A magazine from irwinmitchell

Edition 3

Focus on Manufacturing

>> We review the **State of the Nation**

>> The impact of **Brexit**

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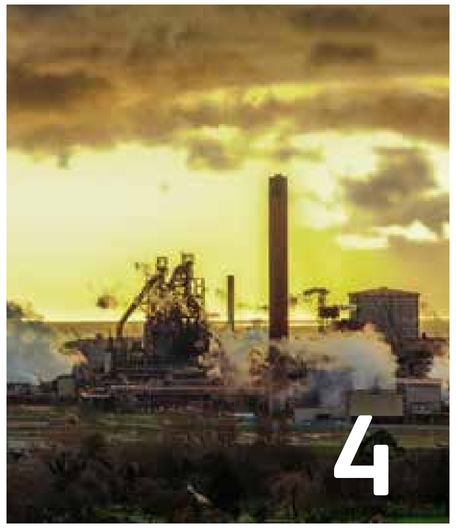

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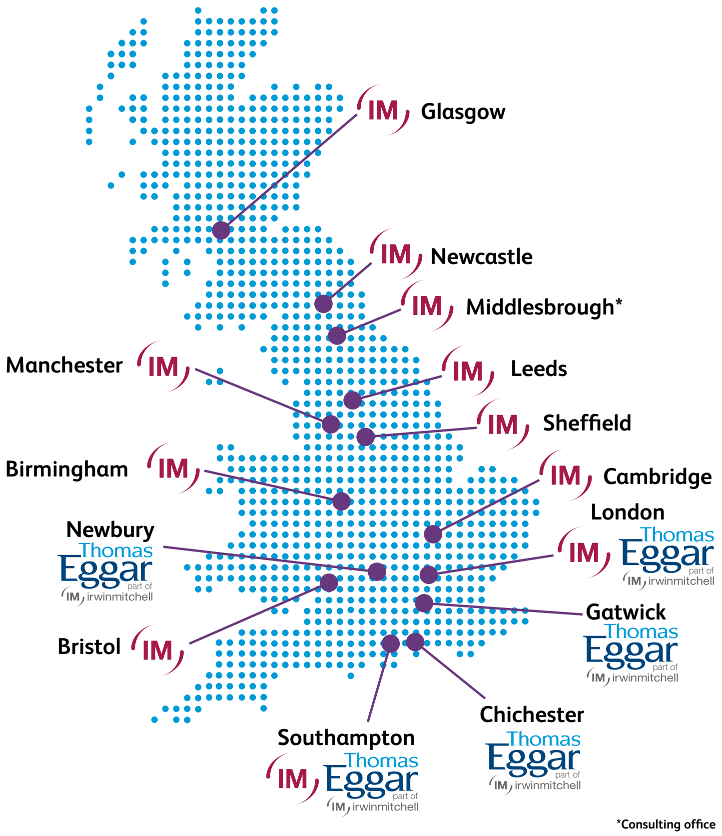

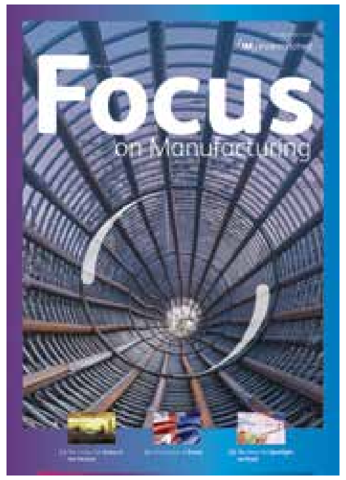

Welcome...

The times, they are a changing, so sang Bob Dylan over 50 years ago.

That sentiment is as true now as it was in 1964, certainly for the UK's manufacturing sector. The country's steel industry faces troubling times, the global marketplace continuing to threaten its viability, and Britain's membership of the European Union hangs in the balance with a referendum on the issue on 23 June.

Now is undoubtedly a period of great uncertainty for the UK's manufacturers and we review some of the challenges faced by the sector on page 4 whilst looking at the implications for the sector of the so-called Brexit on page 10. The headline is this: the next 12 months will have impact upon the sector for generations to come.

In places, major changes have already hit home. The Modern Slavery Act came into force last year, bringing with it onerous requirements for many UK manufacturers which we explore in detail on page 18, at the same time offering practical steps on what manufacturers can do to ensure their compliance with the new Act.

In this edition, our sector specialists also consider the importance of governing law clauses in contracts (page 12), sentencing guidelines for health and safety offences (page 20) and the consequences for a supplier or customer in the event of a link in the supply chain becoming insolvent (page 16).

Despite the headlines being around the perils faced by the sector, optimism is abundant. The Markit/PMI index score indicates an inclination towards further growth and the sector as a whole continues to be ripe for corporate deals; our review of M&A activity in the sector on page 22 shows a particularly healthy appetite amongst foreign investors for UK manufacturers, with deal activity in the sector up 5% from the previous year.

The lure of the UK's manufacturers will be on-show at Aubaine Mayfair in London on 20 April when we host a number of private equity houses and sector leaders at the Directorbank Industrials event. Meanwhile, the issue of enticing "tomorrow's engineers" into the sector will be the focal point of our breakfast seminar the same day, co-hosted with the Insider at the Holiday Inn Rotherham-Sheffield.

With this edition, we also take the opportunity to introduce you to the sector specialists who have joined our team following our merger with Thomas Eggar in late 2015, bringing with them a wealth of experience in the manufacturing sector. Andrew Jackson, who joins our Commercial Litigation and Dispute Resolution team in London, shines the spotlight on the supermarket supply chain in his article on page 14 and will join us alongside Phillip Gray in our Real Estate team.

The integration of our colleagues at Thomas Eggar will significantly enhance our offering to manufacturing clients in London and the South East and we are extremely proud of our continued growth having now created a £250m-turnover firm with over 2,800 staff able to service our clients from 17 locations across the UK.

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State of the Nation

Over recent months, many column inches within national newspapers have told a grim story of UK manufacturing and sounded the literary equivalent of death knells for the sector which bore the Industrial Revolution and upon which much of the country's prosperity has been founded.

The naysayers are many but, tellingly, the manufacturing sector remains buoyant and the harbingers of doom appear to be being brushed off by a sector accustomed to challenges, the need for innovation and, most apparently, to *doing it on its own*. The most recent Markit/PMI measure of manufacturing confidence continues to confound expectations and in March stood at 51, remaining above the key 50-mark point which would indicate contraction in the sector. 2015 saw UK car manufacturing output hit a 10-year high. The *green shoots* of recovery, to borrow a quote from the Chancellor, are sprouting. The challenge now is to ameliorate the hostile environment into which they have grown.

Steel industry – reinforcement needed

In the six months to March 2016, over 5,000 jobs were lost in UK steel production, firstly as SSI's Redcar operation collapsed into administration and later with the swingeing job cuts announced by Tata across four of its UK bases. Employment contracted severely at a number of other steel manufacturers, including Sheffield Forgemasters, during the same period, and worse could be to come with the pending closure of Tata's Port Talbot steel plant.

A recurring theme emerged during the fall-out from those redundancies; the existence of a perfect storm of high domestic energy prices, an uncompetitive currency and a flood of cheap imports, problems exacerbated by shrinking global demand for steel. SSI, Tata and Forgemasters all laid blame, at least in part, at the door of Europe's regulatory regime which was accused of failing to stem the inflow of cheap imports, particularly from China, with the effect of undermining the competitiveness of the UK's steel manufacturers.

The EU has responded; in February it imposed tariffs of up to 16% on Chinese steel imports to a lukewarm reception amongst UK manufacturers. *Too little, too late*, complained most, many drawing comparisons with the USA where preliminary tariffs of 236% were imposed on the imports of certain grades of Chinese steel in November 2015. The political appetite appeared, even at a pan-European level which has seen 40,000 steel-sector jobs lost in the previous year, to be lacking.

David Cameron wants "a strong British steel industry" but the will of UK government has so far done little to assuage the concerns of the sector. Sajid Javid, the Business Secretary, recently said that "the UK steel industry is absolutely vital for the country and we will look at all viable options to keep steel making continuing in Port Talbot".

Maybe that is the case, but the perception amongst the UK's manufacturers is that the government is only just now reacting to a crisis which has been anticipated for some time. Sheffield Forgemasters was but one voice in a chorus of many which criticised the government for failing to secure, or support, contracts for UK manufacturers in UK-based projects. Hinckley Point C was one such example.

The government will point at Crossrail, where almost all of the steel was British steel, as evidence of its support for UK manufacturing. *Where we can, we will* appears indicative of the government's approach. Whether that is true will be viewed largely in the context of current and forthcoming major infrastructure projects; how much UK steel will be utilised in the £563m redevelopment of Bank station, construction of the Thames river super-sewer or in the work to electrify cross-country rail routes. In the long-term, of course, the HS2 project offers government a highly-visible opportunity to demonstrate its commitment to supporting domestic steel industry.

Tata Steel will also point to their repeated warnings of a crisis in the sector which went unheeded by the government. The government has been accused of "abject failure" when it came to protecting the UK's steel industry and a number of manufacturers feel it is now *too little, too late*.

Whether this government does what it can, where it can to support the UK steel industry may ultimately be a question for posterity.

Brexit - should we stay or should we go now?

The referendum wagon has already rolled into town, and for the first time since 1975, Britain will go to the polls to decide whether to be a part of the European Union. Whilst newspaper headlines in the run up to 23 June will be dominated by talk of the "migrant crisis" and issues of national security, the economic consequences of so-called Brexit would be significant and its bearing on the UK's manufacturing sector profound for generations to come.

We explore, on page 10, some of the key drivers which are likely to be at the heart of the sector's decision to vote to remain in or leave the EU, and we give our thoughts on what a post-EU world might mean to the UK's manufacturing sector.

Apprentices – the young ones

Safeguarding the future of the UK's manufacturing sector is not only a question of investment in infrastructure; it is essential that human capital is sustained and developed alongside the machinery, robotics and infrastructure which will form the tools of tomorrow's manufacturers and historic failures to address skill shortages continue to weigh heavy on the sector.

The tide may just have begun to turn, however. In August 2015 the government reaffirmed its commitment to an apprenticeship levy as just one of a ream of measures designed to create three million new apprenticeships in the UK by 2020. The will of big business coupled with the efforts of SMEs will undoubtedly bear fruit but it remains to be seen whether the determination of private industry, without addressing what the sector bemoans as chronic underinvestment in skills training by central government and local authorities, will produce the number of qualified apprentices envisaged by the government.

What is beyond doubt is that the will exists in the manufacturing sector to create a highly-skilled, value-added sector capable of competing on the world stage in precision and specialist manufactured goods, and in doing so to continue the work done by generations of steelmakers, cutlers and industrialists who first propelled the UK to the fore of global manufacturing.

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UK POWERHOUSE Update

Economic growth within the UK's key cities will continue to slow during 2016, according to a new report which also highlights that the Government's flagship Northern Powerhouse initiative is still struggling to gain traction.

Our UK Powerhouse tracker, produced in conjunction with the Centre for Economics and Business Research (Cebr), reviews the economic growth and job creation in 38 of the UK's largest cities and analyses how the government can support economic growth and bridge the prosperity gap between London and the rest of the UK.

Our latest report, published in April, reported UK-wide quarter-on-quarter economic growth (by measure of Gross Value Added[1], or "GVA") of 0.6% in Q4 2015 with respectable growth of 2.3% across the whole of 2015. The South East reported the highest levels of growth with Milton Keynes, Outer London and Cambridge the star performers (achieving year-on-year growth of 2.7%, 2.6% and 2.5% respectively during 2015). Birmingham, Manchester, Aberdeen and Nottingham joined the ranks of those cities which achieved year-on-year growth in excess of 2.0%.

Job creation figures were also encouraging with Stoke-on-Trent recording a 7.4% increase in employment as against Q4 2014. In fact, 20 cities recorded employment growth in excess of 2.0%. Only one city of the 38 reviewed recorded job contraction during the same period – Sheffield, a city particularly prone to challenges faced by the manufacturing sector, and one which reported economic growth of only 1.2% in 2015.

The picture across the UK was one of sluggish economic growth at a level not witnessed since 2013. Despite decelerated growth across the Yorkshire region, where Leeds posted a 1.7% increase in GVA and Sheffield a 1.3% increase, the region's combined GVA did exceed £20 billion for the first time. Of those cities comprising the Northern Powerhouse region, only Manchester posted growth figures in excess of 2.0%, indicating the size of the challenge ahead for northern cities in trying to match London's and the South East's economic prosperity.

Indeed, our projections over the next 10 years predict that London's rate of growth will continue to accelerate ahead of almost every other part of the UK. Only Milton Keynes, Cambridge, Oxford, Nottingham and Outer London grew faster than Inner London during 2015 and it would appear that this trend is likely to continue. Our latest findings predict that, by the end of 2025, London's economy will have grown by 26% since our 2015 compared to much lower, though still respectable, levels of growth amongst the cities which make up the Northern Powerhouse (Greater Manchester – 17.7%, Leeds and Liverpool – 17.1%, Newcastle – 16.4%, Sheffield 15.1%). The extent to which devolution and investment in these cities will ameliorate the disparity is yet to be seen.

The value of the gap in economic prosperity between London and the Northern Powerhouse cities currently stands at £62 billion but, according to our projections, may reach £115 billion by 2025.

Efforts to bridge this economic gap will centre on not only the devolution of powers to local governments, as is underway in the Greater Manchester region and is shortly to follow in the Sheffield city region, but also the infrastructure investment which has long been necessary to connect the cities of the Northern Powerhouse with one another, and the capital. Our report follows a series of announcements at the Budget in March which included a £300 million pledge by the government to improving journey times between the large cities in the north of England.

> **"Increasing infrastructure investment to reduce journey times and improve connectivity across the north of England are vital if the Northern Powerhouse is going to succeed. Not only should there be a significant increase in infrastructure spending in the north, the Government must listen to businesses when deciding where its transport hubs should be located. In Sheffield, for example, the Government's current plan is to locate the HS2 station at Meadowhall even though the financial benefits of it being located in the city centre are shown by all the date to be manifestly far greater."**
> - Paul Firth, Regional Managing Partner, Sheffield

Our report also shows that there are encouraging areas of economic growth within the manufacturing sector, particularly in the vehicle manufacturing industry which reported quarter-on-quarter growth for the fifth successive quarter and, in doing so, hit a ten-year high in production. And, whether it is the function of government efforts or a natural outcome, some movement has been made towards rebalancing the economy with reliance upon financial services has reduced across the UK, most acutely in London.

For further information and to download the latest version of the report, visit **www.irwinmitchell.com/ukpowerhouse**

[1] Gross Value Added (GVA) is a measure of the value of goods and services produced in an area

The Apprentice

The realities of “you’re hired” and “you’re fired”

Lord Sugar seems to hire and fire his apprentices at will, apparently based on the flimsiest of decisions about their abilities, performance or suitability to work with him. But is it really so easy to dismiss a trainee from your business, or are there hidden pitfalls that could make the reality of appointing The Apprentice more of a Dragons’ Den than a Match of the Day?

The answer is, as with most employment issues, that it depends upon what the contract says. For centuries, apprentices were employed on contracts of employment and as the law developed, they gained employee rights as well as specific rights relating to apprentices.

As long as the primary purpose of the engagement is training, and the obligation to carry out work is secondary, the contract may well be one of an apprenticeship. The key difference between “ordinary” employees and common law apprentices is that the law makes it much harder to dismiss apprentices. Case law tells us that acts which would ordinarily result in dismissal for an employee may well be insufficient to justify the dismissal of an apprentice, unless the ability to teach them is fundamentally undermined because of their misconduct.

Equally, the potential redundancy of an apprentice should be approached with caution for the same reasons: unless there is a total closure of the business or a fundamental change to the character of the business, the apprentice enjoys a protected status which means that their redundancy is very hard to justify.

The potential compensation for unlawfully dismissing a common law apprentice can be damages for the lost earnings for the remainder of their contract, which can be several years’ salary in some cases, which means that drafting mistakes can be very costly.

By contrast, modern apprenticeship agreements are more straightforward to issue and terminate, as long as they meet certain statutory conditions which include the apprentice agreeing to work for you, the agreement itself meeting a prescribed format in terms of the information it contains, it being governed by English law, and being entered in to in connection with a qualifying apprentice framework.

Agreements meeting those standards can be issued with much more flexibility, including being of an indefinite or fixed duration and with or without a notice provision.

There is no doubt that the recruitment of apprentices can add huge value to your business, and can lead to the recruitment and retention of good quality staff who stay with you for a long time, particularly in the manufacturing sector where hands-on experience from an early stage is invaluable.

Add to that the potential apprenticeship levy, due to come in to force next year, and there are real incentives to the recruitment of apprentices. However, the pitfalls can be substantial, so it is worth checking your contracts and taking early action if you think it is needed.

The moral of the story? Check your contracts carefully and ensure that apprentices are clearly defined as such, and your managers know the pitfalls that can occur. Don’t rely on television shows as examples of good employment practice!

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Making an exit?

Britain's relationship with its continental neighbours has, for more than 40 years, been defined by its participation in the European Union; Britain's stance on free trade, law-making and immigration, to name but a few, have all been shaped by the supranational powers of the EU.

That could all be about to change – in June the country votes on whether it believes that the UK's prosperity lies within, or without, the pan-European bloc.

The opening shots have been fired; there is division within the government and an even split of opinion across the general public. Amongst the UK's manufacturers, the position is no less clear with large manufacturers extolling the virtues of free trade and access to labour whilst a number of small and medium-sized manufacturers lament the expense and frustration of bureaucracy and look to a less onerous regulatory environment without the interventionist hand of the EU.

What will happen?

Uncertainty prevails as to precisely what form a Brexit would take; the timescales, administrative hurdles and cost can only be guessed at presently. What is clear is that:

- If Britain votes to leave the EU, it will have to renegotiate its relationship with the bloc and/or its members to cover issues such as trade, movement of goods and labour and law-making.
- There would be an immediate cost-saving for the government, with various estimates of the extent of Britain's net annual contribution to the EU coming in at between £5.7 billion and £8.8 billion.
- Nothing would happen overnight and it has been mooted that the process of Britain extricating itself from the EU may take in excess of two years during which time it would keep its seat at the table but would be there purely to observe, with its influence reduced to practically nil.
- The impact upon trade is a matter for debate with economists espousing views which vary from the post-Brexit landscape being bleak with the UK's exporters in particular hampered by more expensive international trade to those who believe the UK could prosper absent the bureaucracy and economic restrictions posed by EU membership.

In the event of a "stay" vote on 23 June, Britain would work within the parameters of a redefined relationship with Brussels following the government's protracted deliberations with the EU earlier this year.

What is the relevance for manufacturers?

Britain's trading relationship with Europe would fundamentally change. The extent to which Britain would be able to replicate the free trade arrangement is uncertain. The EU chief, Jean-Claude Juncker, asserted that there was no "Plan B" for Britain's relationship with the EU in the event of Brexit; whether or not that is posturing is a question which may have to be answered after 23 June.

Britain's trade within the EU is in decline and figures from the Office for National Statistics indicate that UK exports within the EU are at an all-time low.

Between 1999 and 2014, exports from the UK to other EU member states dropped from 54.8% of the UK's total outputs to 44.6% as emerging markets opened up to British exporters and, in recent years, a sluggish European economy diluted the appetite for British exports. Continental Europe's status as the primary destination for UK exports would be unlikely to change on account of Brexit, given the strong demand for British goods across most of the EU's member states.

Arguably, the ease with which the UK's manufacturers can access skilled migrant labour would be affected with visas becoming necessary even for migrants from continental Europe.

Given the current skills shortage in the sector, which we have addressed elsewhere in his edition, having Britain on the outside of the EU could further exacerbate extant issues with labour in the sector. In reality, this could be a red herring as entry into the Schengen Agreement would ameliorate potential problems with sourcing a skilled workforce from EU member states.

Britain may become a smaller, less relevant player on the international stage. Over the last 12 months, the UK's steelmakers have looked outwards and lobbied the EU to increase tariffs on cheap Chinese imports in a vain attempt to save jobs, and many would say the EU's perfunctory response pointed to its diminished value to the sector.

Proponents of the union would argue, however, that by Britain standing alone, that clout would be lessened further still and the EU represents the strength in numbers which is required for a group of 28 relatively small economies to stand up to the might of the USA, China, India and others.

How would the post-Brexit landscape look?

In the event of a vote to leave the EU, attention would turn to how Britain manages its trading relationship with the 27 states which would continue to form the EU. Britain may opt to join the European Free Trade Association, together with Iceland, Liechtenstein, Norway and Switzerland.

Alternatively, it may negotiate its own trade agreement with the bloc as a whole or its component members. Three living examples point to what Britain's future relationship with the rest of Europe might look like in a post-Brexit world.

- Norway: A member of the European Economic Area but not the EU, Norway has access to the single market (with the exception of prescribed financial services) but is not constrained by regulation of agriculture, fisheries, justice or home affairs.
- Switzerland: Not a member of the EU but a party to the Schengen Agreement, allowing free movement of people, and a party to a number of individual trade treaties with EU member states.
- Turkey: Neither a member of the EU or the EEA but party to a customs union with the EU, granting it access to the single market whilst not subjecting it to regulation from the EU.

Alternatively, Britain may opt for a clean break from the EU and either fall back on its membership of the World Trade Organisation for the purpose of regulating trade or look to trade treaties with countries beyond Europe, building links with North America, China and India.

At the moment the question is not only what will happen on 23 June 2016 but, in the event of either a "leave" or "stay" vote, what would happen afterwards.

In that regard, the UK's manufacturing sector is in a uniquely paradoxical position, benefitting from producing highly sought-after products which should still find a market across Europe in a post-Brexit world whilst potentially finding itself shut out from markets by a historically protectionist EU. The outcome could be reduced demand for UK-manufactured goods or increased prices for foreign customers for those same goods. This is only one of a number of imponderables as Britain goes to the polls for a referendum of potentially unprecedented consequence.

Wolfgang Schäuble has warned the UK that Germany will be one of several nations to take a tough stance over post-Brexit trade negotiations. It is difficult to gauge how much of what has been said by the UK's European trading partners is rhetoric and, much like the domestic discussions around the subject, cut through the wealth of posturing to get to the crux of what the risks and opportunities are to the UK of a life without the EU. The next few months will be critical not only for the fact that a decision will be reached on the UK's EU membership but also from the point of view of ensuring that UK plc is well-placed to capitalise on either eventuality; be it *with, or without, EU*.

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Litigation

On home soil

The importance of the global marketplace is under the spotlight like never before as Britain considers life without the European Union, but trading internationally poses problems as well as offering opportunities. Deciding by which country's laws, and in which country's courts, a dispute will be resolved is an important consideration whenever contracting internationally and doing so can avoid lengthy, costly and uncomfortable experiences in foreign jurisdictions.

The UK's manufacturing sector has been, for over 200 years, at the heart of the global economy. From rolled steel in the late 18th century to the prestige cars to the 21st century, Britain has long looked outwards for its trade and, as recently as November 2015, the government redoubled its efforts to boost the UK's exports with the launch of its Exporting is GREAT programme. With manufacturers continuing to look out to sea for their customers and suppliers, the importance of ensuring the contracts offer certainty in the event of a dispute is increasingly vital.

It is often assumed that the place of performance of a contract, or even the jurisdiction in which the contracting parties are based, is the exclusive determiner of where any such dispute would be heard however that is often not the case with governing law and jurisdiction clauses overriding default provisions for dispute resolution, leading UK manufacturers to suffer the expense and uncertainty of litigating abroad or under a set of foreign laws.

The choice of governing law determines the statute and case law which will be applied to a dispute. It does not indicate how a dispute is to be resolved, that being the purpose of a jurisdiction clause. The two often sit together within the boilerplate clauses of a contract and are very often overlooked as 'standard' and thus of little consequence compared to the substance of the contract. The reality is that scant consideration of governing law and jurisdiction clauses could have a more profound impact than any other provision of the contract.

Agreeing a governing law clause

Generally, English courts will uphold any express agreement in a contract as to choice of governing law and jurisdiction. When contracting with an entity based abroad, every effort should be made to include within the contract a governing law and jurisdiction clause so as to provide certainty in the event that a dispute should arise. Absent an express agreement, which system of law will prevail depends upon, primarily, whether or not the Court which is to hear the dispute is based in the European Union.

What if I don't have a governing law clause?

When it comes to dealing within the European Union, the Eternal City gives us our guidance; the Rome Convention applies to contracts formed before 17 December 2009 whilst Rome I applies to any contract formed subsequent to that date.

Rome Convention: the governing law will be the country with which the contract has its closest connection, subject to a number of presumptions.

Rome I: the governing law will be determined by a complex set of rules which apply to various types of contract, but will most often be the country in which the performer of the contract is based.

If it doesn't appear straightforward, that is because it isn't. The 'default' position in the absence of an express governing law clause is notoriously complex and has led to significant pieces of litigation involving parties who did not expressly provide for a governing law to prevail. One such piece of litigation hinged on whether a handshake in Kent constituted a submission to English law; it did not and the English company concerned found itself embroiled in litigation conducted in accordance with Japanese law.

The problems posed by the absence of a governing law clause are exacerbated when the contract is with a customer or supplier outside the EU, where no rules or conventions apply to assist determination of which system of laws should prevail. Arguments over governing law are messy, protracted and invariably expensive; all can be avoided by taking steps at the stage of forming a contract to include an express provision, even if that is for the contract to be governed by the law of a foreign jurisdiction.

It is also important to consider that certain English legislation, such as that which entitles a creditor to charge interest on unpaid invoices, does not apply even if the parties expressly provide for English law to apply, if the contract does not have a "significant connection" to England. This is just one of a number of potential pitfalls which may be encountered, and which can be avoided by ensuring legal advice is taken before entering into any contract with a foreign element.

Agreeing a jurisdiction clause

The agreement to a particular governing law, for obvious reasons, most often sits hand-in-hand with the choice of jurisdiction, that being the country in which any dispute would be resolved. Whilst parties can elect to apply a foreign governing law to disputes which are to be heard in a particular jurisdiction, and English courts are experienced in applying foreign governing law, doing so can often add significant cost and delay to proceedings. Wherever possible, therefore, the governing law and jurisdiction clauses should accord with one another.

When agreeing jurisdiction clauses, the most certainty that can be derived is from an exclusive jurisdiction clause setting out in no uncertain terms which country's courts will hear a dispute relating to that contract.

It may be, however, that a contracting party wishes to retain some flexibility as to where it can instigate proceedings, in which case a non-exclusive jurisdiction clause would be appropriate. What is right in each circumstance is a matter on which legal advice is essential.

What if I don't have a jurisdiction clause?

As with governing law, the absence of a jurisdiction clause can lead to complex, and expensive arguments about where a dispute should be heard, even before the mainstay of proceedings has commenced, in turn creating further unnecessary cost and delay.

The default position is that a party should be sued in the country in which it is based, although exceptions apply. For guidance in this area we turn to Belgium, and the Recast Brussels Regulation. This provides for exceptions to the general rule above, in that certain disputes must be allocated to a particular member state of the European Union, such as certain IP disputes and issues pertaining to esoteric areas of company law, as well as insurance, consumer and employment contracts. Again, it is essential to seek legal advice on the impact of omitting or including a jurisdiction clause.

What if I have been sued abroad?

In light of the rules set out above, if you believe that you have been sued in an improper jurisdiction, you can apply to court to dispute the court's jurisdiction and argue that the court should not exercise its jurisdiction. Otherwise, the only option would be to instruct lawyers based in that jurisdiction and defend the litigation in the foreign court. This can often be an expensive and slow process which heightens the anxiety of being embroiled in litigation and it reinforces the importance of deciding upon a jurisdiction clause at the time of forming a contract.

It may be difficult to come to an agreement on a jurisdiction clause but clearly, considering the above, this is an issue that must not be overlooked. Both parties will benefit from certainty even if it does mean not having disputes resolved in their home jurisdiction, and certainty over which governing law will apply will enable contracting parties to seek advice on the implications at the time of entering into the contract, rather than it being done in a rush at such time as litigation arises.

Our litigation experts have experience of negotiating governing law and jurisdiction clauses as well as helping clients in the event of proceedings being issued abroad. It is already an essential area of contracts to consider and, should Britain vote to leave the EU, promises to become an even more complex and problematic area of law.

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Spotlight on: Food

Supplying to supermarkets in a changing environment

The supermarket supply chain is showing signs of refreshing change, which is great news for both manufacturers and importers. We explore whether the changes will redress the imbalance of power between the supermarkets and their suppliers.

For the last 20 years and more, manufacturers and suppliers of food and other consumer goods have presented a dark view of the retail market. No matter how good their product, more often than not growing their business meant selling to the supermarkets. There, due to the supermarkets' traditional market dominance, suppliers faced losing complete control of product pricing, cash flow problems, and the uphill task of negotiating with pugnacious supermarket buyers.

In the last two years, however, the supplier/supermarket sector has changed from both a regulatory and structural perspective. As has been the case with successful legislation in the past, these market changes are complimentary and are causing supermarkets to deal with their suppliers very differently.

Regulatory change

The regulatory change has come in the form of GSCOP (Grocery Suppliers Code of Practice - which came into force approximately two years ago) and the role of the newly-imposed GCA (Grocery Code Adjudicator - currently Christine Tacon), who has the task of enforcing GSCOP.

GSCOP sets out a series of rules which the UK's top 10 supermarkets must follow when dealing with their suppliers, and is intended to redress the imbalance of power between the supermarkets and their suppliers. Above all, under GSCOP, the supermarkets are bound to treat suppliers fairly. For example, under GSCOP, supermarkets can't threaten delisting if suppliers do not agree to profit calls. Nor can they make unilateral deductions on supplier invoices, or force suppliers to contribute to the cost of product sales or promotions in breach of previously agreed supply agreements.

Initially, GSCOP received little support by suppliers, who from past experience thought that it was just another Government scheme doomed to fail. However, the GCA's recent report on Tesco has raised hopes. Many suppliers can associate with the problems the GCA highlighted about Tesco's buying behaviour, and see her report as evidence that GSCOP really could be the foil needed to rebalance competition within the retail sector.

The GCA's report focusses largely on Tesco's delays in paying its suppliers in breach of GSCOP and that element has captured a lot of press attention. However, Tesco's errors are only part of the story. What is more important is that the breaches of GSCOP identified in the GCA's report are widely accepted as not being exclusive to Tesco. Consequently and the remaining nine supermarkets who are also subject to GSCOP will be poring over the GCA's report to establish how and why Tesco fell down, and what they need to do to avoid the same mistakes. Others are also taking note as there is the possibility that in the future GSCOP's remit may be widened to cover other dominant high street retailers.

If supermarkets (and, potentially, other dominant retailers) don't go through the GCA's report carefully, they risk being subject to the next GCA investigation and to a fine. On this occasion, Tesco escaped a fine (as the GCA's powers to impose a fine came after the period she investigated), but the GCA said that she would have considered a fine for Tesco so if she could have done so. This means that a supermarket who now repeats Tesco's mistakes could find themselves being fined of up 1% of its UK turnover.

Structural change

Structural change in the supplier/supermarket market can be attributed largely to two factors; the rise of discounters (such as Aldi and Lidl) and changing consumer trends.

The discounters have taken - and continue to take - a large market share from their more traditional competitors, but their product strategy is very different from the traditional model. In a nutshell, the discounters focus on providing fewer products and fewer varieties of product whilst maintaining good quality. As a consequence, discounters buy more products from fewer suppliers, who therefore take on a more important role in this model. The discounters therefore secure strong relationships with their suppliers so as to safeguard their supply channels. It is therefore no surprise that Aldi has the highest GSCOP compliance amongst the top ten supermarkets.

From a consumer perspective, while in times past consumers were arguably less interested in supply chain relationships, in today's age of the Millennials they are. Consumers now not only want a good product but they want to feel good about what they are buying – crucially, they do not want to feel guilty about it. Demonstrating fair treatment of suppliers is therefore a key marketing component on which supermarkets and other retailers are focussing.

The future

Retailers are now in the process of adapting as fast as they can to these changes. From a regulatory perspective, following the GCA's report, suppliers are already noting a marked improvement in their relationship with Tesco. Looking at this change from a structural perspective, Tesco is not hesitating to advertise its new stance on supplier relationships as means of standing out from any competitors who are currently lagging behind in this sense, but who will want to catch up fast.

Suppliers therefore have good cause for optimism. No longer should dealing with a supermarket be a depressing business. By contrast, if a supplier has a good and competitive product and can meet a supermarket's demands in terms of quantity and quality, there has never been a better time to build a strong supplier/supermarket relationship with the prospect of a sunny future.

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Insolvency

Supply Chain Risk

The Association of Business Recovery Professionals suggests that unsecured creditors, on average, receive 1 % of the debt due to them from a company that undertakes a pre-pack sale and 3 % in cases in which a going concern sale is achieved. Given such poor prospects, investment of time in identification and reduction of insolvency risk can pay dividends.

There are a number of warning signs of supply chain risk, and it is key that you are familiar with these:

- Is your supplier holding notably less stock, so that deliveries are short or late?
- Are there signs that your supplier is subject to creditor pressure such that their creditors are repossessing goods and/or issuing winding up petitions?
- Have you received a request to amend your T&Cs (i.e. title to goods does not pass until payment is received by your supplier's supplier in full or payment terms are extended with your customers).
- Reduction in quality standards.
- Official announcements to your supplier's or customer's shareholders or the stock market such as profit warnings.
- Large scale redundancies or the sudden removal of key personnel.

How to protect your company:

- Due diligence at the outset of a trading relationship can provide a benchmark against which you can measure any deterioration.
- Assessment of key customers and suppliers should be carried out regularly.
- Place limitations (where possible) on the amount each supplier provides.
- Keep direct contact with suppliers, customers and others in their sector so that you are informed of changes and/or deteriorations.
- Within your contracts ensure that you have an all monies clause (i.e. title to the goods does not pass until all invoices have been paid) and include sufficient powers to assist in retrieving such goods.
- Require customers to ensure that goods that have not been paid for are distinguishable and stored separately and mark your goods where possible for identification purposes to assist with your claim.
- Within your contracts ensure that you have the right to terminate the arrangement on the occurrence of specified insolvency events.

Given the increase in formal insolvencies, and research that evidences that the average lifespan of an S&P 500 business is down to just 18 years today, from 82 years in the 1930s, the noticeable trend is that the majority of businesses trade for a much shorter period of time and therefore you must be ever watchful that it is not your suppliers or customers that are facing insolvency.

If a customer or supplier enters an insolvency process it is imperative to understand the type of process that they are subject to. Each process will require a different approach.

Liquidation is essentially the process of last resort:

- As an unsecured creditor you are unlikely to receive payment in a liquidation; and
- As a supplier your arrangement with the company will most likely come to an end rapidly.

Administration on the other hand:

- Is more likely to provide a higher return to creditors than in a liquidation, as there may be a continuation of the business or time to conduct a sale of the assets rather than a firesale approach (as may be required in a liquidation).
- May involve a period of trading the business whereby you can supply the administrators with goods or arrange for the administrators to sell your goods and the payment terms can be agreed between yourselves and the administrators.
- May involve the continuation of the business in the form of a new company, whereby you may be able to leverage continued supply in exchange for payment of all outstanding sums owed.

One of the best examples in recent times of proactive supply chain management was the successful completion by the Olympic Delivery Authority of the Olympic Park and Athletes' Village in London. This was a project that was successfully completed despite some 43 potential insolvencies and 11 actual insolvencies in the construction supply chain. The impact of these insolvency events was mitigated through decisive early actions.

We can help you to protect your supply chain, enhance your protection on the insolvency of a supplier or customer and further advise you if you have concerns regarding a supplier or customer. Please contact our specialist Restructuring and Insolvency team to discuss your circumstances.

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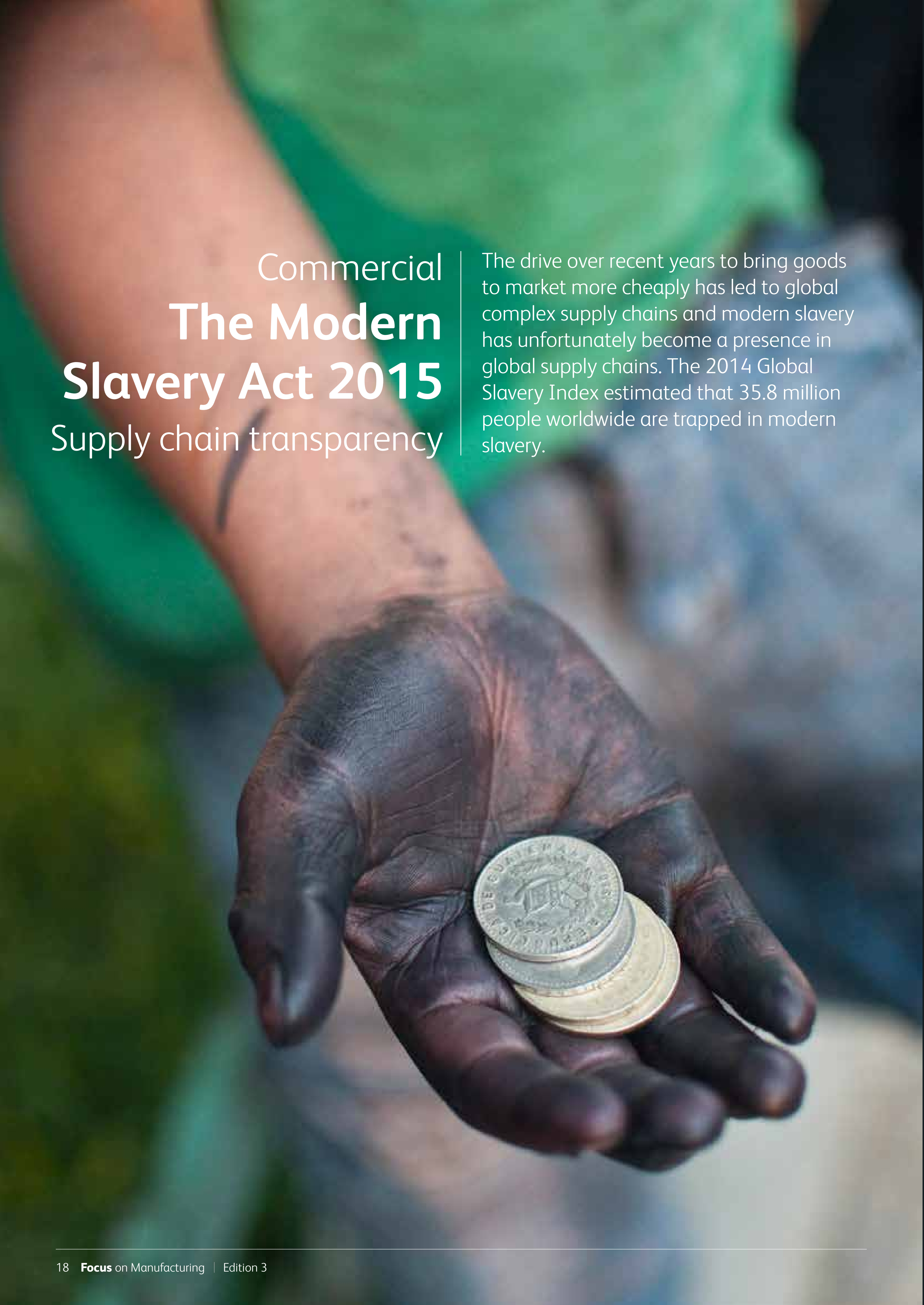

Commercial
The Modern Slavery Act 2015
Supply chain transparency

The drive over recent years to bring goods to market more cheaply has led to global complex supply chains and modern slavery has unfortunately become a presence in global supply chains. The 2014 Global Slavery Index estimated that 35.8 million people worldwide are trapped in modern slavery.

The Modern Slavery Act was introduced last year with a view to ensuring that organisations take proportionate action to prevent the use of forced, trafficked and slave labour. It is fundamental for businesses in the manufacturing sector to understand the requirements of the new legislation and to understand the practical steps which should be adopted.

Annual statement

An organisation with a commercial presence in the UK and worldwide turnover in excess of £36 million GBP (including the turnover of all subsidiaries) must produce a slavery and human trafficking statement every financial year. This statement must address the risks of human trafficking in its business as well as its supply chain together with how the business will mitigate these risks.

The legislation is not prescriptive as to its contents but recommends that the following topics should be covered:

- The structure of the business and its supply chains.
- Its policies in relation to slavery and human trafficking.
- Its due diligence processes in relation to slavery and human trafficking.
- The parts of its business and supply chains where there is a risk of slavery and the steps it has taken to assess and manage that risk.
- Its effectiveness in ensuring that slavery is not taking place in its business or supply chains, measured against such performance indicators as it considers appropriate; and
- The training about slavery and human trafficking available to its staff.

The statement must be signed off by senior members of the business and published on its website with a prominent link from the home page.

Organisations are expected to publish their statements no more than six months after their year end. Only businesses with a financial year ending on or after 31 March 2016 will be required to publish a statement for their 2015-2016 financial year. Organisations with a 31 December 2015 financial year end will not have to publish their first statement until 2017.

Failure to publish as a statement?

At present there are no civil or criminal penalties for failure to report. The Secretary of State may however obtain an injunction to force offending organisations to disclose information. However, the reputational damage to a business is likely to be the most influential factor in compelling an organisation to conform.

What if your turnover does not meet the required threshold?

If your business does not meet the turnover threshold it is not simply a case of ignoring the new legislation. The obligations will flow down the manufacturing supply chain so a business should still be aware of the requirements and consider how it addresses the human trafficking issue. We have seen many instances in recent years of the reputational damage that can be caused by an issue in a supply chain so this is an area which should be taken seriously at all levels. This is also likely to be a criterion for remaining an approved supplier of a large organisation. We are also seeing the requirements flowing down more and more into tenders.

Take responsibility within your supply chain

Ensuring modern slavery is eliminated from a supply chain should now be high on the agenda of every organisation. It is important to ensure that whatever level of the supply chain you are that your business is considering the new legislation and the issues which it is seeking to address.

It would be prudent to consider the following actions proportionate to any perceived risk surrounding your supply chain:

- If your business meets the turnover threshold under the legislation the annual statement must be drafted and be readily available on your website.
- Consider the supply chain which operates around your business and identify locations which may pose a risk as well as any suppliers in the chain which may require further risk assessment (such as audits or factory inspection).
- Carry out all necessary due diligence on any new suppliers.
- Implement an action plan for any perceived weaknesses in the supply chain including whether or not your business should continue working with a high risk supplier.
- Put into place an appropriate policy which your suppliers must adhere to and ensure that this is communicated to your employees as well as any party within your supply chain.
- Consider training for employees.
- Amend your standard contracting terms to include an obligation to comply with the new legislation and your policy; and
- Remain alive to the issue - carry out regular reviews of your supply chain to ensure transparency.

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Regulatory and Criminal Investigations

The bigger you are, the harder you fall

Courts get tough on health and safety sentencing

Significant changes to the sentencing process have come into force allowing for the imposition of unlimited fines for Health & Safety offences.

The mechanics of the new sentencing process
The Court will make an assessment of the culpability of the offender and harm caused based on the facts of the case and submissions made in mitigation. As with all sentencing guidelines there is effectively a 'sliding scale' measuring both of these factors and in general terms, the higher the bracket then the heavier the sentence.

There are four classes of culpability ranging from 'Low' to 'Very High' where there is a "deliberate" breach of the law or "flagrant disregard" for it. If the health and safety failings are found to be minor and the case revolves around an isolated incident then the Court is more likely to consider that the offender's culpability falls into the lowest category of culpability. This may also be the case where a business has made significant efforts to address the particular risk at issue but the efforts were inadequate on this occasion or where there were no circumstances to give an indication that there was a risk to health and safety.

Alternatively, there are a number of factors which a Court may frown upon and considers an offending business to have fallen far short of what would be an appropriate standard. It follows that the following may represent a higher degree of culpability and demonstrates serious flaws or failures within the organisation:

- Allowing breaches to continue over a long period of time.
- Where there are prior incidents where risks to health and safety have been exposed but not acted upon and appropriate changes have not been made.
- Concerns of employees or other persons have been ignored.
- Measures to ensure that established and recognised industry standards are met have not been implemented.

The assessment of 'harm' is a slightly more complicated consideration for the Court in that there is a matrix to follow with the axes being formed by levels of likelihood of harm and the seriousness of harm risked. In terms of the latter, there are three levels of seriousness:

- Level A: Death, significantly reduced life expectancy or injury resulting in lifelong dependency on a third party for basic needs.
- Level B: A progressive, permanent or irreversible condition or an injury with a substantial and long term effect on someone's ability to carry out normal day to day activities.
- Level C: Vaguely referred to as "all other cases not falling within Level A or Level B.

Levels A, B and C are then evaluated against low, medium, and high likelihood of the harm arising. The result is different 'harm categories'. For example, if the most serious level of harm (A) is risked and it is highly likely that the harm arises then the defendant organisation finds itself in 'harm category 1'. If the least serious harm (C) is risked and the likelihood of harm is low or even medium then the defendant organisation will find itself in 'harm category 4'.

The culpability and harm categories identified will then give the Court quite a precise basis for sentence. Each level of culpability whether low, medium, high or very high has within it all four 'harm categories'. These effectively form bands which the Court will look to apply. Helpfully, the resulting 16 bands are then considered against turnover.

Offenders are expected to provide comprehensive accounts for the previous three years to allow the Court to make an accurate assessment of an organisation's financial status. Without that information being provided the Court is entitled to draw reasonable inferences on means from the evidence that has been heard in the case.

Application
Let us assume that a large PLC with over £50 million turnover has blatantly or "flagrantly" ignored its health and safety obligations and this has led to the death of an employee under circumstances where the likelihood of harm was high and therefore easily foreseeable.

The new guidelines would place this as a very high culpability matter and using the harm matrix, a "harm category 1" situation. The company could face a fine between £2.6 to £10 million. The most serious penalty ranges for the other categories of organisation are as follows:

- Medium organisations (turnover between £10 million and £50 million): Fines between £1 million and £4 million.
- Small organisations (turnover between £2 million and £10 million): Fines between £300,000 and £1.6 million.
- Micro organisations (turnover of up to £2 million): Fines between £150,000 and £450,000.

Disturbingly for the larger organisations, there is a black box within the guidelines that says where an offending organisation's turnover or equivalent very greatly exceeds the threshold for large organisations (i.e. is significantly higher than £50 million)… "It may be necessary to move outside the suggested range to achieve a proportionate sentence". This effectively gives the Courts carte blanche to impose whatever figure it sees fit, depending upon the size of the business. A fine of tens of millions of pounds is therefore possible.

General principles however state that the fine must reflect the seriousness of the offence and the extent to which the offender fell below the required standard, taking into account the financial circumstances of the offender. The fine should be fair and proportionate and meet the objectives of punishment, deterrence and the removal of any gain obtained through cutting corners. In serious cases, if the fine would serve to put the organisation out of business then "this may be an acceptable consequence".

This represents a further strengthening of the application of health and safety law. It is certainly the most significant change since the Health and Safety (Offences Act) 2008 that was introduced to allow the Magistrates' Courts to resolve a greater number of cases and to impose sentences which reflected the seriousness of the offences and would therefore encourage compliance.

Fines of up to £20,000 could then be imposed in relation to an extended range of offences and imprisonment could also be imposed on individuals where considered necessary. These powers were not to be applied retrospectively which is another difference from the present changes.

Individuals can still be imprisoned for the more serious Health and Safety breaches where there is clear individual culpability and 'connivance'. The new categories described above also apply but little has changed in terms of application. The maximum sentence at the Crown Court remains a two year custodial sentence and six months at the Magistrates' Court.

Compliance with Health and Safety legislation therefore takes on even greater significance now. The perils of falling foul of the law can now be even more far reaching and costly.

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Corporate

M&A Trends in Manufacturing

Manufacturers have faced a challenging period of late, but corporate deal activity within the sector increased 5% last year, with businesses based in the UK being increasingly targeted by overseas-based organisations.

Our analysis of data provided by Experian, the global information services company, shows that mergers and acquisition (M&A) activity across the sector increased from 933 deals in 2014 to 981 deals in 2015.

In corporate deals where UK manufacturing companies were the target, one third (33.7%) of completed transactions were led by bidders based overseas, with 12% being based in the United States. In 2014, just over a quarter (27%) of deals involving UK based manufacturing firms involved an overseas buyer. According to the data, 11% were from the US.

Regional trends

Signifying that the current dominance of London and the South-East, manufacturers based here were a target for 27% of all M&A activity in 2015 within the UK.

Despite deal numbers across the UK rising by 5%, activity levels in Yorkshire fell from 124 transactions to 105 in 2015. Out of all these deals, 54 involved a local company being targeted either by an organisation from within the UK or based overseas. This number is down on the figure recorded in 2014 and 2013.

In a year which saw the Yorkshire region see its share of deals in the sector fall to 8.2% from 12.3%, the study revealed that manufacturers in the region attracted less interest from overseas-based bidders.

Indeed, out of all the completed deals in the sector where a Yorkshire manufacturer was the target, one quarter (24%) involved a bidder from outside of the UK. This is 35% down on last year's figure in the region.

The picture was quite different in other parts of the UK. In the West Midlands, deal activity remained static but over a third (36%) of the transactions in the region where a West Midlands-based business was the target involved a bidder based from outside of the UK. This is significantly above the national average and also last year's figure in the region of 24.7%.

Private equity

Interest within the sector from private equity backers fell however in 2015 compared to 2014.

Out of all the manufacturing deals where UK companies were the target, 71 transactions were financed through private equity. Almost half of these completed deals involved businesses based in London or the South East.

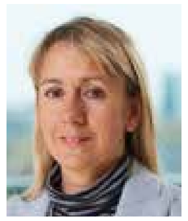
It is of course pleasing to see an overall increase in manufacturing M&A and it is encouraging that UK based firms continue to generate interest from overseas.

Although this is credit to our reputation across the world, it's important that more UK companies review their strategic options and look to grow through overseas' acquisition.

Businesses here simply can't afford to miss out on opportunities abroad. Despite a challenging economic climate and the uncertainty surrounding a possible Brexit, businesses in the sector should continue to assess their strategic options and whilst they do so look at options not just here in the UK, but further afield.

Private equity interest is still lagging behind where it was in 2014, but there are encouraging signs and it will be interesting to see if this changes during the rest of 2016.

Experian's analysis also ranked Irwin Mitchell as the fourth most active legal adviser for M&A work in the UK during Q1 of 2016 as part of our team's continued growth and success in this area.



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