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Evolving Compliance Regulations Impact Scope of Due Diligence

Corporations face greater obligations regarding international supply chain management

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Operating an international supply chain already raises many legal concerns for U.S. companies under U.S. and international laws. And now, new regulatory developments are likely to increase the level of due diligence that U.S. companies need to conduct on their international product and worker supply chains.

The recent legal developments, which include the new Federal Acquisition Regulation (FAR) proposed rule "Ending Trafficking in Persons," and the proposed Business Supply Chain Transparency on Trafficking and Slavery Act of 2014, come at a time of wide news coverage highlighting problems with outsourced production (such as, for example, Samsung ceasing business relations with a Chinese supplier due to child-labor concerns and last year's factory collapse in Dhaka, Bangladesh). Despite these known problems, while an estimated two-thirds of the U.S. gross domestic product (GDP) comes from retail consumption, a tremendous amount of manufacturing is taking place abroad, largely in the Far East. In a time of increasing regulatory oversight and media coverage of the problems with outsourced production, companies in all industries are advised to reevaluate their compliance programs and policies to ensure that they are in line with the new regulations and best practices.

FAR Regulation and the DoD FAR Supplement

Federal government contractors will soon experience the implementation of new regulations on human trafficking. In September of 2013, the government issued a proposed FAR rule that: (a) expands the scope of prohibited conduct; (b) requires a compliance plan and new contract certifications; (c) requires new mandatory notification requirements; and (d) also applies these requirements to subcontractors and suppliers. *See* FAR Case 2013–001, Ending Trafficking in Persons, 78 *Fed. Reg.* Vol. 187 (Sept. 26, 2013).

Along with the existing types of prohibited conduct—including "severe forms" of trafficking, paying for sexual acts and forced labor (*See* 48 CFR 22.17 and 48 CFR 52.222–50)—the proposed new FAR rule includes six additional types: (1) denying access to employee identification documents; (2) misleading or fraudulent recruiting practices; (3) charging

recruitment fees; (4) failing to provide return transportation for employees; (5) providing substandard housing; and (6) not providing employment documents in the employee's native language before employee departs from country of origin. FAR Case 2013 at secs. 22.1703(a) and 52.222–50(a).

The new rule would also require government contractors to develop and implement a compliance plan for contracts performed outside of the U.S. with an estimated value of greater than $500,000, unless the contract is exclusively for commercially available off-the-shelf (COTS) items. Id. at sec. 52.222–50(d)(5). This compliance plan must include specific "minimum requirements" set forth in the rule. Id. at sec. 50 (h)(3). When the compliance program requirement applies, the contractor must also certify that, after conducting due diligence: (i) neither it nor any of its agents, subcontractors, or subcontractor agents are engaged in improper activities, and (ii) if abuses have been found, the contractor or subcontractor has taken the appropriate remedial and referral actions.Id. at sec. 50 (h)(5).

There is also a mandatory "notification" requirement, in that the contractor must "immediately" notify the government if it receives: (1) "any credible information" from"any source"that alleges a contractor employee, subcontractor, subcontractor employee or their agent has engaged in conduct that violates the rule; and (2) any actions taken against a contractor employee, subcontractor, subcontractor employee or its agent for a violation pursuant to the rule. Id. at sec. 50 (d). Violations under the proposed rule can occur not only because of prohibited conduct, but also for: (a) inadequate or nonexistent notification; (b) failure to provide full cooperation in a government investigation; or (c) failure to implement or follow the compliance plan.Id. at sec. 50 (e). The government's remedies for any such violations can include termination of the contract for default and suspension or debarment from government contracting.

The government has also proposed new trafficking regulations specifically for defense-related contracts. These proposed rules for the Department of Defense FAR Supplement (DFARS), will additionally: (a) require new hot line posters to inform workers on how to disclose violations; (b) apply the new FAR human trafficking rule to DoD contracts in excess of $150,000; and (c) require the establishment of a "bill of rights" for contractor personnel accompanying armed forces. DFARS Case 2013–D007, Further Implementation of Trafficking in Persons Policy, 78 *Fed. Reg.* 187 (Sept. 26, 2013).

The final FAR and DFARS human trafficking rules are expected to be issued very soon, since they build on and implement existing law, specifically Executive Order 13627 and Title XVII of the National Defense Authorization Act for Fiscal Year 2013.

New Proposed Act and ABA Model Policies

This past June, U.S. Rep. Carolyn Maloney introduced the Business Supply Chain Transparency on Trafficking & Slavery Act of 2014 (H.R. 4842), which would require qualifying public companies to disclose their efforts to identify and address human trafficking and other human rights abuses in their supply chain. This effort, which has bipartisan support, appears to be the latest legislative effort, following the California Transparency in Supply Chain Act and Dodd-Frank's conflict minerals rule, to address human trafficking overseas by enlisting the might of public companies subject to SEC oversight.

Like the California state law, this federal legislation applies to corporations with annual gross

receipts in excess of $100 million. Maloney's bill applies to a universe of companies beyond just retailers and manufacturers. The bill would also force a company to look further back into its supply chain, in contrast to the California law, which relates only to top-tier suppliers. These details relating to scope and application may be the future battlegrounds where corporate lobbyists try to influence the final versions of the proposed regulation and law.

Proponents of Maloney's bill cite corporate ethics and consumers' desire for transparency as the engines behind this overall approach to combating global labor trafficking. To be sure, efforts by various colleges to pressure brand manufacturers have proven successful. The interest of institutional and individual investors in understanding the potential flaws in a public company's supply chain might prove a compelling factor that is based in capitalism. Notwithstanding the legitimate concern of excessive SEC disclosures, the trend to force corporate transparency in supply chains seems to reflect a growing recognition that the anti-sweatshop movement is not limited to nonprofits and corporate governance scholars. Another consideration is that these regulations come at a time of increased initiatives to try to re-shore manufacturing to the U.S. (and there are similar initiatives, and regulations, being implemented in Europe).

The American Bar Association (ABA) also weighed in on these developments in February by adopting the ABA Model and Business Supplier Policies on Labor Trafficking and Child Labor. The four "black letter" principles contained in these policies include: (1) the business will prohibit labor trafficking and child labor in its operations; (2) the business will conduct an assessment of the risk of labor trafficking and child labor and continually monitor implementation of this policy; (3) the business should (i) train relevant employees, (ii) engage in continuous improvement, and (iii) maintain effective communications mechanisms with its suppliers; and (4) the business will devise a remediation policy and plan that addresses remediation for labor trafficking or child labor in its operations.

The ABA's policies and commentaries provide a useful beginning for assessing whether a company's anti-trafficking compliance program is in line with the current state of good practices. Applying a risk-based assessment and focusing on "first tier" suppliers is consistent with the realities of the global market and many of the industry groups that submitted comments on the proposed FAR rule on human trafficking. The practice of identifying areas most at risk may require sophisticated investigative resources on site, since evidence of trafficking is often not apparent to the untrained observer. Businesses may not readily see through the nuances of a local culture or the economics of a country where suppliers are located. Workers may be coached or intimidated and local governments do not necessarily have an interest in a company maintaining a clean supply chain. Even if U.S. laws and regulations provide consistent guidance, a company tasked with new anti-trafficking mandates will be well served by customizing their compliance program to the geographic and political realities of their supply chain.

Getting Ahead of the Curve

The argument for corporations to get ahead of the curve and implement reasonable policies of their own, in advance of future press conferences at the U.S. Capitol and in the Rose Garden that some companies fear, has been strengthened by recent bad publicity in this area. For example, New York University, which created policies and procedures to govern the construction of its new campus in Abu Dhabi, learned that preventive measures are not always sufficient to avoid reputational and economic harm. The apparent disconnect between NYU's

well-intentioned lawyers and the managers on the ground in Abu Dhabi may illustrate the reality that the effectiveness of a compliance program can hinge on the ability of a company's investigators to understand the local culture and recognize the subtle signs of labor trafficking.

The passage in the U.S. House of a provision in the defense-spending bill giving preference on military bases to supporters of the Accord on Fire and Building Safety in Bangladesh may be further indication of the growing momentum behind these legislative and regulatory efforts. Industry groups succeeded in stopping the bill in the Senate, citing the reasonable concern that the provision would punish American companies while rewarding European competitors. The growing momentum in Congress, and the media's interest in stories similar to NYU's apparent troubles in Abu Dhabi, would suggest that the federal government's efforts to pressure corporations to address labor trafficking should not be ignored.

Given the dynamics of both the movements to re-shore manufacturing and the media exposure of disasters associated with human trafficking, the new regulations significantly impact supply chain management strategies of all companies sourcing products abroad. These new regulations make it plain that a company will have to do more to comply with its due diligence requirements than merely include contractual provisions in its supplier contracts that its third-party contractors and/or factories have complied with applicable laws. The regulations call for active engagement and due diligence by corporations and, for this reason, they are likely to change the scope of compliance required to operate international supply chains.•

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