

## TOP 10 TIPS FOR AN ETHICAL SUPPLY CHAIN IN 2018

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### 1. TAKE PROACTIVE STEPS TO AVOID REPUTATIONAL DAMAGE.

A company can not only enhance its reputation through strong corporate social responsibility, but can also avoid the reputational damage that can come from human trafficking, forced labor, child labor, or other human rights abuses in its supply chain. The damage to the brand and the reputation of company is often more significant than potential penalties or other civil liability. It can impact consumers, as well as investors, employees, applicants, and business partners. NGOs, the media, and others are actively investigating human rights abuses, and companies do not want them to find those abuses as part of their products or services. Businesses can learn from the mistakes of other companies that have been dragged through the press, and they can avoid these risks by following the steps described in this article.

### 2. MAKE SURE YOUR COMPANY WILL STACK UP AGAINST THE COMPETITION IN 2018.

Companies are more commonly expected by stakeholders to conduct adequate due diligence and install compliance programs to assure that there are no human rights abuses, such as forced labor, in their supply chains. Know the Chain ([www.knowthechain.org](http://www.knowthechain.org)) professes to help companies make an impact in their fight to eradicate forced labor. This year, it will benchmark (i.e. rank) 125 companies from three industries: (1) Information, Communications & Technology; (2) Food & Beverage; and (3) Apparel & Footwear by evaluating what companies are doing to address forced labor in their supply chains. Know the Chain first ranked a much smaller pool of companies (but still a significant number of leading brands and Fortune 500 companies) in 2016 and is gaining a following and thus expanding the number of companies and industry sectors to be ranked.

As this trend continues, corporate stakeholders will recognize the competitive advantages of outranking the competition — such as enhanced brand reputation and increased sales that follow from being known as a company that maintains an ethical and transparent supply chain. By contrast, companies that ignore (whether willfully or inadvertently) the risks of forced labor in supply chains and therefore receive lower rankings may jeopardize their market position over time.

### **3. AVOID BUSINESS INTERRUPTION RESULTING FROM LABOR ABUSES IN YOUR SUPPLY CHAIN.**

In addition to reputational damage, labor abuses in a supply chain can cause a delay in bringing a product to market. The Fair Labor Standards Act prohibits shipping goods in interstate commerce if they were produced with child labor or without paying minimum wages and overtime. The U.S. Department of Labor can use this provision, known as the "hot goods" provision, to enjoin shipments of goods and apply pressure on wholesalers and retailers, even when they were not employers of, or had no contact with, the impacted workers. The Department of Labor has used this tool in the garment and agricultural industries, for example, to obtain wages for workers who were not properly paid by their employers, knowing that wholesalers and retailers have an immediate incentive to resolve the issue promptly to avoid a delay in shipments of seasonal apparel or produce.

Additionally, for goods produced outside the United States, U.S. Customs and Border Protection can block imports produced with forced or indentured or labor pursuant to the U.S. Tariff Act. Until recently, the Tariff Act had an exception under which goods produced with such labor could be imported if there were insufficient quantities to meet U.S. consumptive demand. However, in 2016, the Trade Facilitation and Trade Enforcement Act removed this exception and expanded the scope of the law.

### **4. TAKE YOUR SUPPLY CHAIN DILIGENCE UP A NOTCH — MAP IT, APP IT, AND AUDIT IT!**

Companies often have to source raw materials for their products through complex and opaque supply chains located far from where the finished goods are ultimately sold. Even well-intentioned companies, with resources to deploy, can understandably flinch at the prospect of investigating the bona fides of the myriad of entities in distant parts of the world at remote levels in their supply chains. Similarly, a company's outsourcing of production can create an environment in which there is little insight into the conditions under which people work to create their products.

How can a company reasonably, but effectively, ensure that its supply chain is responsible and ethical and that it is not utilizing forced or trafficked labor? One way is by mapping its supply chain and another is by conducting strategic audits. Modern supply chain mapping is the process of engaging across companies and suppliers to document the exact source of every material, every process, and every shipment involved in bringing goods to market. Various vendors sell or lease mapping software for this purpose. Additionally, the U.S. Department of Labor's Bureau of International Labor Affairs (ILAB) has developed an app called "Comply Chain" to assist companies that manufacture goods by providing an eight step process designed to reduce the risk of forced labor in supply chains.

Once the supply chain is mapped, it can be audited. A supply chain audit is the process of identifying the risks or benefits of using one supplier over another and identifying whether there are signs of forced labor in supply chains. Auditing for forced labor in the lower tiers of supply chains can be difficult, but, when done strategically, in

a risk-based manner, through targeted document requests, surveys, and reputational research, a company can often identify the telltale signs of forced labor, such as a downstream supplier that employs migrant workers recruited through third-party labor brokers or cannot or will not produce age and compensation documents for its employees. Such audits are not only best practices, but the U.S. Department of State also encourages companies to have thorough, comprehensive, and periodic audits of supply chains.

## **5. UNDERSTAND CURRENT STATUTORY AND REGULATORY REQUIREMENTS IN THE UNITED STATES AND AROUND THE WORLD.**

In addition to criminal laws prohibiting trafficking and forced labor in just about every jurisdiction, many other laws impose obligations with respect to potential trafficking or forced labor in a supply chain. Certain laws involve transparency or disclosure obligations only, such as the UK Modern Slavery Act and California Transparency in Supply Chains Act. Others impose obligations on companies to take affirmative steps to monitor and work to prevent trafficking or forced labor by subcontractors or suppliers. Examples of these laws include the Duty of Vigilance Law enacted in France last year, which is applicable to certain large French companies, and the Federal Acquisition Regulations for Combatting Trafficking in Persons, applicable to U.S. government contractors. The U.S. Alien Tort Statute is another example of law under which a U.S. company could be held liable for human rights abuses in its supply chain in other parts of the world. The U.S. Supreme Court is currently considering the question of whether corporations (as opposed to individuals) can be held liable under this statute and should issue its decision this year in the case of *Jesner v. Arab Bank*.

## **6. DO NOT IGNORE NONBINDING STANDARDS AND PROPOSED LEGISLATION.**

A company can stay ahead by monitoring nonbinding standards and proposed legislation because they are indicative of the public's expectations and trends relating to supply chain diligence. Examples include the United Nations Guiding Principles on Business and Human Rights, which established an expectation of human rights due diligence; Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, to which many global companies refer in developing policies; and international conventions and protocol on human trafficking and forced labor that are ratified by a number of countries. To illustrate, the issue of modern slavery has been receiving much attention in Australia, which announced its commitment to ratify the International Labour Organization's Forced Labour Protocol in November 2017, while also considering legislation similar to the UK Modern Slavery Act. By staying on top of various standards and proposals, a company can better understand trends in different parts of the world and be well positioned to comply when new legal requirements are imposed.

## **7. FORECAST LITIGATION RISKS UNDER U.S. CONSUMER PROTECTION LAWS.**

Companies can be challenged in costly, civil class actions under state consumer protection statutes. Such claims



typically allege that the company is selling products under the guise of a corporate social responsibility or anti-slavery policy, while simultaneously being aware of human rights abuses somewhere in the supply chain. For example, a recent suit against a large company under California state law governing unlawful business practices alleged violations stemming from the company sourcing and selling a product that actively contributes to the use of illegal slave labor, while falsely claiming that the company enforced its policies against slave labor. Most state consumer protection statutes provide for injunctive relief against offending companies, in addition to monetary and punitive damages. These legal actions can be brought on behalf of a state or nationwide class. Companies should not only educate themselves on the various state consumer protection statutes and monitor the landscape of these class actions, but should consider engaging experienced counsel to help proactively assess and manage this potential litigation risk.

## **8. STAY ABREAST OF ISSUES AND IMPACTS OF SECURITIES FRAUD LITIGATION.**

Securities fraud is another area of litigation that should be monitored and the risk managed. Several lawsuits have been filed during the past few years challenging companies' Corporate Social Responsibility (CSR)-related statements about supply chain, anti-human trafficking policies, food safety programs, audit processes, and environmental cleanup initiatives. Companies also sometimes receive "books and records" complaints demanding access to company records in an effort to gather evidence showing knowledge of falsity, i.e. that the company made the various CSR statements fully aware they were either false or misleading.

The majority of securities fraud cases in this arena have been brought as class actions on behalf of consumers and/or shareholders arguing that they were deceived by the company's CSR representations and suffered damages — often an unwarranted premium for a security interest or merely a purchase they otherwise would not have made. The challenged disclosures are typically found on corporate websites, including statements in sustainability reports, human rights documents, employee codes of conduct, third-party supplier codes, statements of ethics and integrity, and audit protocol descriptions. Although seemingly daunting, some simple steps can help minimize litigation threats to companies such as using disclaimer language near, and altering the tone of CSR statements to sound more aspirational and less like a guarantee of a clean supply chain.

## **9. TRAIN AND EDUCATE YOUR CURRENT EMPLOYEES, AND CONSIDER HIRING A CSR MANAGER.**

As the U.S. State Department reports, human trafficking and forced labor are insidious and fluid crimes that are without boundaries, exist in formal and informal markets of lawful and illicit industries, and affect skilled and unskilled workers from a spectrum of educational backgrounds. Human trafficking and forced labor are easily camouflaged in the depths of U.S.-based companies' long and complex supply chains that cross multiple borders and rely on an array of subcontractors. This means that executives, managers, and key procurement employees of reputable U.S. companies may be connected to (or complicit in) human trafficking much more so than they

imagine.

Most executives, managers, and key employees responsible for generating profits for a company are simply unaware of the risks (and often real problem) of forced labor and human trafficking in their supply chains. No change will occur, however, without effective education of key executives, managers, and procurement employees regarding the problem of forced labor and human trafficking and how it manifests within supply chains. Moreover, companies must also be proactive to train their executives, managers, and employees on how to spot signs of human trafficking and forced labor in their supply chains. Sadly, cost-cutting measures of companies often keep such education and training activities on the back burner or neuter the programs already in place that need to be robust and pervasive to be effective. This is shortsighted. The malignancy of human trafficking that continues to infect a company's supply chain can have long term, devastating effects for the company, including its reputation and growth. Companies are well-advised to have a CSR manager with a budget sufficient to fulfill the responsibility of conducting education and training programs across the company. This not only begins addressing the risk, but also provides companies the immediate benefit of demonstrating to consumers, investors, and lenders that they are truly committed to combatting the evil of human trafficking and forced labor.

## **10. REVIEW AND UPDATE SUPPLIER CONTRACTS AND CODES OF CONDUCT.**

Companies should revisit their supplier contracts — even those recently created or modified — to determine how they can be enhanced to improve transparency between the parties and better allocate risk to help prevent supply chain abuses. In particular, a company should revise the representations and warranties sections regarding compliance with applicable laws and regulations (including a duty to stay apprised of changes in those laws and regulations.) The company should also require ongoing certifications by suppliers, reserve the right to audit suppliers, and carefully craft termination provisions where there is reasonable belief of breach of these provisions by the supplier (or the supplier's supplier). Similarly, companies should review and revise their internal codes of conduct and their supplier codes of conduct. Both internal and external codes need to be up to date and contain clear statements regarding the commitment to human rights, ethical labor practices, compliance with labor laws, and express prohibition of human trafficking, forced labor, and human rights abuses. A company's internal code should also identify who is responsible for the management and administrative oversight of these responsibilities and explain grievance and reporting procedures, compliance standards, and the audit/monitoring rights and processes.

Once a company has taken these steps, it is important to revisit them on a regular basis. Supply chain diligence is more than just a box to check or a policy to draft and put on a shelf. A company should periodically update and revise its approach based on the ever-changing landscape of new laws, standards, and consumer expectations, as well as an assessment of what has worked well for the company and what has not. Staying on top of these issues can help a company avoid legal risk and strengthen its reputation and bottom line.

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