



MEMORANDUM: PRIVILEGED
ATTORNEY/CLIENT COMMUNICATION AND
ATTORNEY WORK PRODUCT

TO **Key West General Employees
Key West Police & Fire**

FROM Darren J. Check, Esquire
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DATE March 5, 2024

RE **Cummins, Inc. Derivative Claims**

DATE CASE FILED	Not Yet Filed
CLASS PERIOD	April 29, 2019 through the present
JURISDICTION	U.S. District Court for the Southern District of Indiana

**Number of Cummins Shares Held: General Employees 940 (Highland Capital)
Police & Fire 1,440 (Highland Capital)**

This Memorandum analyzes potential claims that may be asserted under Indiana law on behalf of the stockholders of Cummins, Inc. (“Cummins” or the “Company”) against Cummins’ board of directors (the “Directors” or the “Board”) and executive officers (collectively, the “Directors and Officers”) in connection with two enforcement actions: (i) *U.S. v. Cummins Inc.*, No. 1:24-cv-88 (D.D.C. Jan. 10, 2024), and (ii) *California v. Cummins Inc.*, No. 1:24-cv-90 (D.D.C. Jan 10, 2024), and the recent \$2.04 billion settlements thereof (collectively, the “Emissions Settlement”). Based on our review of publicly available information, we believe the Directors and Officers breached their fiduciary duties to the Company by failing to make good faith efforts to ensure its diesel engines did not contain defeat devices or similar components in violation of federal and state law, failing to institute and oversee adequate controls to detect and prevent violations of federal and state emissions law, and prioritizing profits over legal compliance.

This Memorandum sets forth the background facts, legal theories, and a potential framework for investigating and prosecuting these potential claims. Reference is made to the draft Litigation Demand attached hereto as Exhibit A, which provides additional background regarding the circumstances described herein.

FACTUAL BACKGROUND

Cummins

Cummins is a publicly-traded corporation (NYSE: CMI), incorporated in Indiana and headquartered in Columbus, Indiana. Cummins is one of the largest global designers, manufacturers, and distributors of engines and related power generation products.¹ Founded in 1919 as a diesel engine manufacturing business, the Company's Engines segment continues to be the largest contributor to the Company's sales and EBITDA and is thereby integral to Cummins' financial performance and continued operations.²

As a diesel engine manufacturer, Cummins is subject to extensive federal and state regulations regarding emissions standards.³ Under the Clean Air Act, 42 U.S.C. §§ 7401 *et seq.* (the "Act") and related standards promulgated by the U.S. Environmental Protection Agency (the "EPA"), the Company must obtain Certificates of Compliance ("COCs") with federal emissions standards before selling its diesel engines in U.S. markets. Cummins must also obtain an Executive Order from the California Air Resources Board ("CARB") demonstrating compliance with stringent California emissions regulations. State and federal law prohibit, among other things, so-called "defeat devices" or calibration strategies that are designed to reduce the effectiveness of emissions control systems in diesel engines. Defeat devices often evade regulatory detection during the certification process.

At various times relevant to the events discussed herein, the Company's Board of Directors has been comprised of the following members: Executive Chairman, and former Chief Executive Officer ("CEO") Thomas Linebarger ("Linebarger"); President and CEO Jennifer Rumsey ("Rumsey"); and directors Gary Belske, Robert Bernhard, Bruno Di Leo Allen, Stephen Dobbs, Carla Harris, Thomas Lynch, William Miller, Georgia Nelson, Kimberly Nelson, Karen Quintos; former directors Franklin Chang Diaz, Robert Herdman, and Alexis Herman (collectively with Linebarger and Rumsey, the "Board"). In addition to Linebarger and Rumsey, the Company's relevant Officers have been comprised of, among others, Vice President and Chief Financial Officer Mark Smith, Vice President of Product Compliance and Regulatory Affairs Melina Kennedy ("Kennedy"), and President of the Engine Business Brett Merritt ("Officers," and together with the Board, "Directors and Officers").

Cummins' History of Defeat Devices

As set forth in Exhibit A, the Emissions Settlement is not the first time Cummins has been sanctioned for installing defeat devices in diesel engines that result in NOx emissions substantially above state and federal limits. In 1999, the Company was fined \$25 million for installing defeat

¹ See Current Report (Form 10-Q) (Nov. 2, 2023) at 9.

² Cummins Inc., Annual Report (Form 10-K) (Feb. 14, 2023) at 35 (hereinafter "2022 Annual Report"); Cummins Inc., Annual Report (Form 10-K) (Feb. 8, 2022) at 33 (hereinafter "2021 Annual Report"); Cummins Inc., Annual Report (Form 10-K) (Feb. 10, 2021) at 32.

³ 2022 Annual Report at 13-14 ("Our engines are subject to extensive statutory and regulatory requirements that directly or indirectly impose standards governing emissions and noise.").



devices, and went on to violate the related consent order *three times* over the next decade, resulting in millions of dollars in additional penalties and compliance costs. Cummins' prior misconduct is estimated to have resulted in thousands of tons of excess NOx emissions.

Despite the Company's decades-long practice of non-compliance, the Company has painted a misleading picture of a robust system of internal controls designed to ensure compliance with emissions laws, including affirmative representations that "Cummins does not use defeat devices"⁴ and enforces its policy of "prohibiting the use of defeat device in all of our products."⁵ For example, the Safety, Environment, and Technology Committee of the Board (the "SET Committee") has the "highest level of accountability for our climate-related risks and opportunities" and oversees the company's "compliance programs."⁶ As described in Exhibit A, the SET Committee meets regularly with Officers and receives mission critical updates concerning compliance matters from the Executive Risk Counsel, the Action Committee for Environmental Sustainability, the Product Compliance and Regulatory Affairs Committee, the Vice President of Compliance and Regulatory Affairs, the Vice President and Chief Risk Officer, and the Chief Executive Officer. Many of these Officers and management organizations also directly report to the Board and/or the CEO.

The EPA, CARB, DOJ, and SEC Investigations

On April 29, 2019, Cummins first disclosed that it had "conversations with the U.S. EPA and CARB regarding certification for the engines in the 2019 RAM 2500 and 3500 trucks" and that it was "formally reviewing its emissions certification and compliance process for its pickup truck applications."⁷ The Company also announced that it had "voluntarily disclosed the review to our regulators and other agencies...."⁸

Subsequent risk disclosures informed stockholders, among other things, that: (i) Cummins had developed and deployed new emissions software in all Ram 2500-2500 engines shipped since September 2019, and had recalled and was in the process of installing new software in model years 2013-2018, based on conversations with regulators; (ii) Cummins accrued \$30 million for Ram recalls by November 2022, (iii) regulators "raised concerns" regarding Cummins' emission certification applications for model years 2013-2023, (iv) the Company would likely be required to pay a material civil penalty to resolve the regulatory investigations.⁹

⁴ Press Release, Cummins Inc., *Cummins Inc. Does Not Use Defeat Devices and Is Committed to Meeting Emissions Standards*, (Jan. 12, 2017), <https://www.businesswire.com/news/home/20170112005824/en/>.

⁵ Cummins Inc., Annual Report (Form 10-K) (Feb. 11, 2019) at 13.

⁶ Cummins Inc., Annual Report (Form 10-K) (Feb. 8, 2022) at 13; Cummins Inc., Definitive Proxy (Form DEF 14A) (March 23, 2011) at 15.

⁷ Cummins Inc., Current Report (Form 8-K) (Apr. 29, 2019) at Ex. 99.

⁸ *Id.*

⁹ See Cummins Inc., Quarterly Report (Form 10-Q) (Oct. 29, 2019) at 57; Cummins Inc., Quarterly Report (Form 10-Q) (Nov. 4, 2022) at 21; Cummins Inc., Quarterly Report (Form 10-Q) (May, 2023) at 48; Cummins Inc. Quarterly Report (Form 10-Q) (Nov. 2, 2023) at 59.



The 2024 Consent Decrees

On December 22, 2023, the Company announced it had reached agreements with the EPA, DOJ, and CARB that would resolve their respective regulatory investigations (the “Settlements”).¹⁰ Under the terms of Settlements, Cummins agreed to pay more than \$2 billion for emissions violations affecting one million Ram trucks equipped with Cummins engines.¹¹ The settlement is one of the largest environmental recoveries in history, behind only the BP settlement following the Deepwater Horizon oil spill, and eclipsing the civil penalty levied against Volkswagen following the Dieselgate scandal. UBS and Evercore analysts believe the settlement is double what the market and stockholders anticipated, based on the Company’s prior disclosures.¹² According to the U.S. and California Attorneys General, “Cummins installed defeat devices in more than 600,000 Ram pickup trucks” and “knowingly harmed people’s health and our environment when they skirted [] emissions tests and requirements.”¹³

Although the Settlements impose certain compliance reforms on the Company, they may be insufficient to prevent similar corporate trauma from recurring because they do not, among other things, impose or reform the oversight or monitoring responsibilities on the Board or the Company’s most senior Officers including, among others, the CEO and Chief Risk Officer.¹⁴ Such reforms may be necessary to ensure that the Directors and Officers exercise their fiduciary duties in good faith in overseeing the Company’s compliance efforts going forward.

The Mounting Litigation and Investigations

After the Company’s widespread practice of emissions evasion and use of defeat devices was revealed to the market, private litigation piled up against the company, its Directors, and Officers. The civil litigation includes a consumer class action, securities action, and derivative action. Unlike our legal theories set forth below and in Exhibit A, the recently filed derivative complaint focuses primarily on disclosure violations in financial reports filed with the United States Securities and Exchange Commission (“SEC”).

¹⁰ Cummins Inc., Current Report (Form 8-K) (Dec. 22, 2023) at Ex. 99.

¹¹ *Id.*

¹² Steven Fisher, *Cummins reaches EPA/CARB settlement*, UBS (Dec. 22, 2023); David Raso, *Cummins EPA ~\$1b MORE Than General Consensus, Likely Costs Stock Short-Term ~2.5% Damage (can afford it, gets it out of way but size could take some cash usage away for '24)*, EVERCORE ISI (Dec. 22, 2023).

¹³ Office of Public Affairs, U.S. Department of Justice, *Attorney General Merrick Garland Statement on the Agreement in Principle with Cummins to Settle Alleged Installation of Illegal Defeat Devices in Engines*, <https://www.justice.gov/opa/pr/statement-attorney-general-merrick-garland-agreement-principle-cummins-settle-alleged> (last visited Jan. 26, 2024).

¹⁴ Consent Decree, *U.S. v. Cummins Inc.*, No. 1:24-cv-88 (D.D.C. Jan. 10, 2024) (Dkt. 2-1); Partial Consent Decree, *California v. Cummins Inc.*, No. 1:24-cv-90 (D.D.C. Jan. 10, 2024) (Dkt. 3-1).



The Settlements also do not resolve ongoing investigations conducted by the SEC and Environmental and Climate Change Canada regarding similar issues giving rise to the Settlements. Nor do the Settlements govern Nissan Titan diesel engines manufactured by Cummins, which are currently subject to recall and regulatory scrutiny regarding emissions compliance. These continued investigations and risk of related litigation and/or settlements have resulted in, and/or will continue to result in, harm to the Company.

LEGAL ANALYSIS, POTENTIAL CLAIMS, AND LITIGATION STRATEGY

Cummins is incorporated in Indiana, so a derivative action would be governed by Indiana law. Under Indiana law, a company's officers and directors owe fiduciary duties to the Company and its stockholders, including the duty of loyalty.¹⁵ A fiduciary of an Indiana corporation can breach their duty of loyalty to the corporation by failing to make a good faith effort to oversee the company's operations, known as a *Caremark* claim. Bad faith is established when either the directors (i) "[completely] fail[] to implement any reporting or information system or controls" or (ii) "having implemented such a system or controls, consciously fail[] to monitor or oversee its operations thus disabling themselves from being informed of risks requiring their attention."¹⁶ A related and overlapping theory of fiduciary liability is a *Massey* claim, which concerns an intentional decision to prioritize profits over legal compliance. A third related theory of liability is known as a *Red Flags* claim, which involves an intentional decision to not take action in the face of sustained and substantial warning signs of a material risk.

After an extensive review of publicly available information, Kessler Topaz has concluded that the Directors and Officers did not exercise good faith business judgment by (i) knowingly failing to institute, monitor and oversee the Company's systems and controls to detect and prevent misconduct related to mission critical engine emission certification and compliance, (ii) knowingly failing to address pervasive failures in the Company's anti-defeat device and compliance programs despite a litany of red flags indicating that the Company's controls were inadequate and that Cummins was at risk of violating positive law, (iii) knowingly prioritizing profits over compliance with emissions standards, and (iv) knowingly causing or allowing the Company to misrepresent its compliance with emissions laws and regulations.

As a result of these breaches of fiduciary duty, the Company has suffered and will continue to suffer significant harm, including: (i) the over \$2.04 billion in costs and significant time and resources required to comply with the Settlements, (ii) the costs of litigation, (iii) reputational harm, (iv) the costs of complying with the years-long regulatory investigations described herein, and (v) the risk of SEC and/or ECCC litigation or penalties.

¹⁵ See *Rapkin Group, Inc. v. Cardinal Ventures, Inc.*, 29 N.Ed 752, 757 (Ind. Ct. App. 2015) ("The standard imposed by a fiduciary duty is the same whether it arises from the capacity of a director, officer, or shareholder....")

¹⁶ *In re ITT Deriv. Litig.*, 932 N.E.2d 664, 668 (Ind. 2010) (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).



Under Indiana law, a stockholder has the right to inspect Board and Committee minutes but not related materials.¹⁷ Generally, minutes of Boards and their committees do not reveal the substantive information considered, and thus we advise against pursuing a books and records demand, as it would likely not result in the production of useful information.

Under Indiana law, a stockholder must make a pre-suit litigation demand upon the Board prior to filing a derivative complaint or establish that demand would be futile.¹⁸ Here, it may be difficult to establish demand futility, *i.e.*, that a majority of the Board lacks disinterestedness or independence, due to, among other things, (i) the inability to obtain Board materials that could establish the requisite scienter requirement, (ii) the size and apparent independence of the twelve-member Board, and (iii) the fact that several of the Directors joined the Board in 2022, after the misconduct began to occur.

RECOMMENDED ACTION

We recommend that you authorize Kessler Topaz to make a demand under the Indiana Business Corporation Law that the Cummins Board pursue litigation against the Directors and Officers related to the Company's longstanding practice of emissions compliance evasion, and to file derivative claims on behalf of the Company in the Indiana seeking an award of damages and other relief for the benefit of Cummins.

To maintain standing to pursue a litigation demand or to litigate potential claims, you must continuously retain at least some portion of your Cummins stock throughout the pendency of the case. Should you need any additional information, please do not hesitate to contact me.

¹⁷ Ind. Code §§ 23-1-52-2, 23-1-52-3.

¹⁸ See Ind. Code §23-1-32-2; Ind. R. Tr. P. 23.1.

