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Whitepaper

Recent Developments Affecting the Regulation of Global Supply Chains

The regulation of global supply chains is increasingly an important aspect of emerging norms with respect to human rights and environmental, social and governance (ESG) concerns. As a direct result of heightened media scrutiny concerning forced labor, human trafficking, and child exploitation in value chains, competent authorities across jurisdictions adopted a series of incrementally more aggressive measures aimed at holding companies that perpetuate these abuses directly accountable for their transgressions. While these measures are not without controversy – owing, in part, to an ongoing debate over the nature and extent of indirect legal liability for the actions of third parties – it seems all but certain these issues will quickly grow to become the forefront of international concerns respecting the dignity of the human person.

While it is nearly impossible to count all major developments as they pertain to the regulation of supply chains in the context of a single white paper, here, we highlight some of the more notable regulatory developments that dominated headlines in 2022 and the beginning of 2023. We also provide concrete recommendations for companies faced with the daunting task of enhancing their corporate compliance programs to account for myriad new and emerging supply chain transparency and accountability measures.

Supply Chain Regulation in the European Union

The EU Corporate Sustainability Due Diligence Directive (CSDDD)

By far the largest recent development in the European Union (EU) impacting the regulation of global supply chains is the release of a preliminary draft of a sweeping new due diligence directive by the European Commission on February 23, 2022. Dubbed the draft directive with respect to "**Corporate Sustainability Due Diligence Directive**" (CSDDD), the original proposal called for sweeping new third-party due-diligence requirements by certain companies operating in the internal market. The reach of the Sustainability Directive extends not only to companies formally incorporated or established in the EU, but also to **non-European companies** with net turnover of more than €150 million generated within the EU in the last financial year – and to certain non-European companies operating in at least one "high-risk sector" with a net turnover of more than €40 million generated within the EU, provided that at least 50% of its net turnover was generated from its participation in a high-risk sector. For the purposes of the Sustainability Directive, "high-risk sector" is defined as encompassing any of the following industries:

(1) the manufacturing of textiles, leather, and related products;

(2) agriculture, forestry, and fisheries; and

(3) the extraction and manufacturing of mineral products.

As a preliminary matter, the Sustainability Directive obligates EU member states to ensure that covered organizations integrate due diligence considerations into the totality of their operations by maintaining a **comprehensive due diligence policy** that contains a description of the organization's overall approach to due diligence and incorporates a code of conduct setting forth concrete "rules and principles" that must be followed by a company and its subsidiaries. These components must be supplemented by a description of the specific process the organization utilizes to implement (or operationalize) due diligence, which include measures taken by the organization to verify adherence to the code of conduct and extend its application to "established business relationships." Covered organizations are under an obligation to update their respective due diligence policies on an annual basis.

The draft Sustainability Directive further establishes the obligation for EU member states to ensure companies take "appropriate measures" to identify both **actual and potential** adverse human rights and environmental impacts in their own operations, as well as those of their subsidiaries. The identification of these impacts includes the evaluation of both quantitative and qualitative information elicited from third-party resources; actual complaints made to the organization concerning actual and potential adverse human rights and environmental impacts; and consultations with affected groups, including workers and other relevant stakeholders. Notably, the Sustainability Directive extends these requirements to the level of an organization's "established direct or indirect business relationships" throughout their respective "value chains" – an intentionally opaque and potentially expansive definition that effectively includes any third party engaged in the production of goods or the provision of services by a covered organization, including, but not limited to, the development of the product or service offered, the utilization of the product in question, and its ultimate disposal (product/service lifecycle). As currently drafted, the Sustainability Directive also includes a robust **complaints component** that obligates companies to provide a mechanism by which both natural and legal persons can submit complaints involving "legitimate concerns" over actual or potential adverse human rights or environmental impacts respecting a covered organization and its value chain. In conjunction with this requirement, the Sustainability Directive further requires that covered organizations devise and maintain a specific procedure for the investigation and disposition of such reports. Where the complaint is "well-founded," an actual and potential human rights and environmental impact is deemed to exist, and the organization has a corresponding obligation to end the abuse so identified.

Preventing and ending actual and potential adverse human rights and environment impacts lies at the very heart of the Sustainability Directive's requirements for covered organizations. To that end, covered organizations that are made aware of such abuses — by self-identification, third-party disclosure or otherwise — have a duty to either bring the abuse in question to an end wholesale, or where impossible, to minimize the overall impact of that abuse on society at-large. In this vein, the Sustainability Directive directs organizations to:

(1) neutralize the adverse impact or minimize its extent by, among other things, paying direct damages to the persons affected and financial compensation to the specific community adversely impacted;

(2) where immediate cessation of the identified abuse is impossible, to develop and implement a corrective action plan with "reasonable and clearly defined timelines" for both action on the part of the organization and measurement of progress;

(3) seek contractual assurances from a direct business partner with whom the organization has an established business relationship to ensure adherence to the code of conduct incorporated into the covered organization's due diligence policy;

(4) make necessary investments, including into "management or production processes and [related] infrastructures" to end or mitigate the abuse in question;

(5) provide "targeted and proportionate support" for SMEs with which a covered organization contracts to avoid the potential that the SME's viability could be jeopardized by virtue of compliance with a code of conduct or corrective action plan; and

(6) in accordance with EU Competition Law, collaborate with other entities to increase the covered organization's ability to bring the adverse impact to an end, "in particular" where no other action taken by the covered organization in isolation is suitable or effective.

With respect to adverse impacts that cannot be brought to an end or mitigated, the Sustainability Directive instructs organizations to:

(1) refrain from entering into new and/or extending existing relations with the business partner in question; and

(2) either temporarily suspend, or altogether terminate, the existing business relationship.

In addition to the potential for **monetary penalties** imposed by competent authorities in individual member states against non-compliant companies, the draft Sustainability Directive also provides for exposure to **civil liability** for companies that fail to comply with the Directive's prevention and mitigation measures and, as a result, precipitate or perpetuate certain human rights abuses. Notably, the draft Sustainability Directive also imposes a new duty of care on an EU-based company's directors for the implementation and oversight of a robust corporate sustainability due diligence process. As of the date of this writing, however, a finalized version of the draft Sustainability Directive has yet to be adopted by the European Parliament and Council.

The EU Corporate Sustainability Reporting Directive (CSRD)

The EU also acted swiftly in the fall and winter of 2022 to enact a new **Corporate Sustainability Reporting Directive** (CSRD) that — in connection with the Sustainability Directive — is also intended to elevate the importance of human rights and environmental considerations in an organization's operations. While EU law already requires certain large companies to disclose information concerning the management of social and environmental challenges, the adoption of the European Green Deal in December 2019 led to a more holistic evaluation of current reporting requirements with a view towards addressing potential deficiencies. This culminated in the April 2021 adoption by the European Commission of a comprehensive proposal for a Directive of the European Parliament and Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) 537/2014, as regards corporate sustainability reporting. The finalized CSRD – with minor amendments from the original proposal – was officially adopted by the European Parliament and Council and published in the EU's Official Journal on December 16, 2022.

Among other things, the CSRD significantly expands the scope of reporting requirements to encompass all large companies, whether publicly listed or not, and without regard to the current 500-employee threshold referenced in the current iteration of the EU's **Non-Financial Reporting Directive** (NFRD). Notably, the CSRD also applies to **non-European companies** (Third-Country Undertakings) generating a net turnover of €150 million and with at least one subsidiary or branch physically present in the EU.

Pursuant to the CSRD, such third-country undertakings are legally obliged to report on a similar set of operational impacts respecting certain environmental and social concerns as their EU-based counterparts. These concerns include, but are not limited to, a company's effects on environmental rights, social rights, human rights, and its capacity for the implementation of effective corporate governance measures. The CSRD also applies to certain small and medium enterprises (SMEs) whose securities are admitted to trading on a regulated EU market, although the CSRD emphasises that SME reporting obligations should be "proportionate" to their respective "capacities and resources" and "relevant to the scale and complexity of their activities."

Under the CSRD, primary responsibility for developing uniform EU sustainability reporting standards is delegated to the European Financial Reporting Advisory Group (EFRAG). In November 2022, EFRAG finalized and published a **set of initial standards** centered around four principal areas. These areas include general requirements/disclosures, environmental concerns, social matters, and governance standards. Under the rubric of environmental concerns, affected companies are obliged to report on activities implicating climate change, pollution, water and marine resources, biodiversity and ecosystems, and natural resource use. With respect to social matters, companies are obligated to report on the state of their own workforce, **as well as the workforce in their extended value chains,** in addition to considering the impact of their activities on consumers and the community at-large. In this vein, it is important to note that the foundation of the new CSRD is the concept "double materiality," under which affected organizations are obliged to report on how the company is both affected by – and in turn influences – external factors that contribute to detrimental societal and environmental outcomes.

The principal effect of the new legislation on the regulation of global supply chains is to provide greater visibility into how the various elements of an organization's operations — and their value chains — affect (or conversely, are affected by) emerging concerns related to environmental, social and governance (ESG) risk factors. This includes greater transparency into the social dimension of ESG, with a heightened focus on how organizations are contributing to workplace safety, fostering sound labor practices (including but not limited to, the promotion of collective bargaining and the avoidance of both forced and child labor), and promoting the concepts of equality, non-discrimination, and diversity and inclusion in the context of their operations. As with the Sustainability Directive, the inclusive nature of the CSRD's coverage to encompass value chains requires organizations to maintain sufficient procedures and processes — in the form of due diligence or otherwise — to account for the factors contained in the initial EFRAG standards.

The CSRD enters into legal force 20 days after publication and must be transposed by member states into their respective bodies of domestic law within 18 months. Notably, the EU has taken a gradual approach to implementation of the new disclosure requirements. From January 1, 2024, large public interest companies (those with over 500 employees) already subject to the NFRD will also be subject to the CSRD, with reports due in 2025. Large companies that are not currently subject to the NFRD will be subject to the new rules commencing January 1, 2025, with reports due in 2026. Finally, publicly listed SMEs and other undertakings will be obliged to follow the new rules beginning January 1, 2026, with reports to follow in 2027 – however, SMEs may choose to "opt-out" of CSRD coverage until 2028.

European National Supply Chain Due Diligence Regulations

In addition to broader developments at the transnational level, several individual EU member states like France — and most recently, Norway and Germany — moved to adopt their own supply chain regulations — part and parcel of a growing trend by foreign jurisdictions to advance human rights and environmental considerations in the context of ethical business practices over the last five years. Building on the French due diligence regulation originally promulgated in 2017 — known as the "Duty of Vigilance Act" (Loi de Vigilance) — both the Norwegian Transparency Act and German Supply Chain Act require a significant

amount of introspection by organizations concerning the manner in which their activities contribute to environmental degradation and negative social outcomes, including poor working conditions and human rights abuses.

German Supply Chain Due Diligence Act

Entered into force effective January 1, 2023, the German Supply Chain Due Diligence Act or *Lieferkettensorgfaltspflichtengesetz* (LkSG) broadly applies to all forms of enterprise with a base or branch in Germany and at least 3,000 employees. Pursuant to the LkSG, affected enterprises are now legally obliged to conduct both human rights and environmental impact related due diligence respecting their supply chains.

Under the LkSG, the term "supply chain" is broadly defined, and includes:

- An enterprise's own products and services
- All steps in Germany and abroad that are necessary to produce the product/provide those services
- The actions of an enterprise conducted in its own business area (whether carried out in Germany or abroad)
- The actions of **direct suppliers** (contractual partners for the supply of goods or services necessary to produce a product or provide a service)
- The actions of **indirect suppliers** (enterprises not constituting a direct supplier but whose own supplies and/or services are integral to the production of the final product or provision of the relevant service)

Generally speaking, while the due diligence obligations imposed by the LkSG on affected companies vary by role (e.g., whether the due diligence concerns the enterprise itself or the operations of its direct and indirect suppliers), affected enterprises are required to:

1. Establish an effective risk management system;
2. Conduct regular and appropriate risk analyses to identify human rights and environment-related risks in its own operations, as well the operations of its direct and indirect suppliers (where applicable);
3. Adopt preventative measures to address any human rights or environmental risks identified;
4. Take appropriate remedial measures to end or minimise the extent of any human rights or environmental impact already in progress;
5. Implement an appropriate complaints procedure; and
6. Document and periodically report on the foregoing obligations.

The aforementioned obligations are **intentionally expansive** and designed to encompass the **entirety** of the affected company's supply chain. Under the LkSG, "supply chain" is specifically defined as encompassing all steps whether in Germany or abroad that are required to produce the products and provide the services of a company — beginning with the extraction of raw materials up to the point of delivery to the end customer. Violations of the LkSG are punishable by significant monetary penalties. For breaches of certain obligations, Section 24 of the LkSG explicitly provides that fines of up to €800,000 or two percent of annual turnover for companies with an annual turnover of more than €400 million may be imposed.

Norwegian Transparency Act

The **Norwegian Transparency Act** (Transparency Act) officially entered into force on July 1, 2022. Among other things, the Transparency Act requires both domestic and certain foreign companies doing business in Norway to implement and account for certain aspects of human rights due diligence in the operations, supply chain, and product/service lifecycle. The three primary obligations of organizations subject to the Transparency Act are: (1) the conduct of human rights due diligence; (2) periodic public reporting on the status of a covered organization's human rights due diligence activities; and (3) responding to information requests from members of the public concerning human rights and working conditions in the covered organization's area of operations, as well as the organization's value chain.

With respect to the first requirement — namely, the conduct of human rights due diligence — the Transparency Act requires Norwegian public limited and listed companies, as well as certain foreign companies that pay taxes in Norway, to carry out third-party due diligence in accordance with existing OECD Guidelines for Multinational Enterprises. "Due diligence" is defined by the Transparency Act as consisting of the following:

(1) embedding responsible business conduct into an organization's policies;

(2) identifying and assessing actual and potential adverse impacts on "fundamental human rights and decent working conditions" that are either caused by, or exacerbated by, the organization's operations, products or services via its supply chain or business partners;

(3) implementing "suitable measures" to cease, prevent, or mitigate such adverse impacts;

(4) tracking the implementation and results of measures taken in response to those impacts;

(5) communicating with "affected stakeholders and rights-holders" concerning how identified adverse impacts are being addressed; and

(6) assisting with remediation efforts and providing compensation to affected persons and communities where required or appropriate.

Pursuant to Section 4, the due diligence required by the Transparency Act must be carried out on a regular basis; in proportion to both the size and nature of enterprise, as well as the context of its operations; and according to the "severity and probability" of adverse impacts on fundamental human rights and decent working conditions.

Under the public reporting requirement of the Transparency Act, covered organizations are required to formally account for their due diligence obligations by publishing a statement that, at a minimum, contains a general description of the covered organization's structure and areas of operations; sets forth guidelines and procedures for handling actual and potential adverse impacts on fundamental human rights and decent working conditions; furnishes adequate information concerning actual adverse impacts and "significant risks of adverse impacts" that the covered organization has identified in the course of due diligence; and describes the measures the organization has implemented, or plans to implement, to cease actual adverse impacts or mitigate significant risks associated with those impacts. Section 5 of the Transparency Act further stipulates that a covered organization must make this information "easily accessible" on the company's website. A covered organization may also incorporate this information into its social accountability report due pursuant to the Norwegian Accounting Act. The information must be published and updated no later than June 30 of each calendar year beginning in 2023.

Finally, Section 6 of the Transparency Act requires covered organizations to make publicly available any information concerning actual and potential adverse impacts identified pursuant to the organization's due diligence efforts. According to the plain language of the act, this includes both general information and more specific details related to a product or service offered by the enterprise. Notably, however, requests may be denied by an organization if:

(1) the request fails to provide a sufficient basis for identifying what the request concerns;

(2) the request is clearly "unreasonable"; z

(3) the request implicates data related to an individual's personal affairs; or

(4) the request concerns operational and other business matters of a proprietary nature, the release of which would compromise the organization's competitive posture.

Responsibility for the implementation and oversight of the Transparency Act is delegated to the Norwegian Consumer Authority. For covered organizations that remain non-compliant with the Transparency Act's requirements, the Norwegian Consumer Authority is empowered to issue prohibition orders and to assess administrative penalties, taking into consideration the "severity, scope and effects of the [subject] infringement."

Proposed Update to UK Modern Slavery Act

While His Majesty's Government has expressly **declined** to follow the EU's lead in adopting legislation substantially equivalent to the proposed EU Sustainability Directive, in late spring 2022, the government utilized the occasion of the **Queen's Speech** to herald its intention to update the U.K.'s Modern Slavery Act, first enacted in 2015.

Under the government's proposed revisions, businesses with a turnover of £36 million or more would be required to publish a modern slavery statement on an annual basis that sets forth in considerable detail the measures taken by the company to prevent modern slavery from occurring in their operations and supply chains. Unlike the current version of the act which prescribes no particular format for Modern Slavery Act disclosures, the proposed revisions would mandate that companies include certain information in their annual report concerning:

- Their structure, business and supply chains
- Relevant policies and due diligence processes
- Identification of those parts of its own operations and supply chains where a risk of modern slavery exists and the measures taken by the company to manage that risk
- A statement concerning the effectiveness of the company's efforts in ensuring that modern slavery is not taking place in its operations or supply chains
- Details concerning the training available to the company's staff with respect to modern slavery.

The proposed revisions would also require that annual statements be published on a government-run registry and impose civil penalties on organizations that fail to comply with the new disclosure requirements. To date, however, no legislation has been introduced in either house of Parliament that would formally codify the modest changes announced by the Government into law. Nonetheless, as international pressure intensifies — owing to the sheer ubiquity of emerging supply chain regulation in the EU and elsewhere — we anticipate that the U.K. will be pressured to move from what is tantamount to an amorphous, voluntary disclosure regime, to a more structured, mandatory framework that will require U.K. companies and organizations conducting business in the U.K. to be more transparent with the forced labor risks inherent in their operations.

Regulatory Developments in North America

Laws Impacting Supply Chains in the United States

Supply chain activity respecting human rights and environmental considerations has been more limited in the United States. While the U.S. Securities and Exchange Commission (SEC) published a proposed climate change disclosure rule in the spring of 2022 – that, among other things, would require public companies to incorporate certain climate-related financial data and greenhouse gas emissions disclosures in public filings – federal government activity in general has been more constrained in comparison with foreign jurisdictions, likely owing to the unique state of a deeply divided domestic political climate.

Nonetheless, the U.S. did move swiftly to implement several facets of the newly-enacted Uyghur Forced Labor Prevention Act (UFLPA) that was signed by President Joe Biden into law in late-December 2021. Pursuant to the UFLPA, the importation of any goods into the United States made with forced labor – including those goods mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region of China – are strictly prohibited. Among other things, the UFLPA establishes a rebuttable presumption that goods originating from the Uyghur Autonomous Region were made with forced labor and are therefore prohibited from entry into the United States.

Under preliminary operational guidance issued by U.S. Customs and Border Protection (CBP) in June 2022, importers were advised to implement and maintain a system of continuous supply-chain mapping and monitoring to ensure that their products were not produced either wholly, or in partial reliance on, forced labor of any kind. Moreover, to overcome the statutory presumption that products originating from the Uyghur region were manufactured in reliance on such labor, CBP advises importers to maintain appropriate "documentation tracing the supply chain from raw materials to the imported good." Such documentation includes, but is not limited to, affidavits from each company or entity involved in the production process, purchase orders, invoices, packing lists, bills of material, and certificates of origin.

Proposal for Canadian Modern Slavery Legislation

As of April 26, 2023, the Canadian equivalent of the U.K.'s Modern Slavery Act has been introduced and read for a third time in the House of Commons, where debate continues. While still in proposed legislation form, if ultimately enacted by the Canadian Parliament, Bill S-211 — aptly titled "An Act to enact the Fighting Against Forced Labour and Child Labour in Supply Chains Act and to amend the Customs Tariff" (Canadian Modern Slavery Act) — would impose certain due diligence and mandatory reporting requirements on covered organizations. Under the current iteration of the bill, the Canadian Modern Slavery Act would apply broadly to any company listed on a Canadian stock exchange, and to any company doing business or holding assets in Canada that meet certain thresholds and that produces, sells, or distributes goods in Canada or elsewhere, or otherwise imports goods into Canadian territory.

Any company subject to the Canadian Modern Slavery Act would be required to publish on its website and submit to the Minister of Public Safety and Emergency Preparedness an annual report by May 31 of each calendar year outlining the steps it has taken to reduce the risk that forced and child labor is being utilized in its supply chain. At a minimum, the report must include a description of the company's supply chain; an explanation of its existing forced labor policies and due diligence processes, as well as training and other steps taken to sufficiently manage forced labor risk; reference to specific measures taken to remediate forced or child labor concerns identified by a covered company; and an assessment of the effectiveness of the covered company's efforts in ensuring that forced and child labor are not being utilized.

Under the proposed law, companies may choose to submit their own reports, or in the case of closely related companies, they may opt to submit a single comprehensive report covering all of their various affiliates and subsidiaries. Underscoring the importance of identifying and ending or mitigating forced labor practices is the fact that the Canadian legislation applies with equal force to public institutions — namely, any federal government institution in Canada that "produces, purchases or distributes goods" domestically or abroad. Federal institutions are required to adhere to the same reporting requirements as private entities.

Considerations for Businesses With Global Supply Chain Exposure

From a practical perspective, the adoption of more stringent due diligence and disclosure standards across multiple jurisdictions requires organizations evaluate their existing third-party risk management practices to ensure alignment with emerging legal requirements. It is indisputable that organizations with sizable international operations face the greatest compliance challenges. It is equally true, however, that such organizations can develop a cohesive strategy for managing their obligations by closely monitoring regulatory developments and adopting new policies and procedures designed to meet or exceed current expectations.

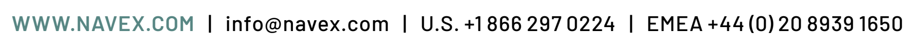
As a practical matter, then, this means large corporations can't avoid forced-labour compliance issues. They need to strengthen their capabilities to identify and reduce such abuses in their supply chains. Above all that means better due diligence of suppliers, asking them about forced labour and screening against other sources; providing training to procurement employees and even key suppliers themselves; and confirming that your internal reporting systems can handle allegations of forced labour either from their own employees or those of the suppliers.

To do so, organizations must be intimately familiar with the nature and extent of their operations – from the provision of raw material to the manufacturing of the product, and ultimate distribution to the final end-user. To that end, organizations should consider carefully mapping the entirety of their value chains to capture entities and individuals **directly involved** in the product or service lifecycle. Once identified, organizations should objectively evaluate the potential risk posed by each actor forming part of their value chains from a human rights and environmental welfare perspective. In the case of entities and individuals indirectly or peripherally involved in enabling a covered organization to provide a service or product, some degree of due diligence is required, although from a practical standpoint, it may be possible to rely on contractual assurances as the primary means of mitigating regulatory risk.

In addition, third parties with whom the organization contracts in countries or regions with lax human rights protections and poor environmental records should be subject to both initial and recurring comprehensive due diligence, as well as continuous monitoring. Such third parties should also be contractually bound to permit the primary organization to periodically audit its books, records, policies, and procedures for evidence of compliance with the organization's human rights and environmental stewardship policies. Organizations lacking such policies should immediately move to implement them and adjust policy and procedure particulars to conform to specific national and transnational legal requirements.

Moreover, organizations must be committed to ensuring their activities do not contribute in any major way to human rights abuses and/or environmental degradation. To that end, each constituent team within the organization — and external business partners — should be cognizant of the emerging importance of supply chain transparency and accountability measures and be empowered and encouraged by leadership to report any suspected violation of the law or company policy. The company itself should also carefully consider whether the benefit posed by conducting activities in certain countries or regions with poor social or environmental records justifies the exposure to risk created by emerging legislative and regulatory requirements.

As concerns over human rights abuses and environmental degradation continue to dominate the global regulatory landscape, we can expect to see a steady increase in jurisdiction-specific due diligence and reporting requirements that are intended to force organizations to come to terms with oft-neglected unintended consequences associated with their operations. While the nature and extent of such legislative and regulatory schemes may vary considerably – owing, at least in part, to a lack of international consensus over which specific environmental and social goals should be prioritized over others — companies must become acquainted with these requirements, and appropriately adjust their compliance programs to account for social and environmental considerations.



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