



GERMAN INDUSTRY
CHINA PLUS 1

BUSINESS TRANSFER CHINA-VIETNAM

LEGAL ISSUES

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April 2020

MAIN SCENARIOS

1. Relocation of (self-owned) manufacturing operations from China to Vietnam

1. Switch of supplier from China to Vietnam

RELOCATION OF MANUFACTURING OPERATIONS

Case study: Foreign investor wants to shift final assembly of electronic products from China to a new factory in Vietnam.

However, certain parts will still be sourced from an affiliated group company in China.

RELOCATION OF MANUFACTURING OPERATIONS LEGAL ISSUES

- (1) Can an assembly operation be licensed as a manufacturing project in Vietnam?
 - (2) Can Chinese parts be imported for assembly / processing in Vietnam?
 - (3) Can second-hand equipment from China be imported?
 - (4) Can the parts be imported free of customs duty and then re-exported to an ASEAN export destination?
 - (5) Under which conditions will the final products be regarded as „Made in Vietnam“?
 - (6) Are there trademark risks in export manufacturing?
- (POLL QUESTION 1)

CAN AN ASSEMBLY OPERATION BE LICENSED AS A MANUFACTURING PROJECT IN VIETNAM?

- A foreign investor needs to obtain an investment registration certificate („IRC“) and an enterprise registration certificate in order to establish a production company in Vietnam.
- Under Vietnam’s Investment Law, foreign investment into manufacturing is encouraged with certain investment incentives.
- Incentives apply to productions of products with at least 30% value added
- This does not mean that manufacturing with lower added value is not allowed.
- However, application documents must credibly demonstrate that sufficient local processing takes place in order to constitute a manufacturing activity as opposed to mere trading.
- Only sorting, packaging or labelling is not sufficient.

CAN CHINESE PARTS BE IMPORTED FOR ASSEMBLY / PROCESSING IN VIETNAM?

- Investment Law of Vietnam:
- “Investors are not required by the State to satisfy the following requirements:
- Give priority to buying, using domestic goods/services; or only buy, use goods/services provided by Vietnamese producers/service providers.”
- Many foreign investors would prefer to increase the share of local suppliers, but find it difficult to find qualified suppliers.
- There is no legal prohibition to import parts from China.

CAN THE PARTS BE IMPORTED FREE OF CUSTOMS DUTY AND THEN RE-EXPORTED TO AN ASEAN EXPORT DESTINATION?

- Solution: Establishment in an export processing zone
- *Export-processing zone* means an industrial park specialized in manufacturing of exported products or provision of services for manufacturing of exported products and export.
- In order to be granted an IRC and a subsequent EPE certification, investors first need to obtain a “pre- approval” of the customs authorities confirming their compliance with the requirements to have a fixed fence, the installation of CCTV and the implementation of a management system for raw materials and supplies for the production of exported goods.
- Subject to these conditions, tax exemptions for VAT and import and export taxes will apply.
- 100% of final products shall be exported.

CAN SECOND-HAND EQUIPMENT FROM CHINA BE IMPORTED?

- Generally, import of second-hand equipment from China is allowed in Vietnam.
- An investor may shift production equipment from an existing production line in China to a new factory in Vietnam for further use.
- Restrictions:
- General prohibition of import for any used equipment, if it has been "*discarded*" or "*banned*" by the exporting country (i.e. rubbish), or does not comply with the applicable regulations for the product.
- Age limitation for machinery and equipment to a max. of 10 years calculated from its manufacturing date until the date of import to Vietnam.

A CAUTIONARY TALE



UNDER WHICH CONDITIONS WILL THE FINAL PRODUCTS BE REGARDED AS „MADE IN VIETNAM“?

- Decree issued in 2018: Mere assembly of a product from imported finished components is not enough to establish Vietnamese origin of the final products.
- In June 2019: Products at the Ho Chi Minh City factory of the Japanese electronics manufacturer Asanzo were entirely assembled from finished Chinese-sourced parts, but sold into the local market as „Vietnamese products with Japanese technology“ after simply being re-labelled.
- Vietnamese implementing regulations to the „*Framework agreement on comprehensive economic co-operation between the association of South East Asia nations and The People's Republic of China*“, decisive factor for Vietnamese origin is the Regional Value Content – „RVC“) of the final product. A threshold of at least 40% RVC must be met in order to justify the indication „*Made in Vietnam*“.
- September 2019: Draft of a new circular on this issue. It may enter into force in the second half of 2020 and reduce the RVC-threshold to 30%.

SWITCH OF SUPPLIER

Case study:

Foreign medical equipment manufacturer has been sourcing main components for a certain product from a Chinese supplier for many years.

- Manufacturer now considers sourcing from Vietnam.
- Motivation factors:
 - Cost issues
 - Higher tariffs in the US market
 - IP challenge and competition risk from supplier

(POLL QUESTION 2)

TRADEMARK RISKS IN EXPORT (OEM) MANUFACTURING

Vietnam factory manufactures products for export to another ASEAN country. Investor owns trademark rights in that country, but not in Vietnam, where trademark rights are owned by a third party.

- Def. „Use of trademark“ in Vietnamese IP Law:
 - Affixing the protected mark on goods, goods packages, business facilities, means of service provision or transaction documents in business activities;
 - Circulating, offering, advertising for sale or stocking for sale goods bearing the protected mark;
- If the Vietnamese factory labels the products already with the protected mark in Vietnam before they are shipped to the export countries, an act of trademark use in Vietnam can be assumed. Currently, no final clarification from any Vietnamese court or authority.
- An applicant can request the customs authorities to impose measures of this kind against suspected export consignments.

SWITCH OF SUPPLIER

- Legal Issues:
- Evaluation of supplier performance risk and legal remedies for non-performance
- Applicable law
- Dispute settlement
- Enforcement of judgments and arbitration awards in Vietnam vs. China
- IP risk - disclosure of sensitive drawings, specifications or customer data

IP CHALLENGE AND COMPETITION RISK FROM SUPPLIER IN CHINA

- Common IP risk scenario in working with Chinese suppliers:
- In order to enable Chinese supplier to build components, foreign manufacturer had to:
 - Disclose technical drawings and specifications to supplier
 - Allow supplier to keep tailor-made tools / moulds for the product
 - Transfer manufacturing process know-how on an ongoing basis for 10 years
- As a result:
 - Chinese supplier registered Chinese patents in relation to the components
 - Designed his own final device, thereby becoming a direct competitor
 - Approached international customers of the final device and exhibited the final device in international exhibitions
 - Finally attacked the Chinese patents of the foreign manufacturer with an invalidation request based on lack of novelty due to prior disclosure

IP AND COMPETITION RISK IN VIETNAM

- Similar risks *theoretically* also exist in Vietnam:
 - Disclosure of specifications and know-how transfer will also lead to „upgrading“ of Vietnamese suppliers
 - Attempts to obtain local IP rights also legally possible in Vietnam
- **But:**
 - Actual competition risk from Vietnamese suppliers is much less significant
 - Scale and capacities of Vietnamese suppliers not comparable to China
 - No systematic attempt from Vietnamese applicants yet to create local patents for „recycled foreign technology“

REMEDIES OF BUYER UNDER VIETNAM CIVIL CODE

Article 447. Right to claim on warranty

If a purchaser discovers a defect in a purchased object during the warranty period, it has the right to require the seller to **repair** the object free of charge, or **reduce its price** or **replace** it with another object, or it has the right to **return the object in exchange for a refund**.

Article 448. Repairs of objects during warranty periods

A seller must repair a defective object and assure that it satisfies the **quality standards or characteristics as undertaken**.

Article 449. Compensation for damage during warranty periods

In addition to demanding the performance of warranty obligations, a purchaser has the right to require the seller to **compensate for damage** caused during the warranty period due to technical defects of the object.

EVALUATION OF SUPPLIER PERFORMANCE RISK AND LEGAL REMEDIES FOR NON-PERFORMANCE

- Recommendation: Conduct legal, commercial and technical due diligence on Vietnamese supplier (on-site) before signing long-term contracts
- Contract should contain:
 - Proper quality standard and mechanism to confirm quality issues
 - Sequence of legal remedies of buyer in case of quality defects and delay
 - Rights of termination
 - Penalties (clarify relationship between fines / penalties and compensation of actual damages)

APPLICABLE LAW, DISPUTES

- Foreign court judgments can generally not be enforced against Vietnamese parties.
- The same applies to Vietnamese court judgments. No enforcement in Europe.
- Vietnam is member of New York Convention and therefore obliged to recognise and enforce foreign arbitration awards.
- However, the actual enforcement record of Vietnam is not very good.
- In a number of cases, enforcement was denied due to „violation of fundamental principles of Vietnamese law“, even though the contract was governed by a foreign law.
- Consider using VIAC arbitration

SUMMARY

1. Manufacturing operations can be relocated from China to Vietnam, including assembly/processing. Mere sorting, packaging or labelling will not qualify as manufacturing operation.
2. Imported Chinese parts and second-hand equipment (subject to restrictions) can be used for manufacturing.
3. Consider the advantages of export processing zones if you want to re-export final products.
4. Be aware of Vietnamese rules of origin.
5. Be aware of trademark infringement risks even in export manufacturing. Register a Vietnamese trademark if possible.
6. In sourcing, IP and competition risk arising from Vietnamese suppliers is lower than in China.
7. Use well-drafted procurement and supply contracts that are in line with basic principles of Vietnamese law (even if governed by a foreign law).
8. Include a well-drafted arbitration clause.

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