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The Next Compliance Deluge

Understanding foreign states' mandatory corporate social responsibility reporting

- » Corporate Social Responsibility (CSR) has evolved from a "nice idea" or "marketing opportunity" to a true business imperative.
- » Companies are increasingly becoming sophisticated with respect to CSR reporting and are checking internationally accepted reporting guidelines for comparison and bench marketing.
- » Consumer boycotts, shareholder lawsuits and states are willing to prosecute companies that provide inaccurate disclosures. Counsel needs to become conversant with human rights law, environmental law and international mandatory CSR reporting standards.

Illustration by Peter Giesbrecht

Henry Thoreau once mused *"What we call wildness is a civilization other than our own."*[1] Picking up on the theme, scouring other countries' national mores, standards and priorities concerning human rights, the environment, labor practices and other social and governance issues for inspiration and practical lessons was once the luxury of the inquisitive scholar or traveler. For litigators representing business interests in the "wilderness" of other nations, in contrast, domestic corporation law was the only platform dictating behavior. Little attention was paid to the effects a foreign organization might have on the local population, rule of law, or ecosystem. This *terra incognita* approach to comparative law, however, began to erode as the concept of CSR began to gain transnational currency.

While CSR today may have the attention of corporate counsel, executives, and board members, this was certainly not always so. CSR, indeed, has undergone a dramatic revolution – a revolution that should be front-of-mind for litigators working with transnational clients. The practice has evolved from a "nice idea" or "marketing opportunity" to a true business imperative mandating compliance.

CSR reporting is variously referred to as environmental, social and governance reporting (ESG), integrated reporting, or Global Reporting Initiative (GRI) compliance. Setting aside the issues of nomenclature, they all share a similar focus on laws and business behavior at the intersection of three key areas: human rights (broadly defined), impact on the environment, and how a company conducts itself with regard to corporate behavior such as bribery and labor laws. Disclosure, thus, is the name of today's CSR game.

2012 and Beyond: The United States Transformed Into the Global CSR Leader

While legislatively-dictated CSR was once viewed as a largely European-led phenomenon, between 2011 and 2012 the United States rocketed to a position of

1. *The Journal of Henry David Thoreau*, February 16, 1859 entry (Houghton Mifflin Co., 1906).

primacy when it comes to enacting new and innovative CSR initiatives. There, indeed, has been a veritable U.S. groundswell of recent (and recently-announced) CSR laws and regulations, including the Executive Order On Strengthening Protections Against Trafficking in Persons in Federal Contracts, California Transparency in Supply Chains Act, Business Transparency in Trafficking and Slavery Act, and the Security and Exchange Commission's (SEC) Conflict Minerals Rules. Despite the recent U.S. Supreme Court ruling in Kiobel v. Royal Dutch Petroleum,[2] these enactments, alongside European efforts and newly emerging legal principles around corporate responsibility emanating from the United Kingdom among other places, make for a new disclosure regime.

Today's compliance reality is that, while specialization certainly has its place, businesses and organizations are well advised to seek compliance professionals with broader compliance experiences to help them devise customized, integrated compliance programs that are responsive to the broad spectrum of today's domestic and foreign risks. To underscore this point, consider the focus and scope of some of these new U.S. laws.

Executive Order on Strengthening Protections Against Trafficking in Persons in Federal Contracts

On September 25, 2012, President Obama signed a landmark Executive Order aimed at rooting out human trafficking in federal contracting. To strengthen the government's zero-tolerance policy on human trafficking by federal contractors and subcontractors, the Executive Order prohibits federal contractors (and their subcontractors) from engaging in a number of trafficking-related activities, such as using misleading or fraudulent practices to recruit employees or destroying or confiscating an employee's identity documents. Although Federal Acquisition Regulation (FAR) rules are expected to be released any day now, the Executive Order seeks to require all federal contractors and subcontractors to take the mandatory actions including: taking concrete steps to prevent employees engaging in trafficking; filing annual certifications confirming that neither the contractor nor its employees engaged in any trafficking-related activities; developing and maintaining detailed compliance plans for contracts exceeding $500 million and involving services to be performed abroad; and reporting any activities "inconsistent with" the Executive Order.

Groundbreaking Disclosure Rule: California Transparency in Supply Chains Act

The California Transparency in Supply Chains Act of 2010, which went into effect on January 1, 2012, applies to all:

1. retail sellers and manufacturers;
2. with more than $100 million in annual global gross receipts;
3. that "do business" in California.

The Act requires these businesses to disclose (through a link on the homepage of their websites) in considerable detail their efforts to eradicate slavery and human trafficking from their direct supply chains for tangible goods offered for sale.

SEC Conflict Mineral Disclosure Rules

The SEC's promulgation of the Dodd-Frank Wall Street Reform and Consumer Protection Act disclosure and reporting rules concerning "conflict minerals" defines in the Act conflict minerals to include gold, tin, tantalum, tungsten and their derivatives, or any other mineral or mineral derivative as determined by the Secretary of State to be financing conflict in "covered countries" – the Democratic Republic of Congo or an adjoining country. Subject companies, beginning for calendar year 2013, must conduct a reasonable country of origin inquiry, due diligence on source suppliers and report via the filing of Form SD with the SEC.

The Promises and Pitfalls of CSR Reporting

Hitherto, the United States had appeared to lag behind other countries in issuing CSR reports, largely because CSR reporting in the United States has been unregulated. However, with this patchwork of new regulations, a reporting regime is gradually forming. As a consequence, different types and names of reports exist under the umbrella of CSR reporting. By way of example, consider "trafficking reports," "climate change reports," "environmental reports," or the catch-all "sustainability report" or "CSR report."

Regulated or not (and compulsory or not), scores of Fortune 500 companies annually let their stakeholders know what they are doing to comply with compulsory

2. *Kiobel, et al. v. Royal Dutch Petroleum*, SCOTUS, 10-1491

U.S. and foreign laws and regulations, as well as their "voluntary" CSR efforts. While such reporting has many benefits, there are also some very real (and often overlooked) pitfalls. What is included in a company's CSR report may, for example, trigger government investigations, civil tort claims, class action lawsuits, shareholder and consumer initiatives, and other actions.

Failing to file, however, is in most countries (other than the United States) a rapidly disappearing option. For example, in India, France, Brazil and Malaysia, a listed company failing to file a CSR report runs the risk of being de-listed. Those counseling companies doing work in these geographies must be particularly attuned to these evolving issues.

Imagine Yourself in the Middle of This Situation…

It is an otherwise ordinary Wednesday when you get an email informing you that protestors are amassing outside your client's Paris headquarters. Their placards decry human rights abuses and call for an end to "the slave trade" at one of your client's Asia-based assembly plants. You just finished a call with the client-company's general counsel when she phones back to tell you that the company has just been served with process by a non-profit at their corporate offices in California. The suit alleges that one of the company's most popular products, frequently touted for its "green credentials" because it was made with "90% recycled materials," is deceptive and that the client is engaged in "green washing."

The client prides itself on its reputation in the marketplace as an environmentally conscious corporation. The company's annual report even had a section in it regarding efforts to source and incorporate recycled material into their products and touting their commitment to "treating all employees fairly" and that they made an "effort to monitor their third-party manufacturing operations in Asia."

Later in the week, the senior vice president of Asian operations contacts the general counsel to tell her that he has just received notice from an overseas securities regulator where their subsidiary was listed, informing the company that, because the company had failed to file the new mandatory CSR report, it is being investigated. Meanwhile, workers in the Asian assembly plant had gotten wind of the demonstrations in Paris and taken their story to the international press, alleging that local labor officials had been bribed to look the other way, allowing children to be hired on the assembly lines. By Monday, the company share price has dropped and appears to be on the decline.

Consumer groups or human rights activists are frequently the first to raise a question or make an issue out of something a company has reported on, or failed to mention, in its CSR report. Consider the recent U.S. Supreme Court ruling on requirements for class certifications[3] granting that plaintiffs claiming material misstatements in a securities fraud claim did not have to prove the misrepresentation materially affected the stock price. Inquiries by private parties can, in turn, prompt questions by authorities or regulators in host countries. An allegation of labor officials being paid to look the other way when children are involved or working conditions fail to meet standards can turn into a bribery investigation, prompting the interest of U.S. regulators as well as those in the host country. Conversely, an investigation into allegations of corruption may identify potential violations of labor rights or evidence of human trafficking. If a company has incorrectly claimed in its annual CSR report to have examined its supply chain and determined it clean, this could be grounds for a shareholder or consumer claim against the company for publishing false or misleading information. Corruption, human rights, environmental practices and labor policies all roll up under CSR and increasingly are having material financial impacts on corporate balance sheets.

If the company's annual report touches on its CSR policy, but fails to make mention of problems, boycotts can ensue and shareholder or consumer class actions may be launched against the company for failing to disclose critical information. Attorneys counseling organizations issuing CSR disclosures must, therefore, ensure that they can be backed up by hard data.

Additionally, if a company is listed on one of the exchanges that now require transparency, but has failed fully and accurately to report both the efforts it has made to meet CSR international norms (or has downplayed challenges in meeting CSR obligations), the company could face possible de-listing, prompting perhaps yet another shareholder lawsuit.

Some form of mandatory CSR-related reporting already exists in Argentina, Austria, Belgium, Brazil, Denmark, China, France, Germany, Greece, India, Indonesia, Italy, Malaysia, the Netherlands, Norway, Portugal, Spain, Sweden, and the United Kingdom. Many directives of international institutions are now ratified by states, for example the United Nation's (UN) Guiding Principles on Business and Human Rights, ratified in 2011 [stating that all businesses have direct responsibility for all of the ways in which they impact and prevent human rights abuses their actions cause, while obligating them to ensure adequate remedies exist to address reported abuses]; mandatory ESG reporting efforts by the European Union (EU) (anticipated to be passed in 2013); the UN World Economic Forum; and the UN Declaration on the Rights of Indigenous People. This means that between local country law and international treaties, many

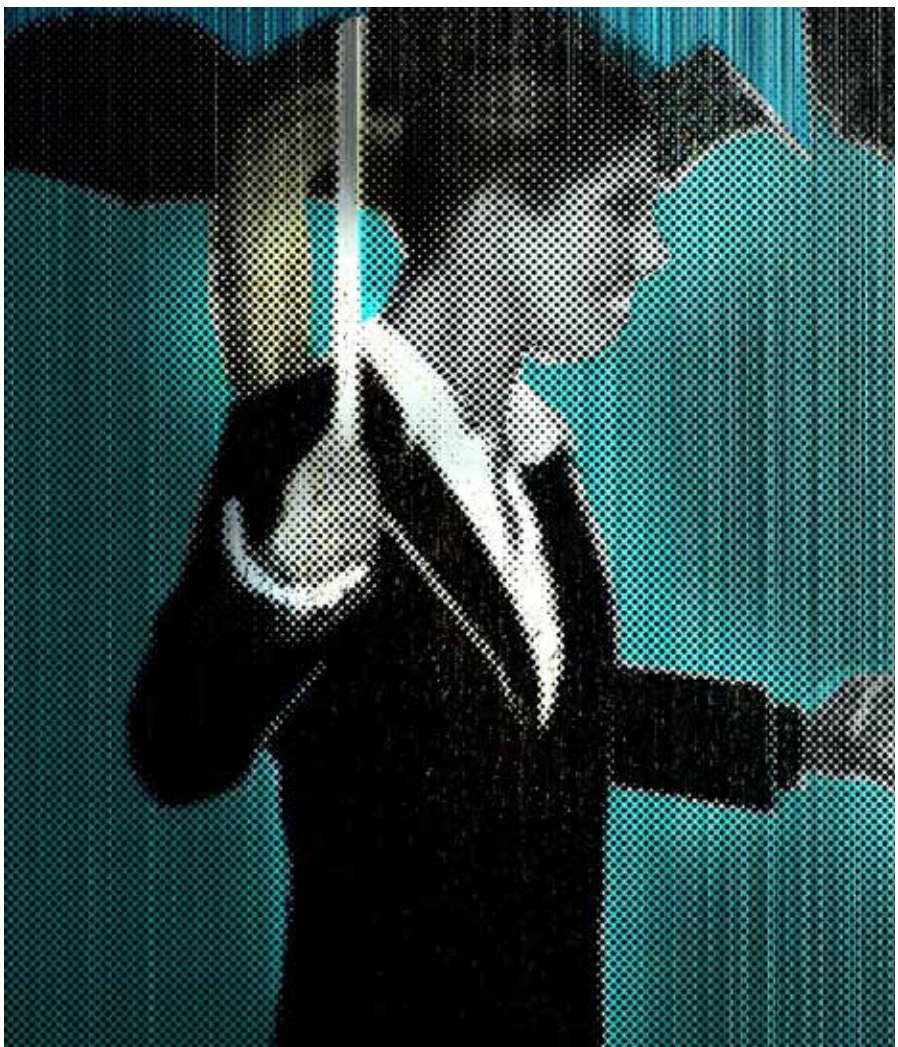
3. SCOTUS, Amgen, Inc. v. Connecticut Retirement Plans (11-1085)

multinationals are obligated to comply with and report under multiple CSR reporting laws. That wilderness of differing values in different countries can mean operating under conflicting and overlapping regulations, increasing the chance for violations of the disparate laws and follow-on investigations and litigation.

Many of the most recent international CSR reporting requirements have emanated from securities regulators. By way of illustration, in May 2008, the Shanghai Exchange issued the Shanghai CSR notice, informing all listed companies that henceforth they were expected to establish a CSR strategy and to file an annual report detailing what steps each company has taken to achieve its CSR elements (such as employee health and safety, environmental quality, etc.). This was followed recently by the Chinese Government's Assets Supervision and Administration Commission (SASAC), which issued a directive in early January of 2012 for sustainability reporting by all state-owned enterprises (SOEs). Spain, too, passed in 2012, a Sustainable Economy Law requiring all state-owned companies to produce sustainability reports and all businesses with more than 1000 employees to produce an annual CSR report and file it with the *Consejo Estatal de Responsabilidad Social de las Empresas.*

How to Get Ahead of the Problem(s)

Familiarity with the CSR reporting standards required of businesses in the country or countries where your client is conducting business is crucial to building an advance defense via the CSR report. Corporate culture has typically removed both the general counsel's office and its external litigation team from CSR departments, lodging them in marketing, public relations, or even human resources. But increasingly, the CSR policies and the way in which a company discloses how it implements those policies have a direct impact on the legal department and ultimately the matters on which external litigators will defend the company. Stakeholders are increasingly sophisticated with respect to CSR reports and are checking internationally accepted reporting guidelines for comparison and benchmarking, meaning that companies and their counsel need to be cognizant of international norms around expected CSR behaviors and reporting.



The uptick in "name and shame" campaigns, consumer boycotts, shareholder lawsuits and states willing to prosecute companies means that the risks involved with inaccurate disclosures cannot be ignored. Business trial lawyers as well as corporate counsel need to become conversant with human rights law, including anti-trafficking efforts, environmental law, and international mandatory CSR reporting standards, among other things.

Compliance professionals recognize that today's effective CSR compliance and reporting go far beyond simply arranging for the occasional FCPA training, patching together an "Environmental Sustainability Report," or maintaining a "paper-only" code of business conduct. By coordinating compliance efforts to address the various risks sketched out above, businesses put themselves in the best position to avoid potentially devastating criminal and civil liability. Moreover, these companies may avoid consumer and advocacy group actions, and can demonstrate to U.S. and foreign authorities that their compliance efforts are genuine and up to contemporary best-practices standards.