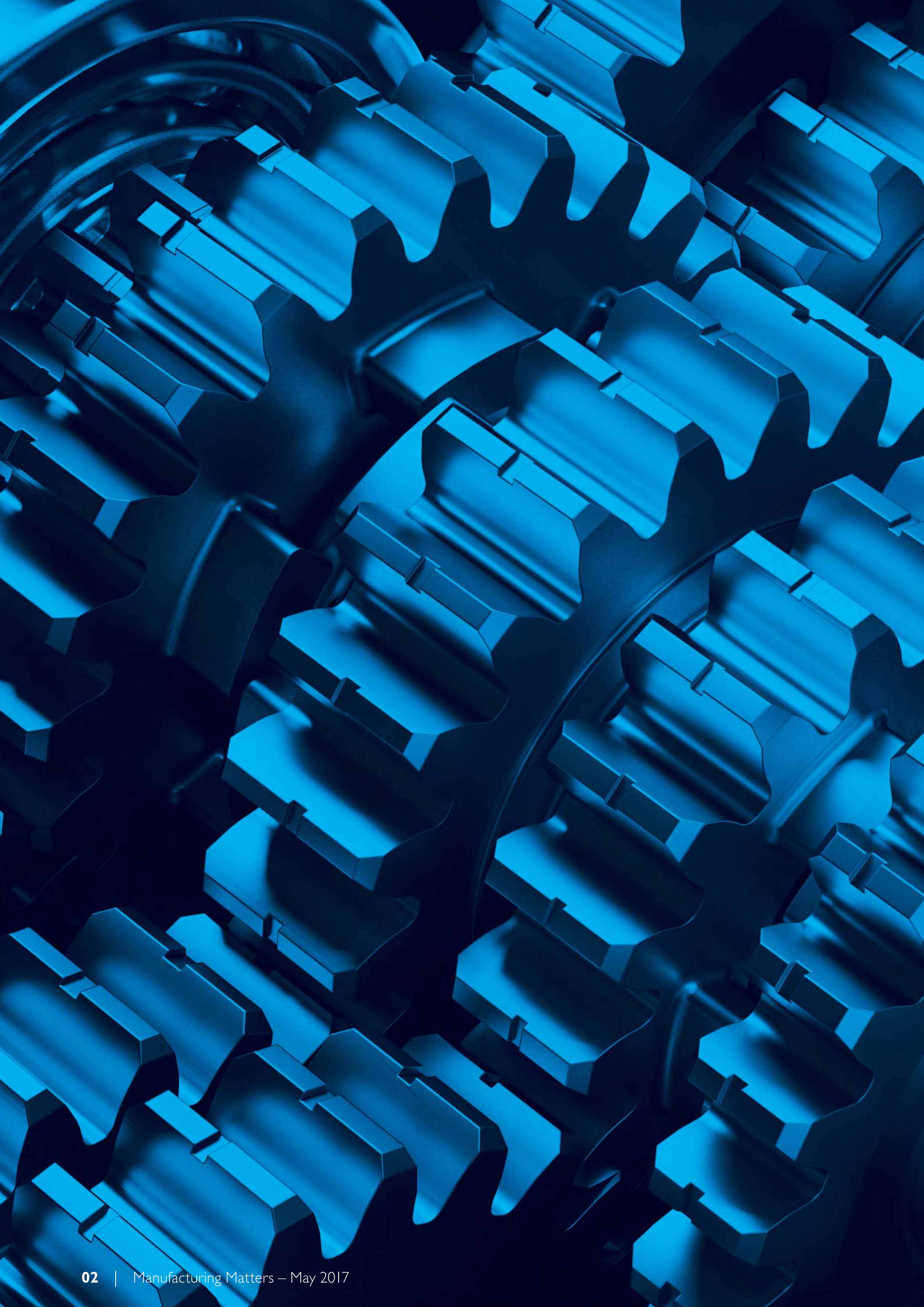
MANUFACTURING MATTERS

MAY 2017



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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As mentioned in the last issue of Manufacturing Matters, "Smart Manufacturing", including automation, is gaining momentum. A number of leading global manufacturers have already adopted it, and according to The Annual Manufacturing Report 2016, 85% of UK manufacturers have implemented automation in the last 12 months.

DLA Piper was a proud co-sponsor of Automation 2017, an annual conference that took place on 29 March 2017 at Aston Villa Football Club, Birmingham. The conference was a great opportunity to explore how manufacturers can remain competitive, boost efficiency from existing plant machinery and engage their workforce ahead of the next project.

On another note, the resilience of Britain's manufacturers in the face of seemingly unending challenges never ceases to amaze me. There has been an overall downturn in UK manufacturing, led by the steel sector (which is reported to have decreased by 9%) and the strength/weakness of the pound has made competition in international markets even more difficult to plan and predict. On a positive note, UK exports of higher added value products remain strong and overall manufacturers are optimistic about the future.

Skills (or the lack of them), remains high on most agendas – shortages exist in:

- engineering and automation
- toolmaking
- technical and practical positions
- problem solving
- planning and organisation; and leadership and management roles.

Encouragingly, manufacturers do seem prepared to invest in people. Hopefully the recently-announced Apprenticeship Levy may encourage even more investment – we will have to wait and see!

IN THIS ISSUE

- Direct-to-consumer selling – What you need to know about GDPR
- Keith Warburton, Global Business Culture – UK Manufacturing needs a global mindset
- Pensions – Key issues for your agenda
- Collective bargaining stalemate?
- Brexit – Is the only certainty uncertainty?
- Transfer pricing
- Damian Waters, CBI – The future of Industrial Strategy
- A new duty for large companies

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.

DIRECT – TO – CONSUMER SELLING
WHAT YOU NEED TO KNOW ABOUT GDPR

With the growing prevalence of online retail and direct sales, more and more consumer product manufacturers are turning to direct-to-consumer (DTC) selling as a means of driving sales, strengthening their brand and loyalty, and taking greater control over the end-consumer's shopping experience.

Apple is perhaps one of the most ubiquitous and successful examples of a manufacturer who has looked to take the DTC route, with their online and offline DTC offering a key focus in its drive to increase sales and control its overall customer experience. Other notable companies looking to exploit DTC sales include Nike, who is looking to increase such sales to $16 billion by 2020 (an increase of 250% from its 2015 position), and Tesla Motors, who has fought to overturn legislation in the US which prohibits the direct sales which are central to its business model. UK car manufacturers are now offering direct sales too.

In addition to the financial benefits associated with DTC sales, manufacturers are increasingly attracted to the rich customer data which can be collected through DTC sales. Effective use of this customer data can allow manufacturers to tailor advertising campaigns and personalise the shopping experience of its customers in order to rationalise its marketing activity and, ultimately, drive revenues through loyalty.

Once a manufacturer has collected their customer's data, however, it does not have a free hand to exploit that data in any way it pleases; to the extent that the data collected is personal, then the manufacturer's use of their customer's data is governed by the Data Protection Act 1998 (DPA). For the purposes of the DPA, personal data is data relating to a living individual who is or can be identified either from the data or from the data in conjunction with other information that is in, or is likely to come into, the possession of the relevant data controller.

Manufacturers dealing with the personal data of its customers on a daily basis are likely to be well-versed in the data protection principles underpinning the DPA. From 25 May 2018, however, the General Data Protection Regulation (GDPR) takes direct effect in all EU member states, replacing the existing European directive and each member state's national data protection laws. The GDPR contains a number of key changes to the DPA and Directive, and manufacturers dealing with customer data as part of their DTC sales approach should be aware of these.

You may wonder what impact the Brexit vote and Britain's expected departure from the EU will have on the GDPR? Given that Britain will still be a member of the EU on 25 May 2018, all UK businesses will need to be GDPR-compliant by this date. Likewise after that date, it is expected that for as long as there are transfers of data between the UK and the EU, then the UK will need its own national law that provides an equivalent level of protection of personal data, as is provided by the GDPR, to continue strong trading relationships and also as the GDPR applies wherever personal data is processed relating to EU citizens. There is a key benefit of having a standardised data protection approach across organisations operating across many countries.

One of the key changes to existing data protection law contained in the GDPR is that non-compliance could lead to heavier sanctions; the revised enforcement regime is underpinned by power for regulators to levy financial sanctions of up to 4% of the annual worldwide turnover of the organisation's group or up to €20 million, whichever is the higher. This is a significant change from the current regime, including in the UK, where the maximum fine is currently £500,000.

In light of the pending implementation of the GDPR and its tougher penalties for non-compliance, we have set out below a list of ten essentials for compliance which manufacturers handling personal data through its DTC channels or otherwise should seek to follow:-

1) Be transparent with data subjects about the processing of their data – greater detail is needed, balanced with ease of access and understanding, as well as careful use of consents;
2) Appoint a data protection officer to manage compliance;
3) Implement procedures which allow individuals to exercise their rights to access and correct their data;
4) Put in place rigorous data security breach notification procedures;
5) Train and educate staff involved in data processing;
6) Consider international data transfer restrictions and put in place legally approved transfer mechanisms;
7) Contractually stipulate warranties from third party data processors, and put in place the contractual requirements set out in the GDPR through a contract updating exercise;
8) Document data processing operations in detail;
9) Ensure continuous monitoring and follow up of compliance efforts – so that you can justify why particular processing is taking place; and
10) Adopt a privacy-by-design and privacy-by-default approach when developing new products or services, or new uses of personal data.

There are clear benefits to be derived in the adoption of a DTC sales model, but it is an approach that brings with it new and evolving risks which will need to be carefully considered by manufacturers seeking either to continue existing DTC sales or break into that space for the first time in the new GDPR world.

Further detail is available at our Data Protection microsite – www.dlapiper.com/dataprotection. For further information on how we can assist you, including through the provision of GDPR compliance reviews, please email us at dataprivacy@dlapiper.com

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UK MANUFACTURING NEEDS A GLOBAL MINDSET

UK manufacturers have a great story to tell to global markets – innovative products, great quality and leading edge techniques. So why is the UK manufacturing sector portrayed as punching below its weight when it comes to exporting and expanding internationally?

According to Think Global Growth CEO, Keith Warburton, manufacturers often let themselves down by underestimating the importance of a few critical factors which can lead to sub-optimal international market penetration. Keith outlines a few key areas that manufacturers need consider when attacking global markets:

Preparation and Research Many organisations try to enter a new market on the back of an opportunistic meeting, which often leads to companies 'getting into bed' with the wrong partners. Global expansion should be based on a well-thought through strategic plan underpinned by thorough research. People often underestimate the time it takes to see a return on investment and this often leads to people pulling out of a project before it bears fruit.

In short, quality preparation and research into new markets is probably the biggest distinguishing factor between success and failure. Quality research costs money and it may slow progress in the early stages, but without the right level of information and strategic thinking at the outset, your long term growth may suffer.

Cultural Knowledge and Understanding Often cited as a soft issue, the cultural aspects of doing business in an alien environment could make or break the project. Do you understand the cultural drivers and expectations of the people you will be doing business with? What are their attitudes to contractual arrangements? What is their decision-making process and who really are the decision makers?

Most of the emerging markets are relationship driven and people will not do business with you unless they have decided that you are the type of people they would be happy and comfortable to do business with. Not learning about the business culture in-country (and that is not just whether they bow or shake hands) is absolutely imperative. There are no aspects of business which are unaffected by cultural drivers.

Develop a Digital Mind-set Most manufacturers would agree that the world is 'going digital', but many would also admit to failing to understand how this impacts on manufacturing, let alone them. Information is now truly global – we are but a few clicks away from almost any information, that goes for our prospect customers too.

Manufacturers need to 'get digital'. They need to understand how they appear to their prospect global customers across all media channels. They also need to appreciate which channel they need to be present on. Is it a pure website play, or might Facebook or Twitter be useful to have a presence on? How does your LinkedIn profile appear these days? Up to 70% of the decision to contact your company will have been made long before you are aware someone is looking. Are they passing your virtual door without knocking? And all of this is further complicated because not all global markets use the same digital channels in the same way. Google is not as globally ubiquitous as you might think and LinkedIn simply doesn't work in certain markets.

Going digital can be the major influence to gain a competitive advantage. It is imperative that manufactures don't ignore these emerging trends, but embrace them.

STRETCHING YOUR EXISTING SUPPLY CHAIN

It is easy for UK manufacturers to become so focussed on securing that first international sale that they do not fully consider how they are going to deliver on the promise. It may be possible to deliver to the customer on time, in full, once or twice by superhuman effort. However, it is a totally different proposition to achieve this every time, especially as volumes grow and customer demands mature.

Too many companies assume that they can just add additional capability to their existing supply chain network to "fit" an increasing global footprint. By their nature global supply chains are longer and more distant in both time and geography. This can often result in the supplier "packing" more material into the supply chain, having less visibility of where their products are, and less control over their flow to the customer. Costs, especially working capital, spiral. Service standards can fall and the supply chain becomes fragile. At its worse this draws huge resource from the supply chain team which results in falling standards and rising costs.

An essential part, therefore, of any global expansion is a strategic review of the business supply chain and a well-structured plan to ensure it continues to provide the right cost/benefit while expanding into new markets. Ultimately it must be robust and sustainable enough to ensure that all the effort expended in entering into new markets is rewarded with a long term reliable income.

CONCLUSION

Now is the time for UK manufacturers to take stock of their global business strategy and review what is working and what is not. Brexit means that the status quo probably won't be maintained and that new international markets will need to be addressed. You can do this in an ad hoc way or you can take control through planning, knowledge and precise implementation. Which alternative seems most likely to breed success?

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PENSIONS
KEY ISSUES FOR YOUR AGENDA

Many underestimate the significant impact that defined benefits (DB) pension schemes can have on manufacturing companies. Pensions now influence every aspect of day-to-day corporate life.

The pensions arena in 2016 was defined by the outfall arising from Brexit, companies continuing to implement effective auto-enrolment strategies and the burden of ever-changing legislation. Further reforms and pressures are expected, the highlights of which are set out below.

BREXIT

A significant amount of pensions legislation originates from the European Union (EU), although as yet it is unclear to what extent the Great Repeal Bill will mirror EU law. Brexit opens up the opportunity for the UK Government to reconsider legislation, in particular aspects such as TUPE may be clarified. Notably, the scheme funding reforms contained within the IORP II Directive, that are currently anticipated to be implemented by 2018, may not apply in the UK.

Market volatility and heightened uncertainty have caused weaker predictions for growth and low yields in which risk-free assets are generating no or little returns. Consequently, some trustees saw their schemes' deficits worsen overnight, placing pressure on employers to repair these widening pension deficits.

This weakening in the employer covenant may mean that companies experience increased pressure from trustees for assurances, and employers must prepare for the possibility of an employer covenant assessment. Further, international companies considering corporate restructuring as a result of Brexit must pay close attention to the impact upon the employer covenant.

MANAGING RISK

There remain many DB schemes within the manufacturing sector, and whilst these may be closed to future accrual, they need to be managed.

Current economic uncertainty means that employers need a clear strategy for managing pension scheme funding in order to reduce their exposure to DB pension scheme risks, which can have a negative impact on share price. We have been discussing with clients ways in which their pension scheme liabilities can be managed.

Since the introduction of TPR, DB pension schemes have become increasingly important stakeholders in corporate transactions. A target with a pension scheme deficit can put significant constraints on the actions a potential buyer can take. Sponsoring employers considering a sale must satisfy themselves that there is little or no risk of being targeted by TPR by ensuring proper support for pension scheme liabilities.

Employers should also consider their Experian score in respect of the Pension Protection Fund (PPF) levy. We have been assisting clients to review their levy score and have made recommendations of action which can be taken to reduce the levy. Those manufacturing companies that are able may benefit from considering a group company guarantee, which can provide a very significant reduction in the PPF levy.

GENERAL DATA PROTECTION REGULATION (GDPR)

As mentioned on page three, the GDPR will replace the Data Protection Act 1998 from 25 May 2018. The GDPR will have a considerable impact on the way that employers and pension schemes can lawfully collect, use and share information about members and the data held in respect of pension schemes by employers will need to be treated in line with the new regime.

Both employers and pension schemes should utilise 2017 to prepare for the GDPR. It will be necessary to review practices to establish whether amendments are required to any documentation such as contracts with third party administrators or practices, to ensure compliance in readiness for the GDPR. We have been carrying out audits for our clients in respect of their existing documentation.

UK: AUTO-ENROLMENT AND TPR

In December 2016, the DWP announced the broad scope of its planned 2017 review of the auto-enrolment process. This will cover a wide range of aspects including the scope of the regime, the appropriateness of earnings and age thresholds and the level of the charges cap. This may mean a change in the legislation, requiring a review of processes by employers. In addition, employers will have to continually monitor compliance with auto-enrolment procedures and ensure that contributions are being paid timely and effectively. The number of Compliance Notices issued by TPR has now reached over 26,000, demonstrating TPR's willingness to act.

ACTION POINTS

It will be no surprise that there is lots on the horizon. Actions which employers can take in order to prepare for any changes are:

- **consider the impact of Brexit on the employer covenant and whether any action needs to be taken in respect of funding support;**
- **review the calculation of the PPF levy and consider whether any action can be taken to reduce this;**
- **audit agreements with third parties to ensure compliance with GDPR; and**
- **monitor auto-enrolment to ensure compliance and make changes where appropriate to incorporate new requirements.**

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COLLECTIVE BARGAINING STALEMATE?

Employers who recognise a trade union for the purposes of collective bargaining should be aware of a recent tribunal decision which may impact on their ability to implement contract variations when union negotiations reach a stalemate.

Section 145B of the Trade Union and Labour Relations (Consolidation) Act 1992 (TULRCA) prohibits employers making offers directly to union members to change their terms and conditions in order to avoid collective bargaining.

TULCRA defines a "prohibited result" as being that one or more of the workers' terms "will not" or "will no longer" be determined by collective agreement. There is no binding case law on what this means in practice. In particular there is uncertainty about whether employers who, despite bargaining in good faith with the union, fail to reach agreement on a new contractual term are able to then approach employees directly to agree the change, without breaking the law.

Following previous tribunal cases, it was generally considered that for the legislation to be breached the employer had to be seeking either the total or partial elimination of collective bargaining.

This position has been called into question by the recent employment tribunal decision in Dunkley and others v Kostal UK Limited.

BACKGROUND

The employer had a recognition agreement with Unite providing for collective bargaining. In pay negotiations in November 2015 the company made a pay offer of a 2% increase in basic pay plus a 2% Christmas bonus, in return for changes to terms relating to sick pay for new starters, reduction in overtime rates and consolidation of breaks.

The union balloted members on the offer, which was rejected. The employer then sent a notice to all employees summarising the deal and giving until 18 December to accept. The notice stated that failure to sign and return would result in the Christmas bonus not being paid. In January the employer sent a further letter to employees who had not accepted the offer stating that if no agreement could be reached this may lead to notice being given to terminate employment. In the meantime the dispute between the company and the union was referred to ACAS but a collective agreement in respect of pay for 2015 was not concluded until November 2016. The claimants – all members of Unite – brought claims under s.145B.

DECISION

The tribunal held that the employer had breached s.145B. It found that the employer took the conscious decision to bypass further meaningful union negotiations in favour of a direct and conditional offer to individual employees. It was, the tribunal found, improbable that the employer did not intend to circumvent the collective bargaining process when it made the offers. The tribunal discounted the fact that the employer intended to determine terms and conditions collectively in the future.

Interestingly, the tribunal failed to accept the employer's arguments that the impact of this would prevent the employer ever implementing a change to terms with union members if the Union refused to agree. The tribunal disagreed and considered the option was still open to employers of terminating the contract and offering re-engagement on the new terms. In our view, however, this misses the point that the offer of re-engagement would in itself be in breach of s.145B if the tribunal's interpretation of s.145B is correct.

Although this is only a tribunal decision and therefore not strictly binding, we are aware that Unite is seeking to rely on it to prevent employers engaging directly with employees in relation to terms and conditions. There is now a much higher risk that trade unions will encourage employees to bring claims if offers to change terms are made direct to union members, even where collective bargaining has been followed in good faith and reached a stalemate and where the employer intends to collectively bargain on all future matters.

WHY IS THIS IMPORTANT?

The consequences of a breach of s.145B can be significant. An Employment Tribunal will award £3,830 to each employee who has been made an offer in breach of the statutory provisions (whether or not they have accepted the offer) and the contract variation may not be effective. In addition, dismissal for failing to accept such an offer will be automatically unfair with no minimum service requirement. While this legislation only restricts offers to union members, making offers only to non-member employees presents other risks.

WHAT SHOULD EMPLOYERS NOW DO?

To mitigate the potential for a breach of s.145B employers need to:

- Be clear in communications with the union and the employees what the business reason or need is for any proposed change to terms and conditions and the reason for any urgency.
- Ensure if offers are made to employees the terms are the same as those offered via the trade union and, in most cases, that the scope of collective bargaining going forward remains unchanged;
- Exhaust collective bargaining procedures first. Avoid expressing hostility towards collective bargaining arrangements. In determining the employer's purpose, the employment tribunal must take into account any evidence that the employer had recently changed or sought to change, or did not wish to use, collective bargaining; and
- Review collective bargaining agreements.

Our employment team has extensive experience and succeeded in defending British Airways against a s.145B claim. If you would like to discuss your current arrangements or on-going or anticipated change, please contact Alan Chalmers.

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BREXIT

IS THE ONLY CERTAINTY UNCERTAINTY?

It remains difficult to predict exactly how the UK's exit from the EU will be effected. The UK's vote to leave the European Union was the first step in a process that is likely to be unparalleled in scale and complexity.

What remains clear is that Brexit will have an impact on the rights and obligations of commercial parties in all sectors. Given that the prime minister has made it very clear that Brexit means Brexit, it seems likely that this remains a question not of "if" but "when."

Now that the UK has given formal notice of its intention to leave the EU, a two year exit negotiation will begin, the outcome of which is unpredictable. The only certainty for the foreseeable future is uncertainty.

In the rest of this article, we review the priority areas on which UK businesses are currently focussed.

GETTING STARTED

Many businesses have set up a Brexit committee to co-ordinate all communications and prepare an overview of the potential impact and their business response. Some businesses also need to consider their public reporting obligations, and what, if anything, they need to say in public statements or in their annual report.

REGULATORY REVIEW

A top level review to assess which EU regulations currently affect the business is essential for all businesses operating in the UK; this is proving to be an enormous exercise. The UK's regulatory framework has become significantly entwined with that of the EU and the unwinding process will be enormously complex. For the time being, it is 'business as usual' – at present the UK remains a member of the EU and must continue to abide by European laws and regulations.

CONTRACTUAL RELATIONSHIPS

Going forward, we may see parties who want to escape their contractual obligations, for whatever reason, employing Brexit-related legal arguments founded in "force majeure" or "frustration". These are not easy arguments to win, but we are advising businesses to review such clauses carefully. Cautious parties should consider express carve-outs for any Brexit related circumstances.

Defined terms should also be checked, such as references to the "EU" and EU regulatory bodies. These may not work as intended post-Brexit.

Other points to consider include:

- future corporate reorganisation by parties to a contract;
- exchange rate fluctuations and pricing;
- allocating compliance costs between parties;
- appropriate means of dispute resolution;
- potential breaches of financial covenants, financial ratios or material adverse change clauses; and
- impact on ability to borrow and sources of EU funding;

SUPPLY CHAIN MANAGEMENT

It is key to analyse the extent to which a business involves supplies of goods or services between the UK and (a) other EU Member States and (b) other countries with which the EU has concluded or is currently negotiating trade agreements. The impact of the imposition of tariffs and the increased administrative burden needs to be considered, though realistically it is difficult to assess at this stage.

Some businesses are considering relocation in order to maintain free access to the EU market. Relocation carries with it a number of challenges, including:

- relative merits of alternative locations;
- new authorisations;
- implications for headcount;
- lead times for obtaining floor space and relocating or hiring necessary staff;
- delegation back to the UK; and
- personnel issues and relationship management.

Free movement is one of the core elements of EU membership. If this is curtailed, some businesses may be affected significantly. Visa requirements, for example, could make it difficult to recruit UK-based employees from the remaining EU Member States. Individuals may also prefer to be located in the EU where their movement would remain unrestricted. UK employees currently working in the EU might also need assistance with visas in due course. Businesses should consider what messaging to give to employees about the potential impact, although this is difficult to assess in a relative vacuum.

CONCLUSION

The decision to leave the EU raises significant challenges and potential opportunities. While there is much uncertainty regarding the shape of the UK's future relationship with the EU post-Brexit, it is clear that Brexit will affect the rights and obligations of all parties to commercial activity in the UK, the wider EU and beyond.

Therefore, consideration should be given now to the strategic action that businesses may wish to take in a number of areas, including contractual relationships, financing and supply chain management, to manage the risks and maximise the opportunities presented by Brexit. Proactive businesses will be best placed to meet the challenges of the coming years.

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TRANSFER PRICING POST BEPS

Transfer pricing audits are being used by tax administrations as a way to collect more revenue from taxpayers to fund cash-strapped treasuries globally. This trend creates many transfer pricing risks across the entire supply chain of multi-nationals. As shown in the recent court case in the U.S. involving Medtronic, manufacturing activities can be the source of significant transfer pricing controversy. It therefore pays to be prepared for some of the transfer pricing questions that are heading toward multi-nationals as a result of the revisions to the OECD Transfer Pricing Guidelines, the OECD/G20 base erosion and profit shifting (BEPS) initiative, and the rapidly changing global tax environment.

WHAT TYPE OF MANUFACTURING ENTITIES DO YOU OPERATE?

In the past decades, manufacturers have been characterised as one of the standard forms: toll, contract or full-fledged manufacturers (owning or licensing in valuable intangible property). This characterisation is closely associated with the functions, assets and risks of the manufacturers; a manufacturer's remuneration is determined on the basis of where it sits in this continuum.

The post-BEPS OECD Transfer Pricing Guidelines provide an enhanced framework for tax authorities to question the label given to manufacturing entities based on the conduct of the parties involved. Gone are the days where a contract that is commonly seen in third party situations (such as a toll/contract manufacturing arrangement) will be respected without questions and further investigation by tax authorities. In this new world, everything hinges on what exactly is being done on the ground. If, by contract, you are operating a routine toll manufacturer (and is supposedly rewarded on the basis of a cost-plus fee), then it is critical that the functions being performed on the floor are consistent with the contractual arrangement, with particular attention to the functions that relate to control and oversight of key manufacturing risks, as well as the development of new processes and products.

Doing things as a matter of practical expediency or doing what is logical can have costly tax implications if these actions are inconsistent with the contractual relationship. Ultimately, if actions on the manufacturing floor are unavoidable and not consistent with the contractual terms, then it is time to consult a transfer pricing expert to revisit the contract and the associated transfer pricing arrangements.

WHO OWNS VALUABLE INTANGIBLES?

Manufacturing of goods will often utilise a range of valuable intangibles in production. These may be legally owned by the manufacturing entity or another entity, and depending on the type of manufacturing entity, there may or may not be a need of royalties or other payments. Furthermore, some of these intangibles may be patents or other registered IP, but other intangibles may be trade secrets, know-how or other intangibles only identified through detailed functional analyses.

Whilst legal ownership of intangibles continues to be the starting point when determining which group entity should be attributed the "profits" relating to those intangibles, the revised OECD Transfer Pricing Guidelines require that the analysis be taken further, beyond legal ownership alone. Consideration of which entities perform the so-called "DEMPE" (Development, Enhancement, Maintenance, Protection and Exploitation) functions associated with the intangibles is required, and where the DEMPE functions do not align with the legal ownership, adjustments to the transfer pricing policy may be required. A particular area of focus of tax authorities is on the performance of DEMPE functions by manufacturing entities that are purported to operate as routine, low risk operations (toll manufacturers and contract manufacturers). Where such entities are identified as performing DEMPE or related activities that contribute to intangible development and or value creation, the transfer pricing policies are often challenged by tax authorities.

ARE PRODUCT LIABILITY RISKS APPROPRIATELY REMUNERATED IN THE SUPPLY CHAIN?

We have been reminded on numerous occasions in the past year that product liability risks have significant implications on the value chain, for example in the automotive industry, mobile phone production and elsewhere. The functions that have been performed by manufacturers in managing product liability risks are critical to the entire supply chain and these functions need to be rewarded in accordance with the arm's length principle.

When unrelated parties are involved, only the party that has control over product liability risks would be prepared to take on these risks. As such, these parties are the ones who are typically expected to be rewarded for the assumption of such risks. Determining which party in a multinational group conducts the relevant functions pertaining to product liability risks (and thus should be rewarded accordingly) can be tricky. Control over product liability risks may require functions such as controlling the quality of raw material, implementing a vigorous testing process and so on. It is not always easy to determine which party is responsible (R) and accountable (A), and which parties are simply being consulted (C) or informed (I) about the important functions pertaining to product liability risks. The RACI analysis in respect of the functions, assets and risks related to product

liability risks has become even more important under the new OECD Guidelines, as it forms the basis on which to remunerate entities for taking on the risks.

HOW SHOULD THE BENEFITS OF CENTRALISED PROCUREMENT ACTIVITIES BE ALLOCATED WITHIN THE GROUP?

Centralising procurement activities have been a common practice in multi-national groups for many years as it is recognised that such activities can create significant group value through bulk purchases, better supplier network management, improved efficiency and so on. However, the post-BEPS OECD Transfer Pricing Guidelines contain new rules on how to allocate the benefits associated with such centralised procurement activities.

Although the debates around this issue are not new, some tax authorities are focussing their attention in this area. For example, multi-national groups need to be careful to remunerate routine procurement activities where the savings arise mainly from purchase volumes. Under the new guidelines, benefits arising from bulk purchases may need to be passed on to the manufacturing subsidiaries based on their volume commitment. It would not be appropriate to reward such routine centralised procurement entities based on a percentage of their purchases. Instead, their remuneration needs to be based on a proper study of functions, assets, and risks (functional analyses) and an economic benchmarking analysis that reflects the functional profile.

WHAT CERTAINTY IS AVAILABLE?

Transfer pricing is notoriously an area of uncertainty for business, and the BEPS process overall has increased tax administration awareness and focus on these issues. Where transfer pricing disputes arise with tax authorities, this can result in substantial time and expense, as well as economic double taxation. Ensuring that contractual arrangements reflect actual conduct on the ground and that robust transfer pricing documentation is in place supporting the positions taken is a great first step, but the arm's length principle is one which can have wide interpretation, and there is no guarantee that local tax authorities will accept the position taken. Advance pricing agreements ("APAs"), which are a specific tool for reaching a proactive agreement on transfer pricing with tax authorities (of one or more countries), are the only real way to obtain certainty over transfer pricing arrangements in this new tax environment. In many countries, APA requests from multi-nationals are increasing significantly due to a high level of uncertainty and increased transparency.

SUMMARY

Manufacturing operations are not exempt from the scrutiny of tax authorities that are focussing increasingly on transfer pricing audits. A RACI analysis of the key manufacturing risks, such as the product liability risks, is critical to the transfer pricing arrangement of a manufacturer in the post-BEPS era, and a DEMPE analysis provides a framework for determining where profits associated with valuable intangibles should arise.

It is also important to ensure that procurement operations are appropriately remunerated and benefits allocated in a manner consistent with the functions, assets and risks. A proper review of the actual conduct of manufacturing entities through fact finding interviews and site visits can ensure that the contractual arrangements and transfer pricing policy are consistent with the activities on the ground. With some work (or an APA!) costly transfer pricing disputes for manufacturers can be avoided.

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CBI
THE FUTURE OF INDUSTRIAL STRATEGY

In response to the BIS Select Committee inquiry into the future of Industrial Strategy in the UK, the CBI has highlighted a number of priorities designed to build confidence and prosperity, by unlocking growth and productivity across the UK.

Whether national, regional or local, industry and government must work in partnership to deliver a long-term, joined-up and proactive vision for UK industrial strategy. To ensure that an industrial strategy in the UK delivers more than the sum of its individual parts, long term commitment, whole government ownership and alignment across all levels of government will be critical.

APPROACH

Industrial Strategy should continue a sector-led approach, supporting sectors in which the UK holds a competitive advantage, building on the momentum already developed in recent years.

A 'place-based' approach is important, driving prosperity by leveraging strengths across all parts of the country. A number of important policy levers that can help to deliver an effective industrial strategy are now at the level of nations and regions, including skills, innovation and infrastructure. It is more critical than ever that action to boost productivity at the local level links up with a national strategy to deliver policies that are tailored to each part of the UK's industrial strengths. Whatever department, wherever the region, our strategy must pull in the same direction.

There is no shortage of levers government can pull which impact upon industry. From innovation spending, to tax breaks, to investment in skills – all form an important part of creating an attractive business environment. When implemented together, they are part of an Industrial Strategy and are part of a vision that helps to ensure that policies across government departments pull in the same direction. In previous strategies, the Automotive and Aerospace sectors have seen substantial growth as a result of Industrial Strategy.

CHALLENGES

The biggest challenges that manufacturers will face in a post-Brexit world will be in supply chains, labour skills and movement, technology and innovation. The potential impact of Brexit could be hugely disruptive to manufacturers' business models and trading as well as their regulatory and business environment.

Manufacturing outperforms every other sector in exports: it accounts for 45% of UK exports, 57.5% of which are to the EU – therefore the question of trade is of utmost importance. Manufacturers are part of complex integrated supply chains that extend across the EU, for example 60% of parts supplied for cars built in the UK are imported, mainly from Europe. The possible implementation of tariffs between the EU Single Market and the UK has the potential to hugely increase costs. For example, food manufacturers could face an average EU tariff of 22.3% against 2.3% for non-food products.

With new technology offering increased efficiency and productivity on the shop floor, innovation is a vital topic for manufacturers. It is primarily through R&D that EU funding will affect the manufacturing sector. Manufacturing alone accounted for 67% of UK R&D expenditure in 2014 and it is therefore highly exposed to any changes to funding schemes.

STEM skills are in crisis in the manufacturing sector – half of businesses (55%) are not confident of finding people with higher-level skills. We are currently focussed on lobbying to ensure that the Apprenticeship Levy works for the industry, as well as supporting the next generation of leaders.

UK electricity costs are among the highest globally – nearly 80% above the EU median. The CBI is a vocal supporter for these industries, to ensure they get the support they need to meet the costs of energy policies, and that as the government considers its industrial strategy, a low carbon plan for these industries remains central.

SUMMARY

UK Manufacturing has been in a structural decline for the last 25 years: Manufacturing accounted for 15.8% of the economy in 1990, and has now fallen by a third to 9.6%. Preventing the sector from further decline is a key priority for us.

So the UK's Industrial strategy needs to needs to be different. In a transforming world, it creates the opportunity we urgently need to strengthen the foundations of our economy.

The government's Green Paper is a good starting point. But as first draft becomes final version, there are some important questions that need answering.

First, vision – what does success look like in 5, 10 and 15 years from now? What kind of economy does the UK want to be, beyond the characteristics we all agree on, like productive and inclusive?

Second, measurement – what targets will be put in place? The government needs to define its success in terms of measures and performance indicators.

Third, world-beating sectors – will all sectors have deals with the Government, or only some? If the answer is some, then which ones and why?

Fourth, focus. What is the hard-edged action plan that sits behind the 10 pillars?

And fifth, consistency. What is the Government's plan to ensure everything does not change again in three years' time? Firms need consistency and predictability. There are too many historic examples of flash-in-the-pan industrial strategies – this one must be different.

So it's crucial that business and the government work together on a shared vision for our future economy at this crucial stage in the UK's history.

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NEW DUTY FOR LARGE COMPANIES

The Reporting on Payment Practices and Performance Regulations 2017 (Regulations), came into force on 6 April 2017. These Regulations create a duty for large businesses to report on payment practices – with criminal sanctions being a potential outcome for both companies and their directors where the duty is not met.

Section 3 of the Small Business, Enterprise and Employment Act 2015 (SBEE 2015), imposes a requirement on companies to publish prescribed information at particular intervals. This information would include information about the company's payment practices and policies relating to relevant contracts, and the company's performance by way of reference to those policies.

OVERVIEW

The Regulations will apply to companies and LLP's who satisfy at least two of the general thresholds set out in the Companies Act 2006 (Qualifying Companies) – being companies which, on their last two balance sheet dates have: £36+ million annual turnover; £18+ million balance sheet total; over 250 employees.

The Regulations will apply to certain contracts that are defined under section 6 (Qualifying Contracts). A Qualifying Contract is one that satisfies each of the following conditions:

- It is a "relevant contract" (as defined in section 3(2) of the SBEE 2015), namely a contract that:
  - Is for goods, services, or intangible assets (including IP).
  - The parties have entered into it in connection with the carrying on of a business.
- It is not a contract for financial services (as defined in section 2 of the SBEE 2015 and including, broadly, any service of a financial nature, including (but not limited to) insurance-related services, banking services and other financial services). This means that financial services companies need only report on contracts not relating to financial services.
- It is governed by the law of:
  - A part of the UK otherwise than by choice of the parties.
  - A part of the UK by choice of the parties, and either has a significant connection with that part of the UK or, without that choice, its applicable law would still be the law of a part of the UK.
  - A country outside the UK by choice of the parties, and without that choice, its applicable law would be the law of a part of the UK, and has no significant connection with any country outside the UK.

Summarily, BEIS Guidance has provided that a Qualifying Contract must have a significant connection with the UK. Whether a contract has a significant connection with the UK will depend on the circumstances.

REPORTING REQUIREMENTS

Qualifying Companies are then required under the Regulations to publish a report containing the information set out in the Schedule to the Regulations. This information includes:

- Information on payment terms, including:
  - Description of the Qualifying Company's standard payment terms in relation to Qualifying Contracts.
  - The payment period stipulated in these terms.
  - Details of any variations to the standard terms during the reporting period.
  - A description of the maximum payment period specified in the Qualifying Contract.
- An explanation on the Qualifying Company's dispute resolution process.
- Information on the Qualifying Company's payment practices and policies.
- Information on the payment performance of the Qualifying Company, including:
  - The average number of days it took the Qualifying Company to make payment.
  - A percentage breakdown of when those periods were made within the period.
- In addition, the statement is required to provide the name of the director who approves this information.

The information is to be published by Qualifying Companies within the filing period, and on the internet. This service is due to go live in April 2017, with BEIS guidance outlining that some business may need to file their report in **October 2017,** with the majority of companies publishing their information in 2018 for the first time. The filing period is defined as being 30 days beginning with the day after the last day of the reporting period to which a report relates. The web based service is free and will be provided by the Secretary of State.

FAILURE TO PUBLISH

If a report is not submitted in accordance with section 3, the qualifying company and every person who was a director of the company immediately before the end of the filing period commits and offence.

A person guilty of an offence under this regulation is liable in England and Wales to a fine. Whilst there is no specific guidance on the scope of these fines, the aim of these regulations is to prevent large businesses from failing to pay SMEs on time, or in accordance with the agreed provisions. Consequently, it is anticipated that penalties will be significant, partially to cover the costs of any monies owed and also to make an example of those initial offenders. In addition to fines, offenders may suffer consequences as a result of having a conviction such problematic applications for visas and having to disclose the same to lenders, insurers and/or educational institutions.

There is a defence under the regulations however for a director where they can prove that they took all reasonable steps for securing that regulation 3 would be complied with before the end of the filing period.

FALSE STATEMENT OFFENCE

This sets out a clear provision that it is an offence for a person to publish information which is false, misleading or deceptive. Again the penalty for this offence is a fine, however proceedings for this offence can only be brought with the consent of the Secretary of State.

For both of the above offences, there is also a time requirement during which the proceedings must be brought before a magistrate's court.

ENFORCEMENT AND CRIMINAL SANCTIONS

Whilst the BEIS expect the main enforcement of the duty to report will be through "behavioural change" mechanisms, through naming and shaming and public commendation for positive behaviours there are legal sanctions for non-compliance, which will follow a similar pattern to those offences created by the Companies Act 2006 where a company fails to report required information or file annual accounts on a timely basis.

Not only will the Department be monitoring compliance it is likely that complaints from smaller business who feel they are being unfairly treated might trigger a criminal investigation.

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ABOUT DLA PIPER'S MANUFACTURING SECTOR

DLA Piper takes its expertise in and commitment to the manufacturing sector very seriously. We have built a strong reputation for supporting organisations engaged in all aspects of manufacturing: from industrial and advanced engineering, finished products and material solutions and industrial equipment through to aerospace and defence, automotive, chemicals and paints, food and beverage and shipbuilding subsectors. We are committed to understanding the markets in which our clients operate and the specific commercial challenges they face. Our team of lawyers has considerable experience of working with a broad range of blue chip manufacturing businesses, both in the UK and internationally, across a full spectrum of issues. For more information about our manufacturing capabilities, please email us on manufacturing@dlapiper.com, contact one of our specialists below or your usual DLA Piper contact.

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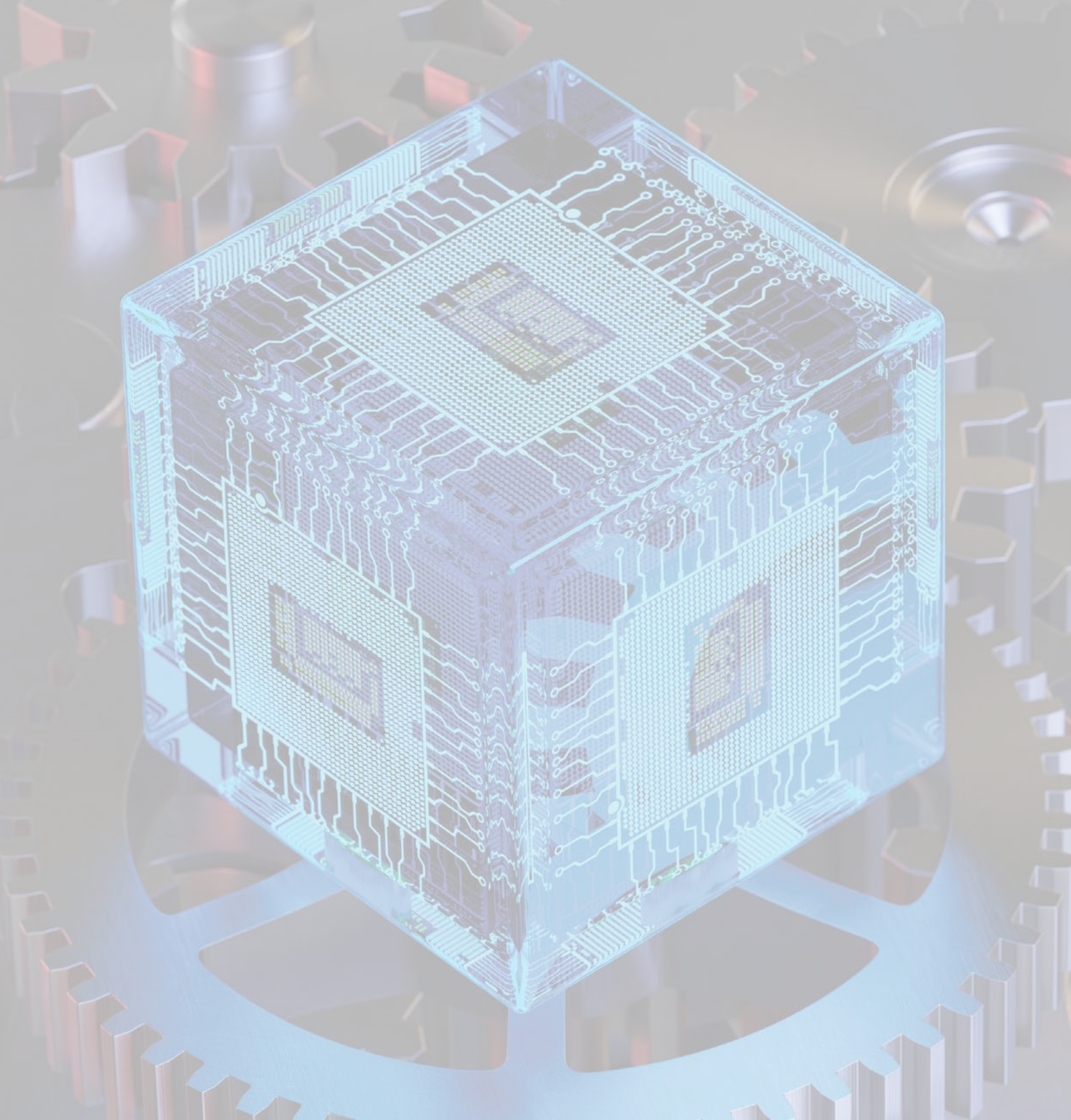

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