



# MANUFACTURING MATTERS

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# INTRODUCTION

Welcome to Manufacturing Matters, DLA Piper's specialist publication providing a round-up of legal news, sector updates and commentary for clients and contacts engaged in the manufacturing sector.



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The UK Manufacturing sector has applied the brakes so far in the third quarter. The Purchasing Managers Index ("PMI") is down to 52.5 in August following the slowdown in July, as reported by Markit/CIPS, the lowest recording in over a year. Despite growth being above the long-term average, this significant curtailment has returned confidence to modest levels which rose previously in response to the exceptional first half performance of the year.

With the exception of a few countries, this softening of growth has been displayed globally and highlights that the UK is not immune to the current global market uncertainty and geopolitical factors that are affecting our sector and, particularly, the UK's closest trading partners. Emphasised by the fall in trading with the Eurozone, who experienced similar cooling in growth, and alternatively the rise in trading with various locations within Asia, The Middle East, and the US, notably those locations that reported positive PMI recordings in the previous month (Japan, South Korea, Brazil, Mexico, US and Canada).

The growth of domestic trading in the UK has again provided the predominant supply of demand. UK SMEs remained optimistic with a continued rise in job creation and investment in modern machinery.

Nevertheless, a reliance on the domestic market will not be enough for the sector with regards to steering the UK economy firmly out of the recession. Instead, the results of this quarter make evidently clear the need for UK manufacturers to address our attitudes towards foreign markets and to explore the opportunities that a strong and efficient export strategy will bring.

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Manufacturing Matters is compiled with current issues and trends in mind. If you would like to get in touch, please contact us by emailing [manufacturing@dlapiper.com](mailto:manufacturing@dlapiper.com).

# MANUFACTURING: MAKING IT GLOBALLY

Earlier this year we commissioned the University of Sheffield Management School to undertake research with some of the UK's largest manufacturers. The aim was to help us better understand the experiences and challenges around operating globally and to ensure that our advice remains topical and relevant to manufacturers. We wanted to find out more about how manufacturers internationalise, which markets form the focus for long term strategy, and lessons learnt along the way.

The research team spoke to 50 of the UK's largest manufacturing businesses, all with turnover in excess of £75 million. If you would like to receive a copy of the report, please email [manufacturing@dlapiper.com](mailto:manufacturing@dlapiper.com). The main findings are summarised below.

- Growth for growth's sake is not a strategy, it's critical to understand the rationale behind expanding internationally
- Think global, act local and make sure the senior management team leads this and reflects this in organisational values

- North America and Europe remain the biggest markets for UK manufacturers looking to expand, but increasing competition is forcing a shift elsewhere
- 53% of manufacturers interviewed said they are looking at opportunities in the BRIC, CIVET and MINT markets
- The majority of manufacturers interviewed felt that the UK leaving the EU would have a negative impact on business
- The expansion of the EU across Central Eastern Europe (CEE) is seen to have created valuable opportunities and opened new markets for manufacturers
- China is seen to have rapidly developed as a market and become easier for manufacturers to expand

- Corruption is regarded as a key challenge – 100% of those interviewed said they had been aware of corruption when investing internationally and felt they needed to be constantly vigilant to avoid this

- Authoritative decision making is critical – make the hard calls early on, failure to do so can increase costs and slow the development of international operations
- The importance of establishing a local presence with the right people cannot be underestimated
- Seek out support, knowledge and expertise – it's out there! This means leveraging formal and informal networks from peers to professional services
- A good product or technology offering is not enough – familiarity with the local culture and business environment is critical for developing a sustainable operation

- Protecting Intellectual Property Rights (IPR) is a major issue and manufacturers would welcome a globally harmonised IPR system

- UK manufacturers must continue to assert their position on the global stage and there is an important role for Government to play in promoting the UK's manufacturing champions

- Internationalisation is a long-term game, but set limits and know when to pull back

Protection of intellectual property, bribery and corruption, HR strategy and knowledge of emerging economies appear to present the greatest challenges. Our manufacturing team is able to offer tailored advice for manufacturers in all of these areas. For further information please get in touch with the relevant contact shown on the back of this edition of Manufacturing Matters or your usual DLA Piper contact.



# AT WHAT COST?

## A UNIQUE OPPORTUNITY TO EXPLORE A CRISIS IN HINDSIGHT



### WHAT IS 'AT WHAT COST?'

At What Cost? is an award winning film created by DLA Piper. The film is about a fictional company, EPTICOM, adopting an aggressive expansion strategy in an unfamiliar territory. Members of DLA Piper's Litigation & Regulatory team stimulate a facilitated discussion around the process of managing legal risk. There are in fact two versions of the film, one is aimed at In House Lawyers and the other more biased towards a board of directors audience. Unfortunately there is no happy ending and the arrogance, hubris, and weakness of people crystallise into an unfortunate combination of events that have damaging consequences for the individuals concerned and for the company.

### WHO IS THE TRAINING RELEVANT FOR?

Everyone concerned with the management of a company. The board, the finance team, in house counsel, the risk function and non-executive directors. Whilst the film has a distinctly American accent, the film highlights issues which are equally applicable under various pieces of UK legislation including the Bribery Act 2010 and the Companies Act 2006. The issues that arise within the film are relevant to a company of any size, type and location, but are focused more towards those key individuals charged with the responsibility of directing and challenging strategy.

### HOW IS IT RELEVANT TO THE MANUFACTURING INDUSTRY?

The manufacturing sector in the UK is growing and there is a real push for companies based here to look at expanding their operations overseas. The manufacturing supply chain and markets are more often than not, international or global in nature. The opportunities offered by overseas expansion are often matched by risks and challenges. This film is designed to stimulate thought and discussion on the most appropriate ways to rise to those challenges (or avoid the mistakes made by the EPTICOM board).

### WHAT IS THE AIM OF THE FILM?

The film highlights very many of the practical issues faced by a company embarking on expansion, or undertaking operations overseas. What we really enjoy about delivering the session is the interaction of the audience and the engaging debate that follows. Using a film as a training media is far more enjoyable than the traditional black letter law, "death by Powerpoint." But ultimately the film is designed to stimulate discussion and debate on a broad range of legal risks affecting this business and to encourage a review of your current arrangements and think about how resilient you are to a crisis.

### WHAT DOES THE TRAINING COVER?

The training covers a lot of ground, from very general (in) appropriate boardroom behaviour and risk management, whistle-blowers, internal investigation, directors' duties, conflicts of interest and internal reporting procedures. There are also key considerations for both companies and individuals under the Bribery Act 2010, Companies Act 2006, and Fraud Act 2006.

### WHAT IS THE FORMAT OF THE SESSION?

Colleagues from the Litigation and Regulatory team are keen to offer this training to clients who are looking for an enjoyable and different session on legal risk management. The film is split into three sections and we take a break and discuss the issues arising at the end of each section. The entire session takes approximately 2.5 hours in total, comes without the hard sell and is offered free of charge.

### HOW IS IT DIFFERENT FROM OTHER TRAINING SESSIONS?

It's format is central to it being an enjoyable, relaxed and stimulating exercise. There is also a bit of something for everyone, whether it's a recognition of the key characters, idiosyncrasies or simply the experience of having to deal with some of the issues that crop up.

### WHY RUN THE SESSION?

From our recent research we know some of the material covered is an issue. Whilst undoubtedly people have enough on their plate dealing with the day job, I do believe that spending a couple of hours with your colleagues and senior management team talking about risk management (in the absence of a crisis), reflecting on current behaviours and discussing how to build resilience is a valuable exercise and will improve performance and drive the confidence to approach opportunities in the right way.

**If you are interested in taking part in one of DLA Piper's 'At What Cost?' training sessions, please contact John Gollaglee, or alternatively speak to your usual DLA Piper contact.**



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# DATA PROTECTION SAFEGUARDING YOUR STAKEHOLDERS' PERSONAL DATA ACROSS BORDERS

The global nature of virtually all supply chains mean that manufacturers will encounter the same challenges that all multinational organisations face in relation to ensuring that data can flow legally between jurisdictions and affiliates.

Data will inevitably need to be collected about the company's employees, customers and suppliers. This data clearly has the potential to constitute personal data for the purposes of the EU Directive and also comparable legislation in other jurisdictions.

Broadly speaking the obligations under data protection legislation will affect:

- how that data is gathered;
- how it is stored, processed and what security measures are put in place to protect the individual;
- how long data is stored before being deleted; and
- where it is stored and processed, where it can be transmitted and what safeguards need to be in place.

Unfortunately, these detailed requirements can vary quite substantially between jurisdictions and deciding on a compliance strategy often requires a "risk based" approach to be taken having understood what full compliance would look like.

## CUSTOMER AND SUPPLIER CONTACT LISTS

For any business, its customer and supplier contact lists have a huge value and the creation of a large central customer or supplier relationship management database can seem a sensible way to fully extract the value from this information.

Often data protection compliance is seen as a restriction on the ability to create such databases. However, the following three examples demonstrate that taking some small steps can not only assist with data protection compliance but can also, at the same time, improve the content of, and the ability to use, the database:

- implement arrangements in place to archive/cleanse records after appropriate periods of time;
- inform data subjects of their right to have their data corrected or removed from the database; and
- manage the access points and put in place appropriate access control.

## DATA TRANSFERS

Under the EU Directive personal data is not permitted to be transferred to a country or territory outside the EEA unless that country or territory ensures an adequate level of protection for the rights and freedoms of the data subjects in relation to the processing of personal data.

It is likely that multinational operators will want to transfer some forms of personal data of EEA based employees to third parties including outsourced service providers or to entities/subsidiaries outside of the EEA.

Ensuring that these transfers are legally compliant can broadly be achieved by adopting one of the following methods:

- the transfer is to a country deemed to have adequate data protection laws in place;
- the transfer is made to a US Safe Harbor Certified Entity;
- the transfer is made under pre-approved EU standard contractual clauses;
- the individual whose personal data is being transferred has consented to the transfer; or
- the transfer is necessary to perform or conclude a contract with the individual, in some jurisdictions this can include employment contracts.

In addition, under the EU Directive it is likely to be necessary to ensure that each entity in the group has a direct contractual relationship with any entity processing data outside of the EEA (including other group entities of affiliates) to ensure that the personal data is processed securely.

## IN CONCLUSION

Operators should not treat these obligations lightly. The penalties for breach can be significant with the UK Data Commissioner now able to levy fines of up to £500,000.

DLA Piper has produced a Data Protection Laws of the World Handbook. This offers a high-level snapshot of selected features of national laws as they currently stand in 63 jurisdictions across the world. For a copy of the Data Protection Laws of the World Handbook or for further information on any of the above, please contact John Townsend or your usual DLA Piper contact.



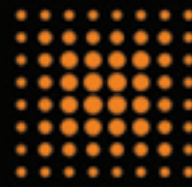
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# AN INTERVIEW WITH MOSTYN THOMAS



**D30**<sup>®</sup>  
IMPACT PROTECTION

Mostyn Thomas is the general manager of D30, the groundbreaking impact solutions business. D30 or “super goo” (as it is known) is a bright orange putty that is soft when handled but stiffens immediately when hit. First discovered by British scientist Richard Palmer in 1999 and earlier this year winning the Queens Award for Enterprise, we caught up with Mostyn to find out more.

**D30 has experienced an impressive growth path, talk us through where the “super goo” idea came from and how you have achieved the growth trajectory (300% in 2 years) that you have ?**

D30 licenses a range of unique patented smart materials. This market changing technology is used to produce a shock absorbing material which can be found in a range of products. D30 was proven during the 2006 Winter Olympics, when the US and Canadian ski teams pioneered D30’s revolutionary soft armour.

After starting out in the snow and extreme sports, D30 brought its unique patented technology into six key industry sectors: sport, motorcycle, industrial workwear, defence, footwear and consumer electronics. Across each of these sectors, over the past six years, D30 has delivered strong performance in international trade, after demonstrating growth both in absolute sales, and in the percentage it exports: an increase to 88% in 2013. Of these export sales in 2013, over 40% were generated from North America, thanks to US customers including American Football helmet manufacturer Schutt Sports, All Star Baseball, RPS, Icon, Klim, Burton Snowboards, and the US Special Forces.

**Unusual name D30, where did the name D30 come from?**

Well, we’ve actually heard a lot of different explanations over the years as to what the D30 name indicates! One of the explanations that we like is that D30 was the name of a lab at the university where the original company founder first invented the technology.

**As a British manufacturing start up business, from your window on the world in Portslade what have been the biggest challenges/obstacles you have experienced ?**

As a British manufacturing business based on the south coast of England, attracting talented chemists, mechanical engineers and industrial designers to join D30 is something we obsess about. A dynamic fast growing company needs a certain type

of character who has not only first class technical expertise but also can deliver in the short term *and* build for the future at the same time. We look for people who can grow with us and are always looking for talented people who want to be part of a British manufacturing success story.

**With the wisdom achieved from a steep learning curve, looking ahead to the next three years, what are the biggest challenges and/or opportunities that D30 faces?**

The sheer amount of interest in the material and the number of applications for the material and our solutions means that the biggest challenge for D30 is making sure we focus on the applications that are the best fit for us as a business. For the consumer electronics market, products are getting ever smaller and more fragile, and yet more important to the successful running of our lives (eg recent launches of the new Samsung Galaxy Note and the Apple Watch). While in sport, everything is getting faster and more extreme with a consequence that the hits competitors take are ever harder and the impact energies higher. Expectations and requirements for impact protection are always changing whilst more and more part of everyday life.

Continuing to maintain great attention to detail for each and every customer as we get larger, will also be a focus. It is about continually reviewing our processes and systems to drive improvement whilst allowing the D30 entrepreneurial spirit, that has served us so well to date, to continue to shine through.

In terms of opportunities and future technologies, head protection is something for which D30 will continue to innovate. Following on from the work the company has done with sports manufacturers in the US around incorporating impact protection technology in to the liners of baseball and football helmets. In a variety of sports and in the military, traumatic brain injuries are a significant issue. The tragic high profile skiing accident suffered by Formula One driver Michael Schumacher, highlighted this and made the global public aware of the scale and implications of traumatic brain injury.

D30 would also like to see the global standardisation and adoption of safety industry standards, especially for industrial workwear. D30 are partnering with RPS, oil riggers across the US who are currently trialling the RPS Crude Hands glove, featuring D30 Smart Skin, that could significantly reduce the number of hand injuries.

### **Earlier this year you won the Queen's Award for Enterprise, what does that mean to D3O?**

The response we have had from customers and suppliers alike has shown us how well respected both the award and the Queen's support for the award is around the world. It was great to be recognised as a successful, innovative British business.

D3O was a small company of just 20 people with some great ideas when I joined in 2011. It has been a great journey and I am proud to see the company grow from its small roots in Hove to a team of 60 in our Portslade offices and trading in 40 countries around the world. Everyone in the company feels proud to be acknowledged for our work and significant export growth. We remain committed to expanding both our technology and our global footprint for our patented, innovative, protective solutions.

### **What approach has contributed to the success of D3O?**

As a management team we constantly talk about keeping the customer at the heart of what we do and we look at all decisions across the whole business through that prism. Many companies talk about being a solutions provider; it is easy to say but much harder to actually do. At D3O it has been key to our dramatic growth. Right across the business from material development, product development, testing, supply chain execution, marketing support, or joint growth roadmaps with our customers we always think about providing solutions to customers' problems not just selling a product. This is how we have built our reputation in the market place and why customers continue to approach D3O to solve their problems and help them boost their sales.

### **How do you think the Government can better support UK manufacturers?**

The Government's key role is in maintaining macro-economic stability for both exporters and importers alike. Harnessing organisations such as UKTI and the Technology Strategy Board have, through practical advice and guidance, helped supercharge our innovation and increase our worldwide revenue potential. The R&D Tax Credit and the Patent Box, can make a significant impact on a business's cash flow. These schemes can give manufacturers the confidence to re invest in innovation and can unlock triple-digit growth as it has done at D3O.

### **Where do you see the opportunities in the manufacturing sector in the UK in the next 12-18 months?**

Exporting products and services still remains a great opportunity for the manufacturing sector. We speak to a number of UK manufacturers and we feel that sometimes they lack confidence. There are some fantastic world class manufacturing companies in the UK, more than people think. As a manufacturing sector in the UK we should have more confidence in the brilliant products, services and people that we have. We are capable of winning

business and servicing new needs in all parts of the globe. Clearly emerging markets are a priority but we can also compete in the traditional export markets and it is just a matter of getting out there and showing people what you can do.

### **Innovation is perhaps an overused word, but not in the case of D3O, where your entire business model lives or dies on innovation I imagine – so in that context do you think British manufacturers do innovation well?**

Yes, there are a large number of companies doing some extraordinary innovation and we are as well placed as any country in the world for innovation. Ideas and the execution of innovation is not the main issue here in Britain, but prioritising and securing the resource to enable it. It's easy to blame the banks for being too risk averse but I also think as an industry we have an obligation to make the broader case for innovation. Every company has a duty to communicate the nature of the innovation process and technical risk in a much clearer way.

### **As a business with a retired windsurfing champion as CEO and a scientist/lecturer as founder do you think that our manufacturers need business credentials or just a great idea and a vision?**

The UK has a great pedigree of producing manufacturing companies whose success is built not only upon the technical expertise and vision of their founder or CEO, but their innate understanding of a particular market, and commercial ability to identify and exploit applications of technology or solutions. Creativity and business acumen are not mutually exclusive: if manufacturers are to be successful they have to be equally good at both. I would also say that great leaders surround themselves with great teams and D3O is no exception in that regard.

### **If you were to sum up British manufacturing in just five words, which words would you choose?**

Growing, surprising, talented, winning, shy!

### **And finally aside from Dr. Martens, trainers, American football players and A list celebrities, what is the most unusual request for a D3O application you have received?**

We have had some very intriguing requests over the years, but perhaps one of the most unusual was from NASA which made an enquiry about using D3O in its space habitat to protect astronauts from asteroids.



**MOSTYN THOMAS**  
General Manager  
D3O

# A MANUFACTURER'S PLACE IN THE AUSTRALIAN SUPPLY CHAIN

## KNOW YOUR RESPONSIBILITIES

Australia is a very vast country. Most goods that come in or out of Australia, are carried, at least part of the way, by road. In recent years, this has led to a paradigm shift in the regulation of Australian supply chains. No longer can manufacturers shift the focus to their logistics suppliers, all players along the transport chain can be touched by the law. This means that any global manufacturer, whether importing finished products into Australia, or purchasing raw materials from Australia, should be aware of their obligations under the “Chain of Responsibility” (COR) laws.

COR laws were first introduced in Australia to stamp out unsafe practices in long vehicle haulage. Over the past decade, laws have been enacted in all Australian states and territories in dribs and drabs. In February 2014, these laws were finally nationalised under the *Heavy Vehicle National Law*, which now imposes uniform offences and penalties for compliance breaches.

So what do the COR laws cover, and why are they critical for manufacturers? Quite simply, the laws state that each and every player along the supply chain must ensure that goods are carried safely and in compliance with the law. The COR laws apply to:

- drivers and operators;
- packers, loaders and unloaders of goods;
- consignees and consignors; and
- those who control logistics schedules.

These categories are defined very broadly, and focus on a person or entity's *actual role*, not just how they are named in documentation. For example, a consignor can include a named consignor on a bill of lading, or an entity who imports goods into Australia. Therefore, most manufacturers who distribute goods in Australia are likely to be consignors or consignees, and sometimes packers or loaders of goods under the laws.

The COR laws require all players in the chain to actively ensure compliance for example, by making sure that:

- consignments carried by road are not too heavy, and do not exceed vehicle or road limits;
- consignments are properly restrained, so that they do not become dislodged and cause injury or damage to people or property;
- drivers comply with strict fatigue regulations, which are necessary given the often vast distances that goods are carried in Australia; and

- drivers and operators are not coerced, encouraged or provided an incentive to break speed regulations through the imposition of unreasonable requirements to deliver goods within a particular time frame.

The COR laws impose heavy penalties for breaches of the law, which can include monetary fines, warnings, improvement notices, prohibition orders, and commercial benefits penalties (which deprive you of any commercial benefit obtained through the breach).

Importantly, authorities can prosecute more than one person along the transport chain in respect of a breach. Therefore, authorities could pursue a manufacturer as the consignor, and also your logistics provider who operates the road haulage element of your supply chain.

Each director or manager of a company can also be held personally liable and punished, for breaches of the law, in addition to the company itself.

A limited defence is available to those prosecuted, namely, you took all reasonable steps available to prevent the breach. This means that having a pro-active approach to compliance is critical, which includes active monitoring of performance on an ongoing basis.

The COR laws may sound draconian, and they certainly have far reach, but the laws should not put off global manufacturers from trading with Australia. They do, however, mean that:

- you should avoid “boilerplate” logistics contracts, particularly those drafted outside of Australia;
- a clause simply requiring your logistics supplier to comply with “all laws” will not be enough. Key contractual provisions around audit rights, record keeping, inspections of sites, KPIs, termination and replacement of contractors must all be tailored to best protect your company, its directors and managers from prosecution; and
- manufacturers may wish to consider a partnership based approach with Australian logistics suppliers, with a co-operative model designed to help you better bear your COR burden.



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# PRODUCT RECALL – AT THE PUSH OF A BUTTON

It isn't until a business finds itself in the unfortunate position of having to conduct a product recall that the realisation dawns what a complicated, stressful, brand damaging and costly exercise it can be. Over the last couple of decades the newspapers have regularly reported high profile and damaging stories regarding recalls which have had to be made by some of the largest global businesses.

The reality is that, damaging though they can be, product recalls are much more common than is realised. Notwithstanding the modern quality control standards, products can still present risks and in order to ensure “the high degree of consumer protection” on which the legislation is premised, such products must be recalled.

If you were to spend any time on the VOSA, MHRA, or Trading Standards websites, you would find many thousands of recalls, this year alone, which have never achieved any press profile. And yet for many the words “product recall” cause an involuntary shudder. For others product recalls are part and parcel of doing business and, because they are familiar and planned for, are dealt with as part of routine business, and not an exceptional dramatic event.

The situation has been reached where any manufacturing business ought to be planning for a product recall in advance, so that should such an unplanned event take place, the process to be followed is not unfamiliar.

The EC Guidance (Guidelines to Businesses to Manage Product Recalls and Other Corrective Actions) places great emphasis on the development of proper recall policies as part of a business's compliance with its legislative duties: to retain relevant information about products and product components, to have such information available to regulatory authorities and to ensure traceability of products. It also provides excellent guidance on risk assessment and a structured decision making process for a recall itself.

Surprisingly our experience shows that until a business has to recall a product, little thought or planning has been given to such an eventuality. In some cases this has inevitably led to a less than impressive response, made decision making and effective action harder and slower, and led to a lack of confidence on the part of the regulator in the business, increasing scrutiny.

The decision to make a product recall can often be difficult, particularly where there is considerable financial pressure. In practice, however, the decision to recall should not be difficult if using the EC Guidance to aid proper risk assessment and decision making.

Our experience shows that one aid to good decision making and putting any financial pressure in a proper context, is an understanding that the General Product Safety Regulations provide for personal liability and potential imprisonment of the decision maker(s):

*“Where a body corporate is guilty of an offence under these Regulations in respect of any act or default which is shown to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the body corporate or any person who was purporting to act in any such capacity he, as well as the body corporate, shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly.”*

Throw into the mix the potential for Corporate Manslaughter or Gross Negligence Manslaughter charges and the need for caution is obvious.

Often what is overlooked pre and post recall are those aspects which are in some ways peripheral to the decision making and execution of the recall itself but actually essential:

- The notification of and relationship with the regulator.
- The potential supply chain implications and contractual liabilities/matrix.
- Replacement of suppliers at short notice to service existing commitments.
- Whether an independent expert needs instructing.
- Capturing the time spent on the recall and ancillary costs for claims purposes.
- Whether insurance is available and notification of insurers.
- A press plan and PR/Customer Services support plan.
- Business continuity – everyone loves a drama, but who runs the business?
- Properly evidencing the decision making process in case of challenge.
- Dealing with any claims by the consumer.

With proper planning, a business can give itself every chance of conducting a calm and effective recall and minimise the business risks as well as ensuring proper legal compliance. Whether it's the policies and planning, training, dealing with the regulator, or assisting with the potentially difficult decision to recall and the civil claims which follow, our experienced Litigation and Regulatory team is here to help.



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# NOT MADE IN CHINA – THE IMPORTANCE OF HAVING A CHINA STRATEGY

China has, since 2011, been the world's largest manufacturer, but many international companies are now looking elsewhere. Wages have risen to match higher living standards and employees are better educated and more demanding. China still suffers from intellectual property abuses and political problems that deter investors and is losing some new factory investments to lower-cost locations, such as Vietnam.

All manufacturers will need to stop relying on low wages and fast economic growth for their China strategy. But they still need a China strategy. They will need to enhance their productivity, their methods of product-development, and above all their supply chains – including more supervision and more simplicity. And they need to engage with China's legal system: intellectual property protection, employee stability, anti-corruption and successful dispute resolution are all vital for success, and simply bemoaning the lack of rule of law is no solution.

## LABOUR MARKET

If you make labour-intensive products, e.g. shoes or clothes, you are probably already hedging between China and other countries to reduce cost. In China, costs have increased due to the higher cost of the labour market and the increase in the value of the RMB. Manufacturers that invest in understanding the labour market and its grey areas save as many costs as those who seek to keep wages low.

## DISCERNING CONSUMERS

For many types of products – for example high-tech gadgets like smart-phones – China's consumers are more discerning than their Western counterparts. More importantly, their tastes exceed the ability of local producers to satisfy them. This has led to far more litigation – even collective litigation – against manufacturers. It is important for manufacturers (and distributors) to have a China strategy in place for defence in such cases. In addition, it is obviously essential to understand China's regulatory standards.

## SUPPLY CHAIN AND DISTRIBUTION NETWORK

Beijing and Shanghai are the obvious places to seek purchasers for international products, but most producers are now aware that there are thousands of other cities stepping up as their consumers become affluent and demanding. Most of the growth in demand comes from these cities, so distribution networks become longer and more difficult to supervise. As with all aspects of business, a failure to supervise properly and a reliance on localisation brings business risk.

The supply chain is also becoming more confusing because of other factors, such as the increased availability of competing products, or products that seem to compete, and the proliferation of delivery methods (e-commerce being the obvious example).

For many industries, the problem is one of demand and production changeability. There are various ways that manufacturers should deal with these issues. Where possible they should try to hedge against this in their contracts or to shift the burden of risk onto their materials suppliers or product

buyers. Many manufacturers do not apply their home-country standards in China, believing that China is a special case where local standards should apply.

## INTELLECTUAL PROPERTY FEARS

Fear of IP theft often results in R&D strategy being removed from the local team in China.

This can result in the product failing to sell when local input is ignored. Some companies refuse to engage with China at all in the belief that this will reduce their IP risk profile. This approach is often wrong: if you don't try to engage with the China market in some way, the technology might be copied anyway.

Businesses can usually strengthen their IP position or decrease the risk by fine-tuning their IP/patent protection strategy. This could involve: a combination of patents and trade secrets and an aggressive patent filing/prosecution strategy in China.

From a commercial perspective, an international entity could consider partnering with a major Chinese player to better exploit the market. This will also put the company in a better position when enforcing IP/patent rights in China in the future.

## RAPID CHANGE AND FREE TRADE ZONES

The final aspect of manufacturing in China that we will discuss is the importance of maintaining an accurate understanding of the various developments taking place in the foreign investment sphere in China, because many of these developments, can be beneficial to manufacturers.

For example the Shanghai Free Trade Zone is the first Hong Kong-style free trade area in mainland China. The Shanghai FTZ includes Pudong airport zone and the Yangshan port (part of the biggest port in the world). Manufacturing businesses will be able to receive their equipment duty-free. Imports of machines, equipment and other necessary goods for manufacturing will all be exempt from duty tax.

Other changes include a gradual shift towards the ability of foreign investors to establish companies without approvals and a new dispute resolution procedure using Hong Kong courts for disputes anywhere in the mainland.

In summary manufacturing in China can still be the right choice. The tasks for manufacturers are to improve productivity, refine product-development approaches, and to both supervise and simplify supply and distribution. If this is done manufacturers can not only make use of the resources, talent and market that China has to offer, but can add cost and product benefits to their global business activities.



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# CHANGING LEGISLATION ON LETTINGS

## DO YOU MAKE THE CUT?

The UK has a statutory duty under the Climate Change Act 2008 to reduce greenhouse gas emissions by at least 80% (from the 1990 baseline) by 2050. The Carbon Plan, published by the Department of Energy and Climate Change (“DECC”) in 2011, stipulates that in order to meet this target emissions from all buildings must be “close to zero” by 2050, meaning that by then all UK buildings will likely be required to have an EPC rating of close to current “A” standards.

A significant reduction in energy demand is seen as a fundamental factor in achieving this target, with section 49 of the Energy Act 2011 obliging DECC to implement Minimum Energy Efficiency Standard Regulations (“Regulations”) by no later than 1 April 2018. The intention being to galvanise positive action in improving energy efficiency in the least efficient non-domestic letting properties thereby reducing wastage and overall demand.

On 22 July 2014 DECC published a consultation on the implementation of the Regulations (“Consultation”) with the most significant proposal being a prohibition on the letting (not the sale) of property with an EPC rating of “F” or “G”. The Consultation evidenced that 18% of commercial rental premises fall below this standard and unless improvements are made, the new regime would therefore render a substantial portion of the existing commercial rental portfolio unmarketable unless the Regulations either do not apply or a landlord can demonstrate that it benefits from an exemption.

The Consultation highlights a number of limitations and exemptions as to the scope of the proposed Regulations, including:

- an exemption allowing landlords to let premises with an “F” or “G” rating insofar as they are undertaking all necessary improvements that are possible without the repayment of those improvements exceeding expected energy bill savings (the “Golden Rule”). This allows landlords to comply with the Regulations so far as is possible, without incurring upfront cost; and
- an exemption where consent is withheld in respect of improvement works that require third-party consent and the landlord has used its “best efforts” to obtain that consent and failed.

DECC proposed that the above two exemptions would last for five years, or until consent is granted, whereby the standard should be met or a landlord must again show an exemption applies.

- an exemption where the building being let is outside the scope of having to obtain an EPC, including those outside of the scope of the Energy Performance of Buildings (England and Wales) Regulations 2012;
- as an extension to the above, lease renewals/extensions do not require an EPC and would, strictly speaking, be excluded. However the Consultation specifies that the

application of the Regulations in such scenarios would “make sense” so this limitation is likely to be removed by the final legislation; and

- application only to lettings for a term exceeding six months and less than 99 years. Such exemption ceases to apply where the same lease is granted to a tenant more than twice.

It appears likely that the Regulations will come into force as follows:

- the Regulations will apply to all new lettings from and including 1 April 2018; and
- the Regulations will apply in respect of existing lettings from and including 1 April 2023.

This means that any lettings that commence on or after 1 April 2018 must comply with the final legislation. It also means that any lettings that commenced prior to 1 April 2018 and have a term that extends beyond 1 April 2023 will become liable to enforcement action under the in-force legislation after that date if they have an EPC rating of “F” or “G”.

The Regulations will be enforced by Trading Standards Officers who will have discretion as to the imposition of civil penalties assessed by reference to a formula that ensures a degree of proportionality and reflects the benefit a landlord has received from a letting during the period of non-compliance with the Regulations. This looks likely to be based on a percentage of the rateable value of the property, with fixed alternatives where this formula cannot apply.

The consultation closed on 2 September 2014 and the feedback is being considered. Whilst the Regulations as discussed above are of course subject to change, it is important that potential landlords begin to consider the efficiency of their property portfolios with the above in mind to ensure that insofar as they are able they are prepared for 1 April 2018.



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## ABOUT DLA PIPER'S MANUFACTURING SECTOR

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