

## SETTLEMENT AGREEMENT AND RELEASE

This SETTLEMENT AGREEMENT AND RELEASE (hereinafter "Agreement") is entered into by and between the STATE OF CALIFORNIA AIR RESOURCES BOARD (hereinafter "ARB"), with its principal office at 1001 I Street, Sacramento, California 95814 and K & N Engineering, Inc. (hereinafter "K&N") with its principal place of business at 1455 Citrus Street, Riverside, California 92507, collectively, "The Parties."

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### RECITALS

1. Vehicle Code section 27156(c) provides, in pertinent part that "No person shall install, sell, offer for sale, or advertise any device intended for use with, or as a part of, any required motor vehicle pollution control device or system which alters or modifies the original design or performance of any such motor vehicle pollution control device or system."
2. Vehicle Code section 27156(h) provides, in pertinent part, that this section shall not apply to an alteration, modification, or modifying device found by resolution of the State Air Resources Board to either not reduce the effectiveness of any required motor vehicle pollution control device or result in emissions from any such modified or altered vehicle which are at levels that comply with existing state or federal standards for the model year of the vehicle being modified or converted.
3. California Code of Regulations, title 13, section 2222(b)(2) provides, in pertinent part, that "no person or company doing business in interstate commerce shall advertise in California any device, apparatus, or mechanism which alters or modifies the original design or performance of any required motor vehicle pollution control device or system and not exempted from Vehicle Code section 27156 unless each advertisement contains a legally adequate disclaimer."
4. California Code of Regulations, title 13, section 2222(e) provides, "The Executive Officer may exempt add-on and modified parts based on an evaluation conducted in accordance with the 'Procedures for Exemption of Add-on and Modified Parts,' [The Procedures] adopted by the state board on November 4, 1977, as amended June 1, 1990."
5. The Procedures provide, "Examples of emission related parts are shown in Appendix 1 of these procedures. Such parts require an exemption from the prohibitions of Sections 27156 and 38391 of the California Vehicle Code...in order to be legally advertised, offered for sale, sold, or installed in California."
6. California Code of Regulations, title 13, section 2222(f) provides, "Each person engaged in the business of retail sale or installation of an add-on or modified part which has not been exempted from Vehicle Code section 27156 shall maintain records of such activity which indicate date of sale, purchaser name and address, vehicle model and work performed if applicable. Such records shall be open for reasonable inspection by the

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Executive Officer or his/her representative. All such records shall be maintained for four years from the date of sale or installation.”

7. California Code of Regulations, title 13, section 2221(a) provides, “Any replacement part subject to the provisions of this article shall be presumed to be in compliance with this article unless the executive officer makes a finding to the contrary pursuant to Section 2224(a).”

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8. California Code of Regulations, title 13, section 1900(a)(23) provides, “Replacement part” means any aftermarket part intended to replace an original equipment emissions-related part and which is functionally identical to the original equipment part in all respects which in any way affect emissions (including durability), or a consolidated part.”
9. Health and Safety Code section 39048 defines “racing vehicle” as “a competition vehicle not used on public highways.”
10. Vehicle Code section 360 defines “highway” as “a way or place of whatever nature publicly maintained and open to the use of the public for purposes of vehicular travel. Highway includes street.”
11. In addition, California Code of Regulations, title 13, section 2225(a) provides, in pertinent part, that the Executive Officer may seek fines for violations of Vehicle Code section 27156 or other laws or regulations, as applicable.
12. Health and Safety Code section 43016 states, in pertinent part, “Any person who violates any provision of this part, or any order, rule, or regulation of the state board adopted pursuant to this part, and for which violation there is not provided in this part any other specific civil penalty or fine, shall be subject to a civil penalty not to exceed five hundred dollars (\$500) per vehicle, portable fuel container, spout, engine, or other unit subject to regulation under this part, as these terms are defined in this division or state board regulations.”

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13. ~~ARB alleges that, between July 2010 and September 2013, K&N sold, offered for sale, and/or advertised aftermarket parts capable for use on highway motor vehicles in California (hereinafter “Subject Parts”).~~
14. ARB alleges that the Subject Parts altered or modified the original design or performance of the motor vehicle pollution control device or system.
15. ARB alleges that the Subject Parts were not exempted by ARB pursuant to California Code of Regulations, title 13, section 2220 *et seq.* and, contrary to K&N’s contentions, did not qualify as replacement parts.
16. ARB alleges that the advertisements, offers for sale, sales, and installation of the Subject Parts were unlawful and in violation of Vehicle Code section 27156(c)

and California Code of Regulations, title 13, section 2220 *et seq.*

17. K&N is a California corporation.

18. K&N promptly and fully cooperated with ARB throughout its investigation.

~~19. K&N has no prior enforcement record with ARB.~~

20. K&N has taken steps toward future compliance by applying to ARB and receiving over a dozen Executive Orders in accordance with K&N's established practice of applying for Executive Orders, including for parts that K&N contends, and ARB disagrees, meet the criteria for replacement parts. While ARB contends that K&N's actions did not retroactively exempt the Subject Parts, K&N's actions demonstrate K&N's commitment to environmental compliance.

21. ARB alleges that if the allegations described in recital paragraphs 1-17 were proven, civil penalties could be imposed against K&N as provided in Health and Safety Code section 43016.

22. K&N admits the facts in recital paragraphs 1 through 17, but denies any liability arising thereunder.

23. K&N is willing to enter into this Agreement solely for the purpose of settlement and resolution of this matter with ARB. ARB accepts this Agreement in termination of this matter. Accordingly, the parties agree to resolve this matter completely by means of this Agreement, without the need for formal litigation.

## TERMS AND RELEASE

In settlement of any and all claims that ARB has against K&N for the violations alleged above, ~~and in consideration of ARB not filing a legal action as well as the other terms~~ set out below, ARB and K&N agree as follows:

1. As a condition of this Agreement, K&N shall pay the total sum of five hundred twenty one thousand dollars (\$521,000.00) upon execution of this Agreement.

K&N shall pay a sum of three hundred ninety thousand seven hundred and fifty dollars (\$390,750.00) by cashier's check payable to the **California Air Pollution Control Fund** as a penalty.

K&N shall pay a sum of one hundred thirty thousand two hundred and fifty dollars (\$130,250) to the School Bus and Diesel Emission Reduction Supplemental Environmental Project (SEP). Payment shall be made by cashier's check payable

to the San Joaquin Valley Air Pollution Control District and "For School Bus and Diesel Emission Reduction SEP" shall be annotated in the Note or Memo line on the check.

**Please send the signed Agreement and any future mailings or documents required per the terms of this Agreement to:**

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**Gretchen Ratliff, Air Pollution Specialist  
Air Resources Board, Enforcement Division  
9480 Telstar Avenue, Suite 4  
El Monte, CA 91731**

**Please send a copy of the signed Agreement and payment using the attached "Settlement Agreement Payment Transmittal Form" (Attachment A) to:**

**California Air Resources Board  
Accounting Office  
P.O. Box 1436  
Sacramento, California 95812-1436**

2. K&N shall not install, sell, offer for sale, or advertise in California any aftermarket part in violation of California Code of Regulations, title 13, section 2220 *et seq.* or Vehicle Code section 27156, although in the event of any future alleged violations, this Agreement shall not bar or preclude the Parties from asserting any legal contentions applicable or relevant to such alleged violations. For all parts which K&N claims are exempt from the regulations and laws because they will be installed, sold, or offered for sale exclusively on racing vehicles, K&N shall, commencing with the publication of its next catalog and within 30 days for all other advertisements, advertise each and every non-exempt part in California with one of the following disclaimers ("Racing Only Disclaimer") in approximately font size 8 on each page on which any aftermarket non-exempt part appears:

A. "NOT LEGAL FOR SALE OR USE IN CALIFORNIA"

B. "NOT LEGAL FOR SALE OR USE IN CALIFORNIA ON ANY POLLUTION CONTROLLED MOTOR VEHICLE"

C. "LEGAL IN CALIFORNIA ONLY FOR RACING VEHICLES WHICH MAY NEVER BE USED, OR REGISTERED OR LICENSED FOR USE, UPON A HIGHWAY"

3. This Agreement shall apply to and be binding upon K&N and its principals, officers, directors, agents, receivers, trustees, employees, successors and assignees, subsidiary and parent corporations, predecessors and upon ARB and any successor

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agency that may have responsibility for and jurisdiction over the subject matter of this Agreement. Nothing in this Agreement is intended to create personal liability that does not otherwise apply.

4. Now, therefore, in consideration of the payment by K&N to the California Air Pollution Control Fund and the San Joaquin Valley Air Pollution Control District in the amounts specified above, ~~ARB hereby releases K&N and its principals, officers, directors, agents, receivers, trustees, employees, successors and assignees, subsidiary and parent corporations, and predecessors from any and all claims that ARB may have relating to all Subject Parts or that may be based on the allegations described in this Agreement. The undersigned represent that they have the authority to enter this Agreement.~~
5. This Agreement constitutes the entire agreement and understanding between ARB and K&N concerning the claims and settlement in this Agreement, and this Agreement fully supersedes and replaces any and all prior negotiations and agreement of any kind or nature, whether written or oral, between ARB and K&N concerning these claims.
6. No agreement to modify, amend, extend, supersede, terminate, or discharge this Agreement, or any portion thereof, shall be valid or enforceable unless it is in writing and signed by all parties to this Agreement.
7. Advice of Counsel. Each Party to this Agreement has reviewed the Agreement independently, has had the opportunity to consult counsel, is fully informed of the terms and effect of this Agreement, and has not relied in any way on any inducement, representation, or advice of any other Party in deciding to enter into this Agreement.
8. This Agreement shall be interpreted and enforced in accordance with the laws of the State of California, without regard to California's choice of law rules.
9. ~~Severability. Each provision of this Agreement is severable, and in the event that any provision of this Agreement is held to be invalid or unenforceable, the remainder of this Agreement remains in full force and effect to the extent necessary to fulfill the Agreement's purpose and the intent of the parties.~~
10. This Agreement is deemed to have been drafted equally by the Parties; it will not be interpreted for or against either party on the ground that said party drafted it.
11. Waiver. The failure of any Party to enforce any provision of this Agreement shall not be construed as a waiver of any such provision, nor prevent such Party thereafter from enforcing such provision or any other provision of this Agreement. The rights and remedies granted all Parties herein are cumulative and the election of one right or remedy by a Party shall not constitute a waiver of such Party's right to assert all

other legal remedies available under this Agreement or otherwise provided by law.

12. The parties agree that this Agreement may be executed by facsimile and in counterparts by the Parties and their representatives, and the counterparts shall collectively constitute a single, original document, notwithstanding the fact that the signatures may not appear on the same page.

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**13. SB 1402 Statement**

Senate Bill 1402 (Dutton, Chapter 413, statutes of 2010, Health and Safety Code section 39617) requires the ARB to provide information on the basis for the penalties it seeks. This required information, which is provided throughout this settlement agreement, is summarized here.

**The manner in which the penalty amount was determined, including a per unit or per vehicle penalty.**

Penalties must be set at levels sufficient to discourage violations. The penalties in this matter were determined in consideration of all relevant circumstances, including the eight factors specified in Health and Safety Code section 43024.

The per unit penalty in this case is a maximum of \$500 per unit per strict liability violation under Health and Safety Code section 43016. The penalty obtained in this case is approximately \$387.94 per unit for 1343 units from among the Subject Parts.

**The provision of law the penalty is being assessed under and why that provision is most appropriate for that violation.**

ARB alleges that the penalty provision being applied in this case, Health and Safety Code section 43016, is appropriate because ARB alleged that K&N sold, and/or offered for sale, and/or advertised the subject non-California emission-related parts that were (a) not exempted pursuant to California Code of Regulations, title 13, section 2222, or (b) were not replacement parts.

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**Is the penalty being assessed under a provision of law that prohibits the emission of pollution at a specified level, and, if so a quantification of excess emissions, if it is practicable to do so.**

The provisions cited above do not prohibit emissions above a specified level. It is not practicable to quantify these emissions, because the information necessary to do so, such as emission rates and time of use, is not available. There are no testing results available that would indicate how much emissions increased as a result of the use of the Subject Parts. However, since the Subject Parts were not certified for sale in California, ARB contends that any emissions attributable to them are illegal. In the interests of settlement and because of the time and expense involved, the parties elected not to do such testing. K&N provided some test results to ARB for certain vehicle applications for which the parts were

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intended that K&N contends, but ARB disagrees, demonstrated no increase in emissions compared to an OEM air intake system.

14. K&N acknowledges that ARB has complied with SB 1402 in prosecuting and settling this case. Specifically, ARB has considered all relevant facts, including those listed at Health and Safety Code section 43024, has explained the manner in which the ~~penalty amount was calculated (including a per-unit or per-vehicle penalty, if appropriate)~~, has identified the provision of law under which the penalty is being assessed, and has considered and determined that this penalty is not being assessed under a provision of law that prohibits the emission of pollutants at a specified level.
15. Penalties were determined based on the unique circumstances of this matter, considered together with the need to remove any economic benefit from noncompliance, the goal of deterring future violations and obtaining swift compliance, the consideration of past penalties in similar case negotiation, and the potential costs and risk associated with litigating these particular violations. The penalty reflects violations extending over a certain period of time, considered together with the complete circumstances of this case. Penalties in future cases might be smaller or larger on a per unit basis.
16. The penalty in this case was based in part on confidential business information provided by K&N that is not retained by ARB in the ordinary course of business. The penalty in this case was also based on confidential settlement communications between ARB and K&N that ARB does not retain in the ordinary course of business either. The penalty also reflects ARB's assessment of the relative strength of its case against K&N, the desire to avoid the uncertainty, burden and expense of litigation, obtain swift compliance with the law and remove any unfair advantage that K&N may have secured from its alleged actions.

**California Air Resources Board**

**K & N Engineering, Inc.**

By: 

Name: Richard W. Corey

Title: Executive Officer

Date: 5/18/2015

By: 

Name: Thomas M McGann

Title: Chief Executive Officer

Date: 4-27-2015