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2013 Automotive Institute Survey Results State of the Automotive Industry



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Executive Summary

The Drive Towards Globalization

Over the last five years, the “Big Three” automakers have made a concerted effort to reinvent themselves following the financial crisis and recession. With a focus on improvements such as refreshing their product lines to emphasize smaller, fuel-efficient vehicles, this transformative evolution has put them in a strong position to compete globally.

In that regard, the U.S. auto industry is growing its footprint in booming global markets such as Brazil, Russia, and China. Automotive analysts predict that the future of car buying and the success of the automotive industry more broadly will be determined outside of America’s borders. According to IHS Consulting, 80 million light vehicles were sold globally in 2012; by 2020, the number will grow to 108 million, about two-thirds of these to be sold in emerging markets.

As the automotive industry continues to move towards globalization, original equipment manufacturers (OEMs) and automotive suppliers face even more complex legal issues across the world that may affect the productivity of their organizations and their bottom line.

What are the top legal challenges that U.S. automotive executives face when doing business overseas? To answer this question, the “2013 Dykema Automotive Institute Survey: Industry Challenges” queried nearly 100 industry executives and other industry insiders from numerous OEMs and automotive suppliers. The survey also uncovered whether automotive executives are addressing these challenges head-on to ensure their organizations remain competitive or whether their focus on other issues is leaving them at risk in these potential areas of liability.

What they told us: Data privacy topped the list of global compliance concerns, likely due to the fact that the privacy and security regulations with which companies must comply vary significantly depending on the specific country or region the company (and its executives) are dealing with at any given time or on any given project.

Taking a closer look to gauge whether automotive executives actually address this data privacy challenge head-on, the survey found that only about a quarter of respondents report their companies employ in-house experts who concentrate on privacy and security challenges, while the large majority of them do not. Rather, 74 percent of respondents said their companies do not employ a chief privacy officer or other senior manager with “privacy” in his or her job title. And while 48 percent of respondents said their companies rely on general counsel or other in-house lawyers to handle privacy matters, another 16 percent of them report the privacy function is not even assigned to anyone in particular. In many cases, these companies must turn to outside lawyers for assistance with global security and privacy questions.

Navigating the complicated corporate bribery laws when doing business overseas was another notable challenge referenced by survey respondents. While U.S. OEMs and suppliers continue to expand into China to take advantage of its growing automotive marketplace, the country’s reputation for corruption in both the private sector and government-related business has not gone unnoticed. It is therefore not surprising that a wide majority of respondents chose China as posing the greatest compliance risk when doing business overseas.

The survey also reveals some surprises related to legal issues not on automotive executives’ radars. Although automotive collaborations often raise legal and operational questions ranging from antitrust issues to the challenges that arise when collaborating with competitors, automakers are increasingly teaming up with competitors to share costs and brainpower as fuel

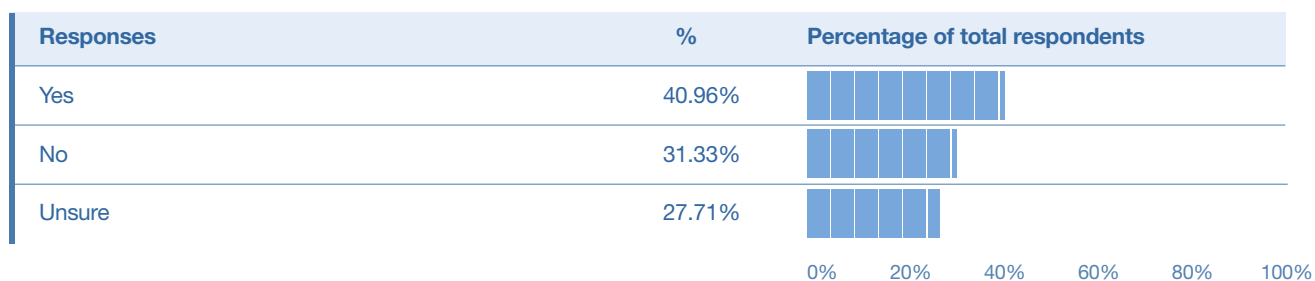
efficiency and environmental requirements get tougher. Forty-four percent of OEMs and 49 percent of suppliers plan to enter into a collaboration in the next 12 months. The desire to fund technological advancements was the top reason given for inspiring OEMs to collaborate, while the desire to expand into foreign markets was the top reason chosen by suppliers.

OEMs and automotive suppliers found other challenges and issues outside of privacy and security, corporate bribery and collaborations that drew their attention. Among the other highlights of the survey were:

- **Court disputes.** Litigation remains a top legal concern for automotive companies with some areas of litigation seeing more activity than others. Supply chain litigation (52%), IP litigation (46%) and warranty litigation (39%) were the top three types of litigations faced by respondents' companies over the last year.
- **Counterfeit goods.** Although the U.S. automotive industry witnesses an estimated \$12 billion per year in trade of counterfeit automotive parts, only half of respondents have taken specific steps against counterfeiting, including customs enforcement and litigation, to protect their brand, and only a few plan to do so in the next year. So, while there are a number of steps a company can implement to fight against counterfeiting, this is an area of concern that is not getting needed industry attention.
- **Environmental impact.** Half of respondents chose compliance audits, waste minimization reviews (zero landfill goals) and energy/resource use assessments as the top environmental issues on their radar in the year ahead. Only eight percent reported having environmental damage claims litigation on their radar. Given that this type of litigation is on the increase nationally, especially with respect to groundwater-related exposures (such as contaminated drinking water, vapor intrusion to structures and discharges to surface waters) and plant decommissioning/site disposition (due to the permanent retraction in domestic automotive manufacturing base brought about by the recession), some respondents may not be taking adequate measures to reduce this risk and may be caught off guard by such claims down the line.
- **Compliance deadlines.** Respondents ranked the Conflict Minerals Act lowest in terms of the global compliance concerns. However, automotive manufacturers are taking seriously near term compliance deadlines to meet the standards of the Conflict Minerals Act (a rule that requires public companies to publicly disclose whether the sourcing of conflict minerals in their products benefited armed groups responsible for human rights violations). Sixty-eight percent of respondents would consider not sourcing a supplier if it indicated products contained or likely contained Conflict Minerals, and 64 percent would consider not sourcing a supplier if it did not comply with a Conflict Minerals request. At the same time, the response to the survey question regarding the percentage of their Conflict Minerals Act compliant suppliers reveals many suppliers are still not compliant and/or the OEMs do not yet know whether their suppliers are compliant.
- **International Tax Rules.** Although nearly half of respondents (49%) give significant consideration to transfer pricing terms when their company engages in cross-border transactions with related partners (such as product sales or licensing between affiliates in two countries), approximately 19 percent give little or no consideration to such matters. While 53 percent of respondents report they always maintain contemporaneous documentation to support their company's determination of transfer pricing items, the other 47 percent never or only sometimes prepare such documentation (and, of those, about 20 percent do not know if the documentation is appropriate). Only 35 percent of respondents report that their businesses have been subject to a tax audit by the IRS or a tax authority in another country in which a transfer pricing issue was raised. The relatively low audit rate is likely to dramatically increase given the heightened scrutiny of transfer pricing both in the U.S. and abroad. Only 34 percent of respondents have utilized advance pricing agreements or competent authority proceedings (and 43 percent do not even know about such tools to resolve or eliminate transfer pricing issues).

Specific Survey Results

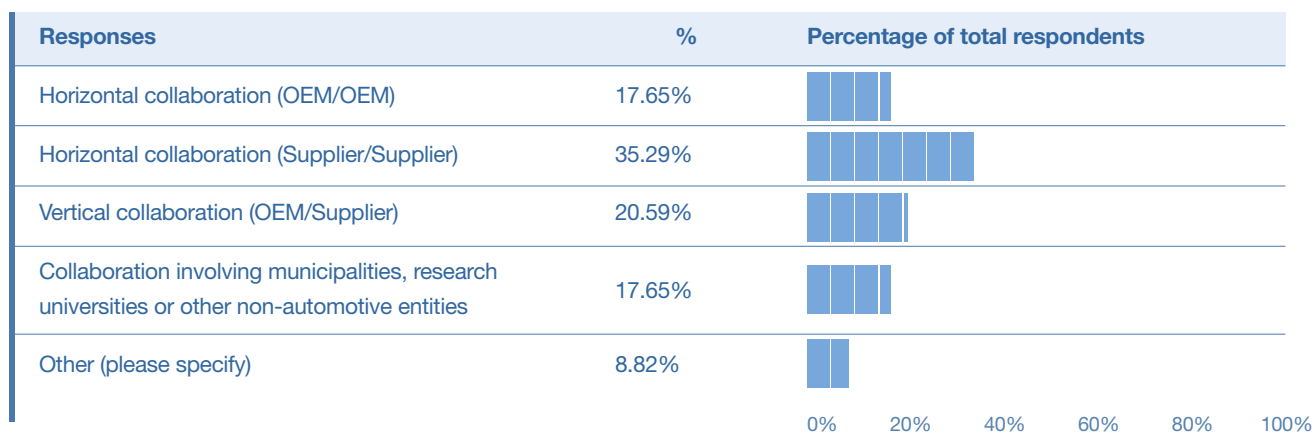
Q1. In the first half of 2013, over 30 collaborations involving the automotive industry have been publicly announced. Does your company have plans to enter into an automotive collaboration in the next 12 months?



Although automotive collaborations often raise legal and operational questions ranging from antitrust issues to the challenges of collaborating with competitors, automakers are increasingly teaming with competitors to share costs and brainpower as fuel efficiency and environmental requirements get tougher. In 2013 alone, GM and Ford teamed up to develop transmissions, Toyota and BMW built fuel cells together, and Continental and IBM announced a collaboration agreement that will see the companies jointly develop fully-connected mobile vehicle solutions for car manufacturers around the world.

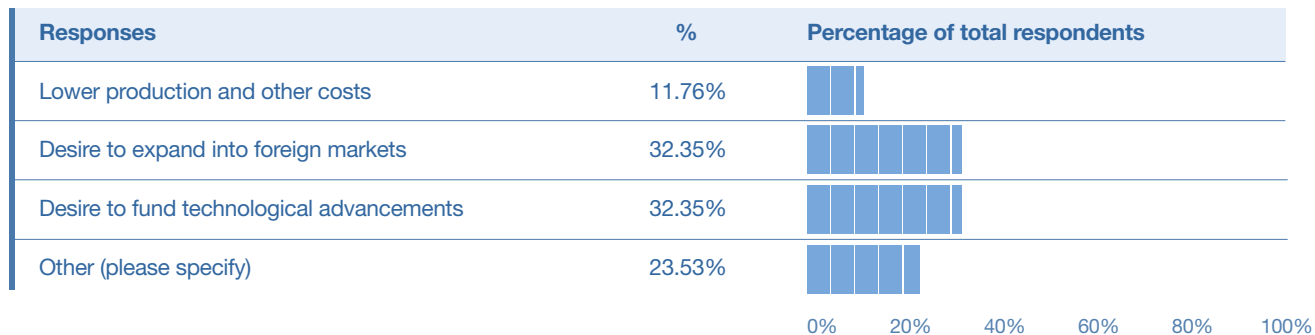
Collaborations are likely to continue into the next year, as 44 percent of OEMs and 49 percent of suppliers have plans to enter into an automotive collaboration in the next 12 months.

Q2. What type of collaboration is your company contemplating?



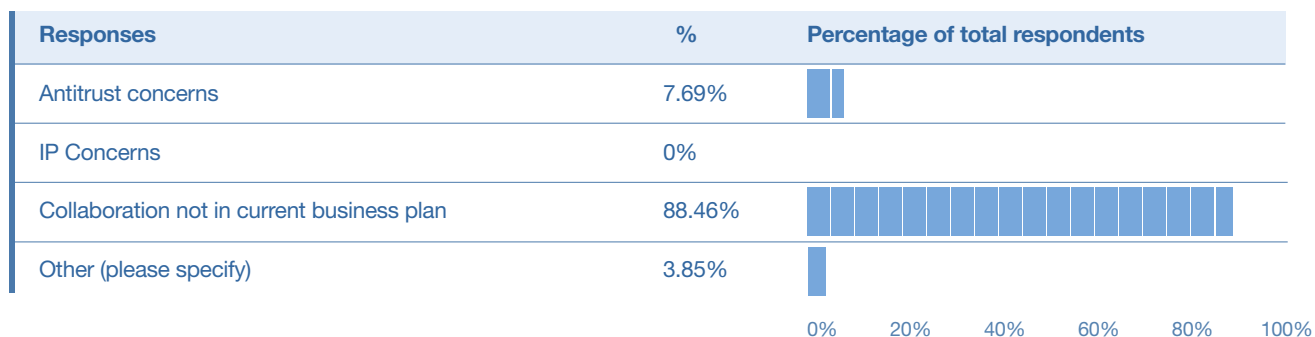
- Forty-six percent of OEMs are contemplating a collaboration with a competing OEM in the year ahead, and 50 percent of suppliers are contemplating a collaboration with a competing supplier in the year ahead.

Q3. What was the main driver in pursuing a strategic collaboration?



- A desire to fund technological advancements was the main driver for OEMs to pursue a strategic collaboration in the year ahead, and a desire to expand into foreign markets was the top reason chosen by suppliers.
- Suppliers also mentioned a handful of other reasons they were considering a collaboration in the year ahead, including the ability to penetrate a new customer, expand product offerings, and the ability to share risk and take advantage of technical expertise from a partner.

Q4. What is the top reason for not moving forward with a collaboration?



- As collaborations have become commonplace, antitrust concerns are no longer viewed as a significant barrier to automotive collaborations. The top reason OEMs and suppliers did not move forward with a collaboration was because it was not in their business plan.








Q5. In 2012, the US automotive industry witnessed an estimated \$12 billion per year trade of counterfeit automotive parts. While the counterfeiting of automotive parts is a concern for automotive makers and suppliers, there are steps they can take to lessen the impact. Please check off which steps your company has implemented in an effort to protect your brand.

	In the last year or previously	Not in the last year or previously	Plan to implement in 2014
Customs enforcement (registered copyright or trademark for goods of concern)	50.70%	45.07%	7.04%
Litigation (administrative, civil or criminal)	49.30%	46.48%	5.63%
Online enforcement	43.94%	50.00%	6.06%
Digital protection	42.03%	49.28%	8.70%

Note: Multiple answers per participant possible. Percentages added may exceed 100 since a participant may select more than one answer for this question.

- Although the U.S. automotive industry witnessed an estimated \$12 billion per year trade of counterfeit automotive parts, only half of respondents have taken important steps, including customs enforcement and litigation, to protect their brands in the last year.

Q6. What types of litigation/disputes has your company been involved in within the last year? Check all that apply.

Responses	%	Percentage of total respondents
IP litigation	46.27%	
Antitrust litigation	16.42%	
Warranty litigation	38.81%	
Supply chain litigation/disputes with customers & suppliers	52.24%	
IT litigation	16.42%	
Dealer litigation	25.37%	
Other (please specify)	23.88%	

0% 20% 40% 60% 80% 100%

Multiple answers per participant possible. Percentages added may exceed 100 since a participant may select more than one answer for this question.

- Supply chain litigation/disputes (52%), IP litigation (46%) and warranty litigation (39%) were the top litigation/disputes respondents' companies have been involved in within the last year.
- IP litigation topped the list of litigation/disputes for OEMs within the last year while supply chain litigation/disputes earned this ranking for automotive suppliers.

Q7. As part of a global industry, automotive companies are faced with complex and ever changing compliance issues. Please rank in order from 1-5 the following areas of global compliance concern in order of importance to your company.

Responses	Rank 1	Rank 2	Rank 3	Rank 4	Rank 5	Weighted Rank (Score)
Data Privacy	28	24	16	6	5	1 (301)
FCPA and Anti-corruption	24	13	13	15	14	2 (255)
Environmental	15	18	19	13	14	3 (244)
Export Controls	9	12	21	26	11	4 (219)
Conflict Minerals	4	12	10	19	34	5 (170)

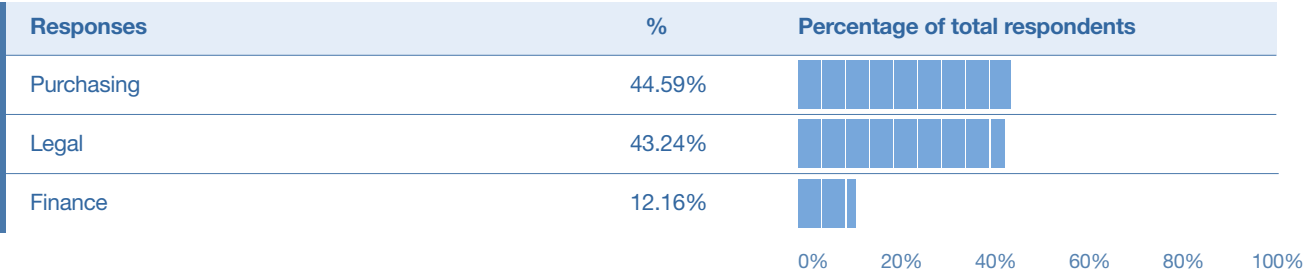
- Data Privacy and FCPA/Anti-corruption were top areas of global compliance concern for respondents.
- Given that privacy and security regulations with which companies must comply vary significantly depending on the specific country or region the company is dealing with at any given time or on any given project, global compliance concerns on the data/privacy side have particularly become a conundrum for automotive executives.
- Foreign Corrupt Practices Act (FCPA) enforcement actions against a number of top automotive companies brought in recent years have demonstrated the dangers that those in the automotive industry face under the statute, which prohibits the payment of bribes to foreign officials.

Q8. Please rank in order the top three countries or regions your company believes pose the greatest compliance risk when doing business overseas.

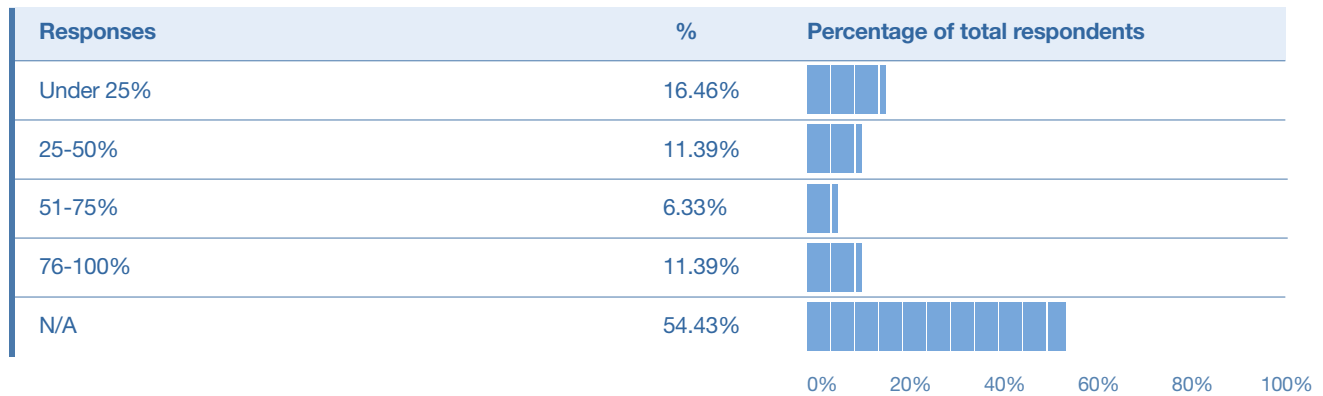
Responses	Rank 1	Rank 2	Rank 3	Weighted Rank (Score)
China	40	15	5	1 (155)
Russia	15	14	14	2 (87)
India	4	16	11	3 (55)
South America	5	5	12	4 (37)
Brazil	3	8	7	5 (32)
Southeast Asia	3	6	10	6 (31)
Eastern Europe	2	4	9	7 (23)
Indonesia	1	5	5	8 (18)

- China, Russia and India (in order) were the top three countries respondents believe pose the greatest compliance risks when doing business overseas.
- Survey respondents supplied a number of reasons for choosing China for the number one risk position, including:
 - The market is so big and the companies are expanding so fast that it almost seems like the wild west of the 1880s. Can the Chinese government employ legal solutions as they manage their economy?
 - FCPA
 - Customs and practices in China
 - Lack of control of regulatory environment
 - Corruption
 - Changes in requirements without warning
 - Political system in China very bribe oriented
 - Lack of local IP enforcement and different ethical standards

Q9. In early June, the SEC's Division of Corporation Finance issued much-anticipated interpretive guidance regarding the conflict minerals and resource extraction issuer disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Which function is taking the lead on Conflict Minerals compliance in your organization?







Q10. To date, what percentage of your suppliers have complied with your Conflict Minerals request?



- Thirty-six percent of OEMs reported that less than 25% of their company’s suppliers have complied with their Conflict Minerals requests.

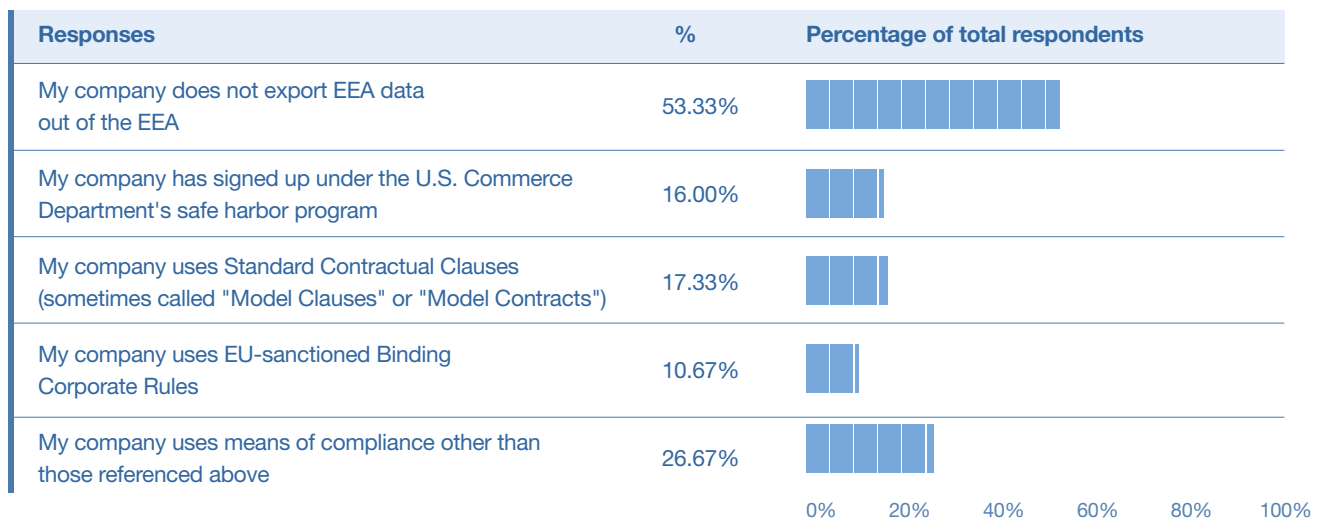
Q11. Related to the Conflict Minerals Act, would either of the following reasons cause your organization to consider not sourcing a supplier?

	Yes	No
Supplier indicated products contain or likely contain Conflict Minerals	 67.61%	 32.39%
Supplier did not comply with Conflict Minerals request	 64.29%	 35.71%

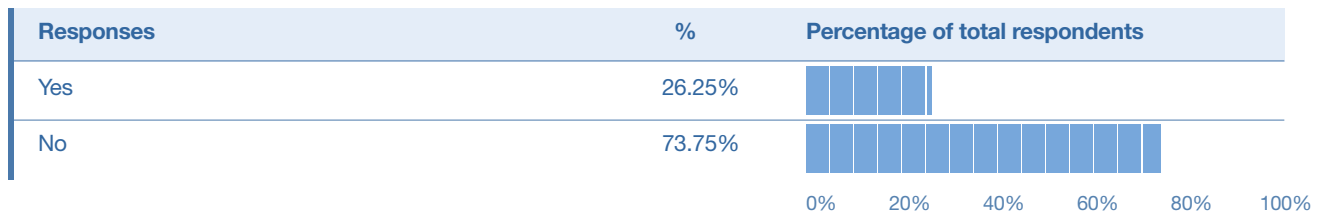
Note: Multiple answers per participant possible. Percentages added may exceed 100 since a participant may select more than one answer for this question.

- Automotive manufacturers are taking near-term compliance deadlines to meet the standards of the Conflict Minerals Act seriously. Seventy-seven percent of OEMs would consider not sourcing a supplier if it indicated products contained or likely contained Conflict Minerals, and 91 percent would consider not sourcing a supplier if it did not comply with a Conflict Minerals request.

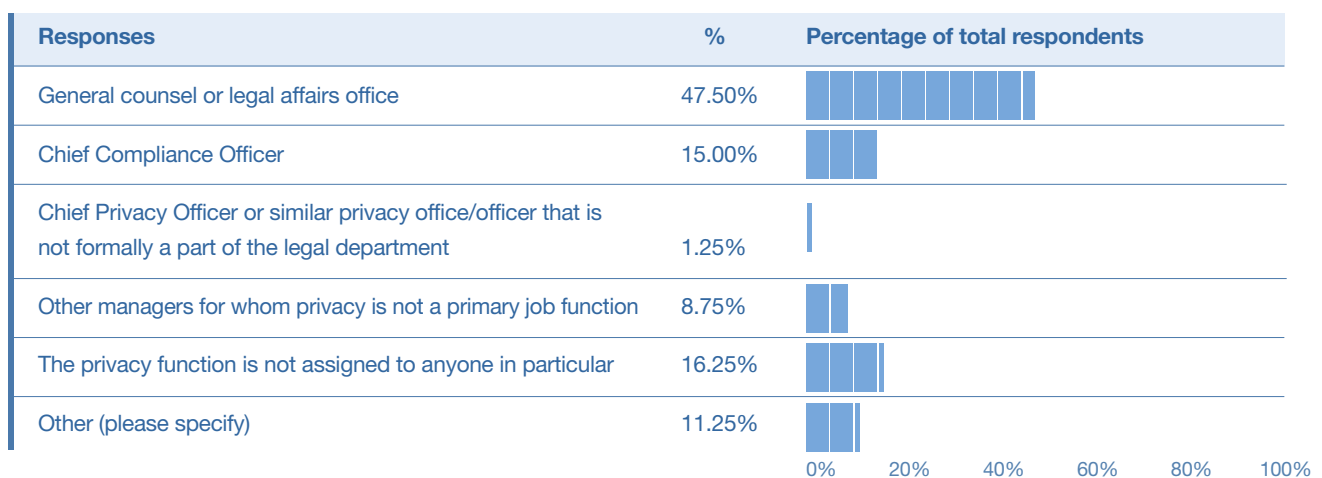
Q12. How does your organization handle compliance with EU law when it exports personal data about European Economic Area (EEA) member state citizens out of the EEA to the United States and other places that don't have EU-style legal protections? Select all that apply.



Q13. Does your company have a Chief Privacy Officer or other senior manager with “privacy” or a similar word in his or her job title?

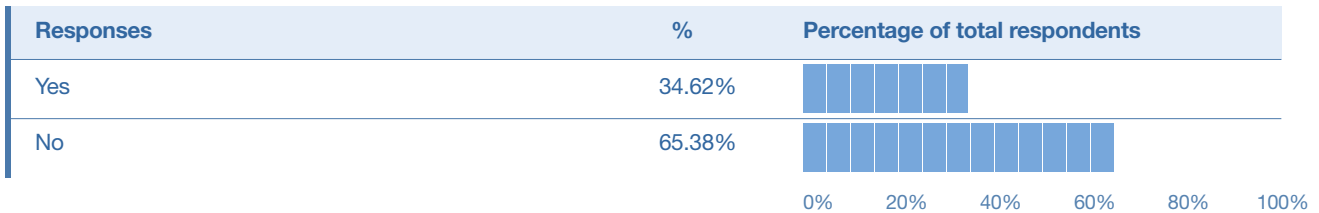


Q14. Who is primarily responsible for compliance with privacy law in your company?

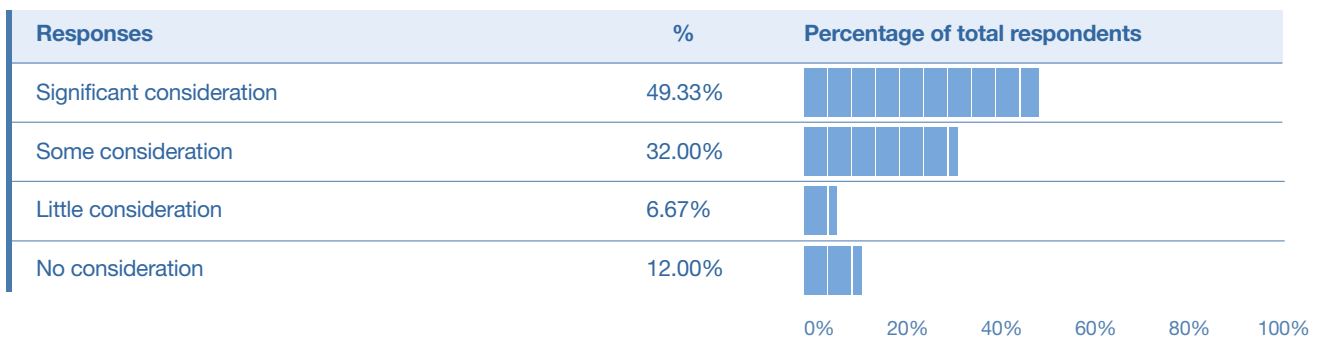


- Fifty-three percent of respondents reported their company does not export personal data about citizens of EEA member states out of the EEA to other countries—such as the U.S.—that do not have EU-style legal protections, demonstrating a serious lack of understanding regarding the rules governing exportation of such data.
- While data privacy was chosen as the top global compliance concern for respondents, 74 percent of automotive companies do not have a chief privacy officer or other senior manager with “privacy” or a similar word in his or her job title.

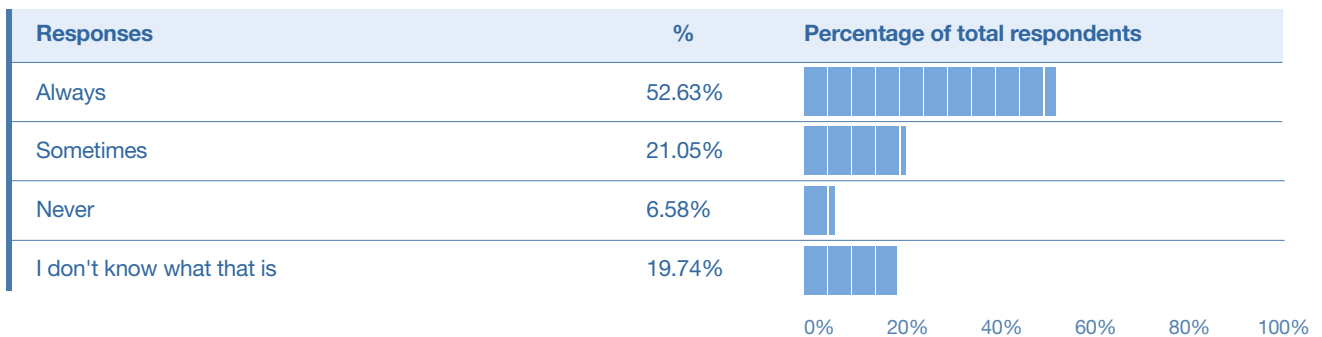
Q 15. During the past five years, has your company been subject to a tax audit by the IRS or a tax authority in another country in which a transfer pricing issue was raised?



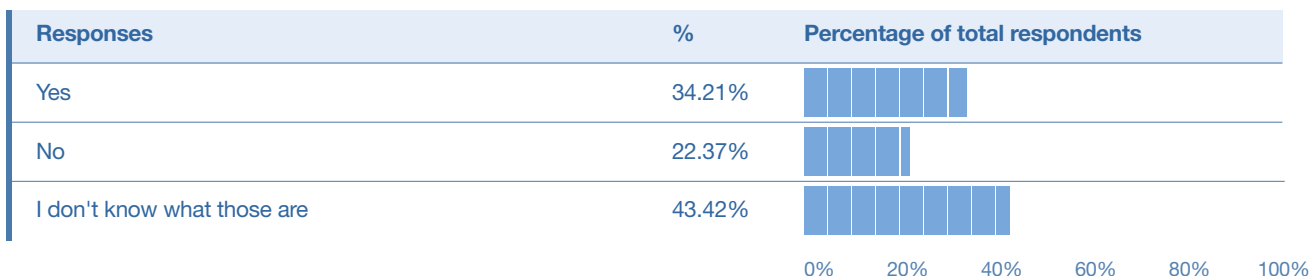
Q16. When your company structures cross-border transactions with related parties (such as licenses or product sales between affiliates in two countries), how much consideration is given to transfer pricing terms?



Q17. Does your company prepare and maintain contemporaneous documentation to support its determination of transfer pricing items?

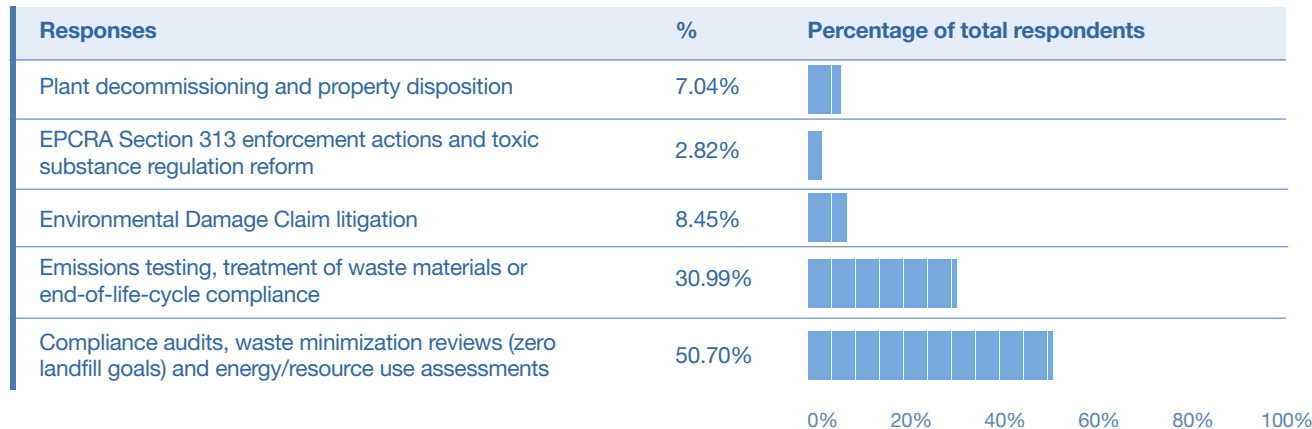


Q18. Has your company used an advance procedure (such as an advance pricing agreement) to support transfer pricing determinations, or used a retroactive procedure (such as a competent authority proceeding) to resolve transfer pricing audit disputes?



- Forty-nine percent of respondents give significant consideration to transfer pricing terms when their company engages in cross-border transactions with related partners (such as product sales or licensing between affiliates in two countries).
- Forty-three percent of respondents are not even aware of either advance or retroactive procedures to help resolve audit disputes. This suggests a significant lack of knowledge on the best practices in this area.
- Sixty-five percent of respondents' businesses, however, have not been subject to a tax audit by the IRS or a tax authority in another country in which a transfer pricing issue was raised – a trend that is not likely to continue.

Q19. With ever-increasing pressure for environmental sustainability and continually rising oil prices, the automotive industry has and will continue to face many tough challenges. Which of the following environmental issues does your company have on your radar in the year ahead?



- Fifty-one percent of respondents chose compliance audits, waste minimization reviews (zero landfill goals) and energy/resource use assessments as the top environmental issues on their radar in the year ahead.
- Only eight percent have environmental damage claim litigation on their radar, which is surprising given that such litigation has increased nationally, especially with respect to groundwater-related exposures (such as contaminated drinking water, vapor intrusion to structures and discharges to surface waters) and plant decommissioning/site disposition (given the permanent retraction in domestic manufacturing base brought about by the recession, particularly in the automotive industry).

Methodology

In July 2013, national law firm Dykema distributed its Dykema Automotive Industry Survey via e-mail to a group of senior executives and advisers in the automotive industry, including CEOs, CFOs and other company officers.

Of the nearly 100 respondents:

- Sixty-one percent identified themselves as CFOs, Directors, Compliance Officers, Managers or Vice Presidents; 13 percent identified themselves as in-house counsel; 16 percent identified themselves as C-level executives; and ten percent identified themselves as consultants.
- Seventy-three percent of respondents have more than 100 employees in their company.
- Types of companies represented include OEMs (32%), suppliers (47%), and service providers (22%).
- Due to rounding, all percentages used in all questions may not add up to 100 percent.



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