oversight over technical and environmental standards of automobiles, while the Ministry of Industry and Trade is responsible for regulating imports of automobiles and automobile parts, and manufacture and assembly of automobiles.

Local assemblers of 'completely knocked down' (CKD) vehicles (ie, those that are imported for assembly in Vietnam) must ensure that assembled units satisfy technical and environmental standards set by the Vietnam Ministry of Transport. For that purpose, Circular No. 30/2011/TT-BGTVT, as amended by Circular No. 54/2014/TT-BGTVT and Circular No. 26/2020/TT-BGTVT, and Circular No. 25/2019/TT-BGTVT of the Ministry of Transport requires automotive designs to be evaluated and approved (as evidenced by a certificate of design appraisal) and the final product to be tested for satisfaction of relevant technical standards (as evidenced by a certificate of quality technical safety and environmental protection) before being permitted into circulation. The final products are also subject to ongoing annual and ad hoc inspection under the Ministry of Transport.

'Completely built up' vehicles (..., those that are imported fully assembled) must undergo a homologation process and receive a certificate of homologation issued by the Vietnam Register. Vehicles exempt from homologation requirements must obtain a notice of exemption from homologation also issued by the Vietnam Register. To be exempt from homologation requirements, Circular No. 31/2011/TT-BGTVT amended by Circular No. 55/2014/TT-BGTVT requires the following conditions to be satisfied: (1) the vehicle must be completely new; (2) the vehicle must have been manufactured within three years prior to the date of import; and (3) the vehicle must be either examined in accordance with a treaty or agreement on mutual recognition of technological standards to which Vietnam is a signatory or manufactured by a foreign vehicle manufacturer that has obtained CoP (conformity of production) clearance from the Vietnam Register.

Decree No. 116/2017/ND-CP, which took effect from 1 January 2018 and was recently amended by Decree No. 17/2020/ND-CP, requires automobile importers to obtain an automobile import licence from the Ministry of Industry and Trade. Decree No. 116 also imposes more rigorous quality inspection requirements and a list of business conditions regarding facilities and environmental protection, among others. Automobile manufacturers and assemblers must obtain a certificate

of compliance with these conditions from the Ministry of Industry and Trade, and are required to maintain fulfilment of these conditions throughout the course of their operations.

Individual vehicle owners must register the vehicle with the competent Police department and purchase and maintain automobile insurance as well as pay road maintenance fees throughout the period of use. Vehicle owners must also undergo periodic inspections and obtain an inspection certificate issued by the Vietnam Register.

Development, manufacture and supply

3 How do automotive companies operating in your country generally structure their development, manufacture and supply issues? What are the usual contractual arrangements?

Most foreign automobile manufacturers operate in Vietnam through manufacturing joint venture companies entered into with local (often state-owned) companies. Automobile parts are, for the most part, imported from outside Vietnam, although there is a small local supplier market as well.

Distribution

4 How are vehicles usually distributed? Are there any special rules for importers, distributors, dealers (including dealer networks) or other distribution partners? How do automotive companies normally resolve restructuring or termination issues with their distribution partners?

Because the distribution sector is not completely open to foreign investors (in other words, foreign investors and certain foreign-invested companies established in Vietnam engaging in distribution activities are subject to legal requirements not applicable to purely domestic companies), foreign-invested manufacturing companies typically work with local distributor networks and agents to distribute fully assembled vehicles into the market. Local distributors and qualified importers also engage in the import and distribution of CBU vehicles from outside Vietnam.

Decree No. 116/2017/ND-CP, as amended by Decree No. 17/2020/ND-CP, requires automobile importers to obtain an automobile import licence from the Ministry of Industry and Trade. One of the licensing conditions is that such importers have warranty and maintenance shops and are authorised by the relevant foreign automobile manufacturers to recall defective imports. Currently, importers no longer need to provide vehicle type approval certificates issued in the country of origin, and imported cars are not required to undergo rigorous quality control tests if they are identical to previously imported cars tested in the past 36 months.

Restructuring or termination issues with distributors are typically resolved in accordance with the relevant distribution or agency agreement between the manufacturer and the distributor. If the distributor relationship is structured as a principal-agent relationship, the Commercial Law of Vietnam provides for compensation upon termination equal to the average monthly remuneration of the distributor for each year of acting as agent for the manufacturer, unless otherwise expressly agreed by the parties. No compensation upon termination is payable in the case of a distribution agreement unless so agreed by the parties.

Mergers, acquisitions and joint ventures

5 Are there any particularities for M&A or JV transactions that companies should consider when preparing, negotiating or entering into a deal in the automotive industry?

Foreign investment activities in Vietnam, including M&A and JV transactions, are subject to completion of a licensing process that can be time-consuming and appear, at times, to be unpredictable and arbitrary. Acquisition of shares or other equity in an existing company is usually more straightforward than the establishment of a new company, but relevant licensing formalities must still be followed.

To establish a new company in Vietnam, a foreign investor must first obtain an 'investment registration certificate' (IRC) issued by the provincial Department of Planning and Investment or the management board of special zones (eg, an industrial zone, export-processing zone, high-tech zone or economic zone) where the new company will be located. Certain special or large-scale projects also require approval from the Prime Minister, National Assembly or local People's Committee. After obtaining the IRC, a second licensing process must be undertaken to apply for an 'enterprise registration certificate' (ERC), which serves as the business licence of the company and signifies completion of its establishment.

An IRC is not required in the case of acquisition of shares or other equity in an existing company in Vietnam. However, consent from the provincial Department of Planning and Investment is required if the foreign investor is acquiring shares in a company that operates a 'conditional' business, the acquisition increases foreign ownership of the target company (unless the total foreign ownership following the acquisition remains below 50 per cent), or the target company holds land in certain strategic locations.

In addition to the aforementioned investment-related licensing formalities, Vietnam's merger control regime stipulates that 'economic concentrations' meeting certain thresholds must be notified to the Vietnam National Competition Commission, and closing may not occur before clearance is granted. This regime applies to transactions occurring both within and outside of Vietnam, so long as any of the following thresholds are met: (1) either party (together with its affiliates) had assets or revenues in Vietnam in the preceding financial year of at least 3 trillion dong (approximately US$130 million); (2) the value of the transaction is at least 1 trillion dong (approximately US$43 million), for transactions occurring within Vietnam; or (3) the combined market share of the parties and their affiliates in the relevant market is at least 20 per cent.

Some business sectors or activities are also restricted or subject to additional conditions if the company has foreign investment capital, so a potential foreign investor should carefully consider any impact the investment may have on the existing or contemplated operations of the target company.

Incentives and barriers to entry

6 Are there any incentives for investment in the automotive market? Are there barriers to entry into the market? What impact may new entrants into the market have on incumbents?

In February 2016, the Prime Minister issued Decision No. 229/QD-TTg specifying incentives relating to finance, trade promotion, land and taxation for the automotive industry. Accordingly, automotive companies engaged in the manufacture, purchase and use of certain types of 'priority' vehicles (eg, small vans used in agriculture with a capacity of 3 tonnes, medium- and short-distance passenger vehicles, cars with nine or fewer seats and cylinder capacity of 1500cc and certain other specialised vehicles) will be entitled to certain incentives. Specific key incentives include:

- projects relating to auto parts production and car assembly of local companies are eligible for loans from the Vietnam Development Bank;
- companies that are part of a global supply chain for production of parts or vehicle exports are eligible for export credit from the Vietnam Development Bank;
- financial support is available from the government for government procurement, development investment credits and projects using priority vehicles;
- goods imported to create fixed assets for auto and auto parts production or assembly projects located in industrial zones, economic zones and high-tech zones enjoy preferential import tariffs;
- 'most-favoured-nation' import duties will be applied to priority and locally made vehicles;
- preferential corporate income tax rates will be set for projects relating to the manufacture of priority vehicles with a capacity of 50,000 units a year and manufacture of certain types of auto parts;
- auto parts production projects may enjoy certain land incentives (eg, exemption or reduction of land rent); and
- in addition to the aforementioned specific incentives, the government may provide support for large-scale automotive projects on a case-by-case basis.

Generally, barriers to entry into the market are more commercial than legal. For example, Vietnam's underdeveloped road infrastructure and cultural preference for motorbikes act as a check on the further development of the domestic automotive industry. Substantial taxes imposed on automobiles in Vietnam, including import taxes, value-added taxes on both new and used vehicles, and special consumption taxes (which can be as high as 150 per cent and apply to both imported and locally produced vehicles) also make them unaffordable to the vast majority of the local population.

In November 2020, the government instructed the Ministry of Finance in collaboration with the State Bank of Vietnam and the Ministry of Industry and Trade to propose policies on taxation and preferential credit to create favourable conditions for the development of Vietnam's domestic automotive industry. The government further instructed the Ministry of Industry and Trade to propose policies to promote the development of the country's leading automotive manufacturers.

Amid the ongoing difficulties caused by the pandemic, the government actively stimulated the incentives for locally assembled automobiles with registration fee reduction until the end of May 2022. The government has further encouraged the consumption of electric cars in the local market and the development of the environmentally friendly vehicle segment by introducing exclusive tax incentives and registration fee reduction for battery-powered cars for the next five years. It is therefore likely that Vietnam will observe a new wave of electric vehicle usage in the near future.

PRODUCT SAFETY AND LIABILITY

Safety and environmental

7 What are the most relevant automotive-related product compliance safety and environmental regulations, and how are they enforced? Are there specific rules for product recalls?

The most relevant automotive-related product compliance safety and environmental regulations are set out in:

- Circular No. 30/2011/TT-BGTVT, amended by Circular No. 54/2014/TT-BGTVT and Circular 26/2020/TT-BGTVT, of the Ministry of Transport (governing the production of completely knocked down (CKD) vehicles);
- Circular No. 31/2011/TT-BGTVT, amended by Circular No. 55/2014/TT-BGTVT and Circular No. 42/2018/TT-BGTVT, of the Ministry of Transport (governing the import of completely built up vehicles);
- Circular No. 70/2015/TT-BGTVT dated 9 November 2015 (setting out duties applicable to car owners); and
- Circular No. 25/2019/TT-BGTVT (governing the manufacture and assembly of CKD and semi knocked-down vehicles that have some domestically produced parts).

Non-compliance with these regulations can result in administrative penalties including monetary fines or revocation of relevant licences and certificates. The Vietnam Register also has the power to inspect the quality and standards of domestic automobile manufacturers on a regular or irregular basis to ensure compliance with relevant regulations.

Specific rules apply to product recalls in the automotive industry. According to Circular No. 30/2011/TT-BGTVT, amended by Circular No. 54/2014/TT-BGTVT and Circular 26/2020/TT-BGTVT, an automobile manufacturer must recall its products if they fail to comply with any applicable technical standards or cause (or may cause) danger to humans or property as a result of technical errors. The manufacturer must recall its products within five days of discovering the technical error and must notify the Vietnam Register in writing to propose a recall plan. Within five days of the date of receipt of the notification, the Vietnam Register must approve the plan (or suggest changes to it) and the manufacturer must recall its products in accordance with the approved plan. The manufacturer must also report the results of the recall plan to the Vietnam Register. Failure to comply with the regulations on product recalls may result in the manufacturer's certificate of quality technical safety and environmental protection for the affected class of automobile to be suspended or withdrawn.

Decision No. 49/2011/QD-TTg of the Prime Minister raised exhaust emission standards for newly manufactured/assembled or imported cars from a Euro 2 standard to Euro 4 from 1 January 2017, with a further increase to Euro 5 from 1 January 2022. Cars already in use and imported used cars are covered by Decision No. 16/2019/QD-TTg of the Prime Minister, which raised emission standards to Euro 4 for imported used cars from 15 May 2019. Cars manufactured prior to 1999 and still in use remain subject to the lower Euro 1 standard. From 1 January 2020, cars manufactured between 1999 and 2008 are subject to Euro 2, and from 1 January 2021, cars manufactured after 2008 are subject to Euro 2.

The concept of Extended Producer Responsibility was introduced in the new Law on Environmental Protection and its implementing decree, Decree No. 08/2022/ND-CP, which came into effect from January 2022 and primarily focuses on recycling and waste treatment contribution requirements for certain types of products. For the automotive industry, starting from 1 January 2027, manufacturers and importers of automobiles to be sold in Vietnam will have an Extended Producer Responsibility to recycle 0.5 per cent out of the total annual production and import of automobiles according to the mandatory recycling standards, which will be increased every three years. Manufacturers and importers can choose to self-recycle automobiles subject to annual recycling plans registered with the Ministry of Natural Resources and Environment and must report results. Alternatively, they can opt for making monetary contributions to the Vietnam Environmental Protection Fund to support recycling activities following the prescribed timeline under law. There is a formula to calculate contribution amounts in this case, and such amounts must be declared to the Ministry of Natural Resources and Environment on an annual basis.

Product liability and recall

8 Describe the significance of product liability law, and any key issues specifically relevant to the automotive industry. How relevant are class actions or other consumer litigation in product liability, product recall cases, or other contexts relating to the automotive industry?

The Civil Code of Vietnam and the Law on Protection of Consumers' Rights both provide a basis for liability for damage caused by manufactured or imported products, including automobiles and automobile parts. The Civil Code sets out the broad principle that individuals or legal entities engaged in production or other business activities are liable for damage caused to consumers as a result of such individual or legal entity's failure to ensure the quality of goods they manufacture or pass on to consumers. The Law on Protection of Consumers' Rights addresses product liability more specifically and provides that manufacturers and importers (including organisations or individuals who affix a commercial name on the goods or use a trademark or commercial indication identifying such organisation or individual as the manufacturer or importer of the goods) shall be liable for any damage caused by defective products manufactured or imported by them. In addition, where the manufacturer or importer of a defective product is unable to be identified, the direct supplier of the defective goods shall be liable for damage suffered by consumers as a result of the defect.

Notwithstanding this basis for liability set out in the law, it has not yet been a common practice in Vietnam for consumers to bring claims for compensation (either individually or as a class) against manufacturers or importers of automobiles, automobile parts or other products for damages caused by defective products. One reason for this is the relatively poor reputation of Vietnam's legal system, and in particular its courts, which are more often than not seen as time-consuming, costly, unpredictable and arbitrary in both proceedings and results.

DISPUTES

Competition enforcement

9 What competition and antitrust issues are specific to, or particularly relevant for, the automotive industry? Is follow-on litigation significant in competition cases?

Vietnam's Competition Law is aimed at preventing acts of unfair competition, acts in restraint of competition and economic concentrations that have or may have a competition-restraining impact on Vietnam's market. Acts that can serve to restrict competition include those that reduce, distort or prevent competition in the market through economic concentration (eg, mergers, acquisitions or other types of business combination transactions), abuse of dominant market position or monopoly or agreements to restrict competition (eg, agreements to divide the market to minimise or eliminate competition). Acts of unfair competition are those that are contrary to general standards of business ethics and that cause or may cause damage to the interests of the state or to the legitimate rights and interests of other enterprises or consumers.

The authorities tasked with enforcing Vietnam's competition regulations have not historically taken an aggressive approach to enforcement, and we are not aware of any case in which the authorities have accused an automotive company of violating applicable Vietnamese competition or antitrust regulations. It is yet to be seen whether the authorities will take a more active approach to enforcement in the automotive industry.

Dispute resolution mechanisms

10 What kind of disputes have been experienced in the automotive industry, and how are they usually resolved? Are there any quick solutions along the supply chain available?

Because Vietnam's court system is relatively unsophisticated and is perceived as being both arbitrary and unpredictable, most disputes in Vietnam are resolved outside of the formal legal system through commercial negotiations or amicable settlement of claims. This is particularly true in the case of product manufacturers or distributors who may be concerned that adverse news coverage or other publicity could negatively impact their brand in the eyes of consumers. Because most claims are handled outside of formal legal channels, and because Vietnam does not have a system of binding case law or other legal precedents, it is difficult to say with any degree of certainty what kinds of disputes have been experienced in the automotive industry. One can speculate, however, that disputes would be likely to arise from issues such as product liability and warranty periods.

When a dispute arises, the aggrieved party may seek one or more remedies including not only damages for loss but also interim or equitable remedies such as specific performance, temporary cessation of contractual performance or termination or rescission of contract. Injunctive relief may also be available upon petition to the competent court.

Distressed suppliers

11 What is the process for dealing with distressed suppliers in the automotive industry?

The process for dealing with a distressed supplier will depend on the terms of the contract between the supplier and the manufacturer or customer, including any remedy provisions included therein. However, where a supplier is, or is at risk of becoming, insolvent, a manufacturer or other customer of the supplier may also petition a court to initiate bankruptcy proceedings and join the list of creditors seeking recovery.

Intellectual property disputes

12 Are intellectual property disputes significant in the automotive industry? If so, how effectively is industrial intellectual property protected? Are intellectual property disputes easily resolved?

The most significant disputes in the automobile industry in Vietnam relate to counterfeiting of automobile parts and fittings and domain name disputes.

As a member of the World Trade Organization, Vietnam has established a relatively comprehensive legal framework to register and protect intellectual property rights. In the case of infringement or other violation of existing intellectual property rights in Vietnam, the owner of such rights may pursue relief through administrative, civil or, in some cases, criminal proceedings. In practice, administrative relief for infringement of intellectual property rights is more common (and easier to obtain) in Vietnam. However, although administrative relief is cost-effective to obtain and generally results in an immediate cessation of the infringement, it has proven to have a somewhat low deterrent effect overall. To date, civil and criminal causes of action have been limited to instances of deliberate counterfeiting.

Generally, intellectual property disputes are not easily resolved due to the intangible nature of the assets and, particularly in the case of patents or industrial designs, the highly technical knowledge that is often in question. This is especially the case in Vietnam, where courts and enforcement agencies are not experienced in handling highly complex or technical disputes.

EMPLOYMENT ISSUES

Trade unions and work councils

13 | Are there specific employment issues that automotive companies should be aware of, such as with trade unions and works councils?

Vietnamese employment regulations are extremely 'employee friendly', and in disputes relating to employment, Vietnamese courts and other administrative authorities generally sympathise with employees over employers. Even in cases of clear wrongdoing, it is extremely difficult to terminate an employee without his or her consent and willingness to cooperate.

Companies are not obligated to establish a trade union for employees, but must recognise and support trade unions or other representative organisations established by employees.

Companies with 10 or more employees must enact and register with the authorities a written set of 'internal labour rules'. An employee may only be disciplined in accordance with the internal labour rules enacted by the company or pursuant to the limited (and poorly defined) offences provided for in the Labour Code. The internal labour rules must be agreed with the company's in-house trade union or other organisation representing the company's employees. The relevant trade union or representative organisation must also participate in cases of employee discipline or where changes are being made to the rights or responsibilities of company employees.

NEW TECHNOLOGIES AND MOBILITY

Legal developments

14 | What are the most important legal developments relating to automotive technological and mobility advances?

Although Vietnam is not at the forefront of automotive technological and mobility advances, car-sharing applications such as Grab (and previously Uber) have experienced rapid growth in popularity since their relatively recent entry to the market. Vietnam's largest taxi firm, Vinasun, sued GrabTaxi Vietnam under Vietnam's competition law for 'unhealthy competition', but both passengers and drivers continue to flock to ride-hailing firms owing to widespread dissatisfaction over the service provided by traditional taxi companies. Although GrabTaxi claimed that it was operating as a technology firm rather than a taxi company, the court concluded otherwise and awarded damages to Vinasun. Both parties appealed the decision, and on 10 March 2020, the Superior People's Court in Ho Chi Minh City officially rejected the appeals and upheld the first court's judgment against GrabTaxi.

In early 2020, the Vietnam government enacted Decree No. 10/2020/ND-CP on automotive transportation business and conditions for automotive transportation business, which officially put an end to the pilot programme for ride-hailing services under Decision No. 24/QD-BGTVT. Accordingly, from 1 April 2020, Decree No. 10 requires that entities that participated in the pilot programme must choose a suitable form of business, either in the form of passenger transportation business by taxi, contract-based passenger transportation business or providing software application to assist with connection in transportation. Other requirements apply depending on the form of business selected.

The first autonomous car in Vietnam was introduced in 2017, using software developed by local company FPT Software. FPT Software subsequently experimented with a level-3 autonomous car in 2019, while Phenikaa Group introduced Vietnam's first level-4 smart self-driving vehicle in March 2021. Although there are currently no regulations in place governing autonomous vehicles in Vietnam, Vietnam's Ministry of Transport supports the development of these self-driving cars as they are considered to be in line with the government's strategy on the 'fourth industrial revolution'. The Ministry has also responded positively to FPT Software's proposal to allow it to operate its driverless cars on a trial basis on internal roads in a hi-tech park in Ho Chi Minh City.

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UPDATE AND TRENDS

Trends and new legislation

15 | Are there other current legal developments, emerging trends or pending legislation relevant to the automotive industry that should be noted?

Vietnam's entry into the EVFTA and other international trade agreements such as the CPTPP and the ASEAN Trade in Goods Agreement will help Vietnam's domestic automobile industry to join the global supply chain while increasing competition between domestic and imported vehicles in Vietnam. As a result, Vietnam's domestic automobile manufacturers will need to focus on improving quality and lowering production costs to compete with imported vehicles.

The Ministry of Industry and Trade published the second draft of a proposed Law on Protection of Consumer Rights in January 2022 for public consultation until March 2022. The draft proposals introduce a number of new consumer protection regulations that may affect the automotive industry, especially in terms of consumer data privacy protection, requirements on warranty policies and recall of defective products. The timeline for the new law's effectiveness is 2024. There are many pending legislative developments in Vietnam in the area of cybersecurity and data privacy that also affect the automotive industry, especially in terms of data localisation requirements and conditions of cross-border transfer of data generated in Vietnam. These proposals are subject to change as regulators seek feedback from market participants.

* *This chapter was co-authored by Ngan Tran, who has since left the firm.*






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ISBN 978-1-83862-978-6