Developing a CSR Supply Chain Compliance Program

PAUL O. HIROSE, PERKINS COIE LLP, WITH PRACTICAL LAW COMMERCIAL

A Practice Note describing key points to consider when developing and implementing a corporate social responsibility (CSR) supply chain compliance program. It addresses preliminary steps a company should take before drafting CSR policies and procedures, such as assessing relevant CSR laws and other supply chain risks and assembling a CSR program design and compliance team. This Note also discusses considerations regarding how to enforce and respond to violations of CSR policies and procedures.

Companies are increasingly held responsible for the unethical or socially or environmentally irresponsible acts of third parties, including possible unknown entities several tiers up or down the supply chain. For example, a US manufacturer can face liability because of its supplier’s:

- Human rights violations.
- Unethical employment practices.
- Corruption.
- Actions causing environmental harm.

Liabilities can be severe. For example, these third-party actions can subject a company to:

- Civil or criminal liability.
- Harm to its reputation or business standing.

To counteract this exposure, many US companies adopt corporate social responsibility (CSR) policies and procedures (referred in this Note collectively as a CSR supply chain compliance program or CSR program). By adopting a CSR program, companies make plans and decisions (for example, selecting a supplier) that reflect the potential impact of corporate actions on various stakeholders and constituencies (for example, requiring suppliers to provide their employees with safe working conditions).

This Note:

- Suggests steps to consider as a company develops and implements a CSR program.
- Discusses enforcement-related considerations.
- Helps companies to address CSR program violations.
- Does not address CSR obligations:
  - applicable to federal government contracts; or
  - outside of the jurisdiction of the US.
- Is not company- or industry-specific and therefore does not necessarily list every step a company must take to:
  - comply with the requirements of all relevant CSR laws and regulations; or
  - conform to relevant industry standard model policies.

For a business briefing for in-house counsel to give business executives to educate them on CSR by defining CSR and explaining why CSR and CSR programs should be important to the company, see Practice Note, Corporate Social Responsibility in US Supply Chains: Business Briefing (http://us.practicallaw.com/5-590-7966).

CSR SUPPLY CHAIN COMPLIANCE PROGRAMS DEFINED

A company that has a CSR program is more likely to have a corporate culture that emphasizes responsibility and integrity and decreases CSR-related risks by avoiding or mitigating legal violations and injury to its brand. Most comprehensive CSR programs have written rules that require officers, employees, suppliers, agents, business and development partners to take actions to meet and exceed relevant legal, regulatory and industry standards (see CSR Laws and Regulations). These written rules typically include:

- **A code of conduct.** This sets guidelines (including those related to CSR) for employees and management to clarify and make decisions that are consistent with the law and the company’s mission, values and principles (see Code of Conduct).
- **CSR policies.** These specific rules support the CSR guidelines within the code of conduct (see Policies).
- **CSR procedures.** These set out the acts or means to comply with a company’s CSR policies (see Procedures).
To help ensure effectiveness, a company must meaningfully implement and consistently and thoroughly enforce the written CSR program documents (see Implement the CSR Supply Chain Compliance Program and Enforce the CSR Supply Chain Compliance Program).

ASSEMBLE A CSR PROGRAM DESIGN AND COMPLIANCE TEAM

Companies typically appoint an internal team to design and implement their CSR programs. To ensure that the team is effective, the company should select high-profile and well-respected company leaders, including top management, to champion and emphasize the importance of the company's commitment to the program. Companies typically staff their CSR teams with representatives from:

- Legal.
- Human resources.
- Procurement.
- Sales.
- Audit and compliance.

Depending on its needs, the company can supplement the internal CSR team with outside specialists, such as legal counsel, to assist in, among other things:

- Developing and documenting the CSR program.
- Educating personnel on the CSR program requirements.
- Interpreting and advising on the applicable CSR laws, policies and procedures.
- Supplier outreach and auditing.

DESIGNATE THE PRIMARY BUSINESS OWNER

To help ensure that its CSR policies and procedures are effective, the company should designate a primary business owner to develop, implement and enforce the CSR program. Designating a point person can:

- Cultivate a compliance-focused atmosphere that supports the CSR objectives.
- Increase the likelihood that employees ask important questions or identify important issues about CSR.
- Build cooperation within and across departments, locations, divisions and business units.
- Ensure accountability.
- Ensure that CSR policies and procedures are applied consistently throughout the organization and that the company handles its supply chain counterparty’s consistently, for example, regarding contract terms.

IDENTIFY AND ASSESS ACTUAL AND POTENTIAL SUPPLY CHAIN LIABILITIES

A well-crafted CSR program addresses actual and potential supply chain liabilities posed by:

- CSR laws and regulations (see Relevant CSR Laws and Regulations).
- Exposure specific to the company’s business, including its relationship with others in its supply chain (see Counterparty-specific Supply Chain Liabilities).

The company should also review the causes and effects of its past compliance violations and vulnerabilities. For example, the company should:

- Evaluate the impact and effectiveness of any responsive corrective measures that the company took in the past.
- Assess the likelihood of similar future violations.

Risks can be posed, shaped or impacted by the company’s:

- Business model and structure.
- Products and services.
- Business locations.
- Suppliers’, agents’ or business or development partners’ locations.

CSR LAWS AND REGULATIONS

At a minimum, the company should design, implement and enforce its CSR program to help ensure that the company adheres to CSR laws and regulations (CSR laws). To date, CSR laws include:

- The Securities and Exchange Commission’s conflict minerals rules (found in Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010) (the Conflict Minerals Rules), companies that are subject to Section 13 or 15(d) of the Securities Exchange Act of 1934 (as amended) must disclose their use of conflict minerals in the companies’ products (see Conflict Minerals Rule Compliance Toolkit (http://us.practicallaw.com/4-524-2148)).
- The Foreign Corrupt Practices Act of 1977 (FCPA), which prohibits subject companies from offering or paying anything of value to any person while knowing that any portion will be offered, given or promised to foreign government officials to assist in obtaining or retaining business (see Practice Note, The Foreign Corrupt Practices Act: Overview (http://us.practicallaw.com/0-502-2006)).
- The UK Bribery Act, which has broad extra-territorial application and generally prohibits bribing another person, being bribed by another person and bribing a foreign public official (see Practice Note, Bribery Act 2010 (http://us.practicallaw.com/5-500-8692)).
- The Sarbanes-Oxley Act of 2002, which generally requires public companies to implement practices and policies to ensure that a company’s financial statements fairly present the condition of the business and that effective internal control systems monitor financial reporting (see Practice Note, The Impact of Sarbanes-Oxley on Private Companies and Corporate Governance Best Practices (http://us.practicallaw.com/0-506-9348)).
- The US Travel Act (18 U.S.C. § 1952), which prohibits engaging in any inter-state or foreign travel or use the mail or facilities associated with foreign or inter-state travel with the intent to carry on or further any unlawful activity (see Practice Note, Anti-corruption regimes in the UK and US: a comparison of the UK Bribery Act 2010 and the US Foreign Corrupt Practices Act 1977: Commercial bribery generally (http://us.p02edi.practicallaw.com/0-503-0676#a905308)).
- The Food Safety Modernization Act (21 U.S.C. § 201-2252), which governs, among other things, the manufacturing, composition and ingredients, packaging, transportation and safety of food products.
- The Lacey Act (16 U.S.C. § 701), which is a US conservation law that prohibits trade in wildlife, fish and plants that have been illegally taken, possessed, transported or sold.
Maryland state laws that prohibit companies that fail to comply with the Conflict Minerals Rules from contracting with Maryland agencies (see 2012 MD H.B. 425 (NS)).

California laws that prohibit companies that fail to comply with the Conflict Minerals Rules from contracting with California agencies (see 2011 CA S.B. 861 (NS)). California also prohibits state contractors from furnishing products made by forced labor (see Cal. Pub. Cont. Code § 6108). California also requires companies to disclose actions they took to combat human trafficking and slavery in their supply chains under the California Transparency in Supply Chains Act of 2010 (Supply Chains Act), which (see Article, California Transparency in Supply Chains Act of 2010 (http://us.practicallaw.com/3-506-8314)). The Supply Chains Act applies a company that is all of the following:

- a retail seller or manufacturer as indicated on its California tax return;
- a company that does business in California; and
- a company with worldwide gross receipts in excess of $100 million.

Legislation similar to the Supply Chains Act is currently pending at the federal level.

For more information about CSR laws and regulations, see Practice Note, Corporate Social Responsibility and the Supply Chain: Relevant Legislation (http://us.p02edi.practicallaw.com/2-520-6599#a484090).

Even if a company believes it is not directly impacted by CSR laws, it should consider drafting CSR policies and procedures to help ensure compliance with all US CSR laws and regulations because:

- The current US legislative trend favors the expansion of CSR legislation. Therefore, even if a company is presently not directly impacted by CSR laws, it may be later.
- It may be indirectly affected by CSR legislation as a member of another company's supply chain to which CSR laws are directly applicable. Therefore, this supply chain counterparty may contractually obligate the company to adhere to CSR laws, for example, to improve its public disclosure profile.
- It can use this "beyond compliance" approach to better promote its brand.

### COUNTERPARTY-SPECIFIC SUPPLY CHAIN LIABILITIES

In addition to CSR laws, a company should consider CSR liabilities relating to its supply chain contracts. For example, a company with supply chain counterparties faces potential liability from:

- Its contractual obligations in its supply chain contracts. For example, a supplier may not want or be able to adhere to the CSR obligations required by its customer.
- Actual, potential or alleged compliance issues of suppliers throughout the company's supply chain. For example, a company's legal, reputation and business standing are at risk if its products include supplier components that the US Department of Labor identifies as having been produced by child labor.

### ASSESS THE COMPANY'S CULTURE AND CSR PRIORITIES AND ASPIRATIONS

Companies with successful CSR programs typically ensure that their programs are consistent with and support the companies' cultures and CSR-related aspirations. This allows a company to better:

- Understand, leverage and support the company's CSR-related strengths.
- Understand and address the company's CSR-related weaknesses.
- Ensure that the CSR program is consistent with and supports the company's values and priorities, which may bolster employee loyalty and strengthen the company's brand.

Therefore, before implementing a CSR program, the company should:

- Review existing mission statements, core values and policies.
- Assess the company's current culture, priorities and aspirations by:
  - reviewing management and employee behaviors, actions and goals;
  - commissioning a study to gauge both management and employee attitudes towards supply chain compliance; and
  - determining how the company can or should grow or evolve to accomplish and exceed the expectations and goals derived from the company's mission statements, core values and policies.
- Solicit employee input on program development and implementation, which helps employees to better understand, internalize and take ownership of the program and its goals.

### SET OUT A WORK PLAN, TIMELINE AND BUDGET

Before drafting and implementing a CSR program, the company should develop:

- A work plan. Members of the work group should understand their role in developing, implementing and enforcing the CSR program.
- A timeline. The company should set out reasonable but firm milestone dates by which the work group must complete its tasks.
- A budget. The company should allocate adequate financial and personnel resources to developing, implementing and enforcing the CSR program.

### DEVELOP CSR PROGRAM DOCUMENTATION

Although this Note discusses codes of conduct, policies and procedures as separate items, companies sometimes combine them or refer to them interchangeably (for example, a company may title a CSR document "CSR Policies" even though this Note categorizes this type of document as a code of conduct).

A company can better defend against an employee's or supply chain counterparty's violation of law or the company's CSR requirements if its CSR program documents are:

- Clear, concise and comprehensive.
- Specific to the company's:
  - industry;
  - business lines;
  - corporate structure; and
  - legal and regulatory regimes of the jurisdictions in which it does business.
For example, if the company’s suppliers are located in developing countries where exploitation is a greater threat, then the company should develop more stringent codes, policies and procedures applicable to its suppliers. Conversely, a general off-the-shelf program may be ineffective and may not be given much weight as a mitigating factor if a violation occurs.

The company must determine to whom the CSR program is applicable. For example, the company may determine that the CSR program is applicable to the company’s:
- Directors, officers, managers and employees.
- Suppliers.
- Agents.
- Business and development partners, for example its strategic alliance partners.

The company must also determine, based on its nature (for example, the company’s business lines and applicable regulatory regimes), whether the company’s CSR program rules and guidelines either:
- Comprise stand-alone CSR program documents.
- Are incorporated into the company’s other general corporate codes, policies and procedures.

**CODE OF CONDUCT**

Often referred to as a code of ethics, a company’s code of conduct:
- Contains the content required by federal, state and local laws (for example, public companies’ codes typically address the requirements of the Sarbanes-Oxley Act of 2002 and the corresponding requirements adopted by the applicable securities exchange).
- Sets out high-level priorities and aspirations to allow an employer to promote professionalism and corporate values and to raise awareness of potential conflicts of interest.

Common topics that address a company’s priorities, aspirations and commitments in the company code of conduct include:
- Corporate mission statement.
- Compliance.
- Conflicts of interest.
- Insider trading.
- Protection and use of company assets.
- Accounts and record keeping.
- Nondiscrimination.
- Freedom of association.
- Employee safety and health.
- Employee privacy.

Several sections of a company’s code of conduct (for example, the sections covering the corporate mission statement, compliance and employee safety and health) typically include CSR-related guidelines such as:
- "The company’s core values—innovation, creativity, quality and reliability—will be reflected in our behavior and in our business conduct."
- "Employees, officers and directors should comply, both in letter and spirit, with all applicable laws, rules and regulations in the cities, states and countries in which the company operates." This compliance-related statement applies to applicable CSR laws, rules and regulations.

For a sample code of conduct applicable to a public company, see Standard Document, Model Code of Ethics and Business Conduct for a Public Company (http://us.p02edi.practicallaw.com/2-505-5388).

**POLICIES**

Policies are the company’s specific commitments that typically support the code of conduct’s CSR guidelines. Sample CSR-related commitments are:
- "We will reduce, reuse and recycle wherever possible."
- "When considering a business partnership, we will base our choice of partner not only on economic considerations, but also on other factors, including, where appropriate, safety, health, environmental management and sustainable conduct."
- "All forms of bribery are prohibited."

Each company should identify and consider adopting relevant recognized industry standards and best practices published by international organizations, non-governmental organizations and industry groups. For a discussion of model CSR policies, see Practice Note, Corporate Social Responsibility and the Supply Chain, Box: Model Voluntary CSR Policies (http://us.p02edi.practicallaw.com/2-520-6599#a374686).

**PROCEDURES**

Procedures set out the acts or means to comply with a company’s CSR policies. For example, CSR procedures commonly:
- Assign responsibilities for CSR policy implementation and enforcement (see Implement the CSR Supply Chain Compliance Program and Enforce the CSR Supply Chain Compliance Program).
- Set out CSR training requirements (see Train Impacted Parties).
- Set out CSR auditing and reporting requirements (see Institute an Internal and External Audit Process).

To be most effective, the company should draft its CSR procedures to:
- Enable the company to readily detect and prevent violations. For example, audit and reporting requirements help the company to better detect violations (see Institute an Internal and External Audit Process).
- Set out a remediation process to address actual and potential violations, for example, a detailed internal investigation procedure (see Plan for and Respond to Potential Violations or Flaws).
- Identify and adopt relevant recognized industry standards and best practices published by international organizations, non-governmental organizations and industry groups. For a discussion of model CSR policies, see Practice Note, Corporate Social Responsibility and the Supply Chain, Box: Model Voluntary CSR Policies (http://us.p02edi.practicallaw.com/2-520-6599#a374686).
- Direct employees to include provisions in supply and other third-party agreements that require counterparties to adhere to relevant portions of the company’s CSR program documents as appropriate.
Emphasize transparency and accountability, for example by:
- setting out discipline guidelines, including regarding termination, for compliance violations;
- listing reports that detail programs, initiatives and related results in annual reports and websites for view by current and potential investors and customers; and
- setting out audit guidelines for suppliers.

**IMPLEMENT THE CSR SUPPLY CHAIN COMPLIANCE PROGRAM**

To help ensure that all impacted parties and stakeholders understand and adhere to program requirements (as applicable), a company must communicate, publicize and promote:

- The program’s purpose and framework. For example, the company can state that the company is implementing the CSR program to:
  - adhere to applicable CSR laws and regulations;
  - address known compliance-related issues and areas for improvement; and
  - update policies and procedures.
- The company’s CSR compliance goals. For example, the company can state that it seeks to:
  - exceed legal and regulatory compliance requirements, for example by responding to suspected violations;
  - promote a culture of compliance and cooperation across and among business units, the legal department and compliance personnel; and
  - foster an environment that encourages reporting of actual and potential violations and protects against retaliation.
- The incentives for individual compliance. For example, the company can create an internal reward policy for those business units with superior compliance records.
- The consequences for breach. For example, termination of employment for serious compliance violations.

When implementing the program, the company must consider how to timely convey the relevant information to all impacted parties, including:

- Board members, officers, managers and other employees (see *Effectively Communicate with Directors and Employees*).
- External stakeholders, such as suppliers, agents, business partners and development partners (see *Effectively Communicate with External Stakeholders*).

**EFFECTIVELY COMMUNICATE WITH DIRECTORS AND EMPLOYEES**

In its internal communications, the company should:

- Publish and publicize readily accessible, clear and comprehensive CSR program documents.
- Educate company directors, officers and employees regarding:
  - the CSR program;
  - the potential personal and corporate exposure and liabilities for violations of the CSR program and the law; and
  - the personal and corporate benefits of compliance.
- Identify those with compliance responsibility, which often includes all directors, officers and employees.
- Characterize the responsible parties as teammates and facilitators (not impediments) to foster a collaborative atmosphere.
- Institute mandatory education modules and training programs tailored to the relevant audience (see *Train Impacted Parties*).

**EFFECTIVELY COMMUNICATE WITH EXTERNAL STAKEHOLDERS**

Depending on the program’s nature and intended impact, the company should consider whether and how to convey its CSR goals and requirements to its:

- Suppliers, agents, business partners and development partners, especially if the company imposes CSR-related obligations on these third parties under its CSR program.
- Shareholders, because a company’s CSR program can impact the company’s share values.
- Customers, because a company’s CSR program can positively impact customer sentiment and brand loyalty.

A company can communicate its CSR program goals and requirements by training the external parties (see *Train Impacted Parties*), publishing (on its website or in hard copy) and publicizing:

- Its CSR program documents.
- A description of its CSR program’s benefits.
- Reports or disclosures regarding its CSR-related activities, which can be required by law. To determine whether a company must make conflict minerals disclosures, see *Conflict Minerals Disclosure Requirements Checklist* (http://us.practicallaw.com/3-504-6973).

A company should carefully consider the timing, consistency and substance of external communications, so that external stakeholders:

- Have ample warning to comply or react, as relevant.
- Who are similarly situated are treated equally. For example, perceived earlier and better communication with one supplier may harm business relationships with other suppliers.

**TRAIN IMPACTED PARTIES**

Many companies incorporate training into their CSR programs. For example, many companies require all employees, suppliers, agents and business and development partners to annually review and certify a CSR training module. CSR training programs help ensure that these impacted parties can:

- Understand their obligations under relevant laws and the company’s CSR-related code, policies and procedures, which reduces the risk of violation.
- Identify actual and potential violations and make the impacted parties aware of the company’s reporting mechanisms.

Often, training is most impactful when it helps the audience to understand and embrace the CSR program’s goals and requirements in the context of the company’s corporate values.
If the company believes that third parties must receive training to help ensure that the company can best implement its CSR program, then it should balance the benefits and risks of training led by the company versus training led by the third-party. For example, the company can insist on training third parties if the benefits of controlling the training outweighs the risks of third-party claims resulting from inadequate or faulty training.

**PLAN FOR THE LONG TERM**

Companies implementing CSR programs should strive to make their programs consistently meaningful, strong and enduring to:

- Protect the time and effort the company invested devising and implementing the program.
- Avoid liability by keeping apace with the current US legislative trend, which favors the expansion of CSR legislation.

To plan for the long term, the company should devise and implement the CSR program with enough flexibility to adapt to future challenges and trends. Therefore, once implemented, the company should continually reassess and update (where necessary) the program by:

- Assigning personnel to track new laws and regulations.
- Joining industry groups for information on relevant legislative activities.
- Connecting with and learning from companies with similar CSR values, which leverages the company’s commitment to build its brand and business.

To fully support these plans and activities, the company must allocate the necessary financial and personnel resources.

**ENFORCE THE CSR SUPPLY CHAIN COMPLIANCE PROGRAM**

For impacted parties to respect and adhere to a CSR program, and therefore make it effective, the company must consistently and fairly enforce the program by:

- Empowering its employees who are responsible for compliance to:
  - investigate and address actual and potential program noncompliance;
  - discipline employees who violate the program rules; and
  - address actual and potential supply chain counterparty non-compliance, which is most effective if done by collaboration among business units.

- Complying with legally required audits. For example, under the Conflict Minerals Rules, some companies that must file a conflict minerals report must also obtain an independent private sector audit (see Practice Note, Conflict Minerals Diligence: Conflict Minerals Audit (http://us.p02edi.practicallaw.com/0-510-6930#a715522)).
- Instituting and executing its own audit process (see Institute an Internal and External Audit Process).

**INSTITUTE AN INTERNAL AND EXTERNAL AUDIT PROCESS**

Audits can be a good way for the company to verify its CSR program’s success and to catch issues that constitute or can lead to a breach by the company’s:

- Employees or agents. A company faces liability if its employees violate CSR laws, company CSR policies or a supply chain counter-party’s CSR policies.
- Supply chain counterparties (for example, suppliers). A company faces liability if its counterparties breach CSR laws or the company’s CSR policies.

Successful audit programs typically:

- Are comprehensive and, in particular, cover those operations and supply chain areas identified as high risk.
- Require auditors to have specific questions and strategies to independently verify data to comply with the code of conduct, policies and procedures.
- Require auditors to:
  - review pertinent documents;
  - interview employees;
  - interview management;
  - observe facilities and operations;
  - review and discuss audit findings with relevant management; and
  - record findings.
- Require internal audits and reports to be conducted at the direction of the company’s inside or outside legal counsel. In this way, the employer has some ability to shield the resulting report under the attorney-client privilege. For more information on attorney-client privilege, see Practice Note, Internal Investigations: US Privilege and Work Product Protection (http://us.practicallaw.com/3-501-8418).

If the company identifies an issue during an audit, it should follow through and promptly and adequately correct it (see Plan for and Respond to Potential Violations or Structural Flaws).

For an audit provision that a company can use in its supply chain contracts, see Standard Clauses, General Contract Clauses: Audit Rights (http://us.practicallaw.com/4-567-1110).

**EXPECT INTERNAL RESISTANCE AND RESPOND ACCORDingly**

When developing and implementing a CSR program, program managers and executives should expect internal detractors to devalue or criticize the program, which may limit or counteract its positive and broad impacts. For example, employees might:

- Criticize the program for requiring additional administrative and other tasks that purportedly hinder business operations and growth.
- Characterize the program as expensive and valueless, particularly because tangible returns on investment are difficult to measure.
- Disparage the public policy merits and effectiveness of CSR laws.

Although the company cannot address all of these concerns (for example, it may be difficult or inappropriate for a company to address the public policy merits of CSR laws), it can try to help the employees understand the importance of the CSR program and promote a culture of compliance, for example by:

- Making employees personally responsible for compliance.
- Providing additional training (see Train Impacted Parties).
PLAN FOR AND RESPOND TO POTENTIAL VIOLATIONS OR FLAWS

A company should react quickly and carefully if it identifies any potential or actual violations or determines that its CSR program has substantive or structural flaws. Otherwise, the company’s knowledge is likely to be used as evidence that it willfully disregarded these violations or inadequacies if problems later result in a breach of law or policy. Therefore, the company must plan for and execute a response to real or potential violations that is:

- **Sensitive.** The company should try to identify problems early.
- **Swift.** The company should immediately investigate and respond to potential violations of laws, regulations and the company’s code of conduct, policies and procedures.
- **Comprehensive.** For example, if the company identifies an issue in one business unit, it should assess other business units to globally address the problem.
- **Transparent.** The company should:
  - document executed remedial actions;
  - reward whistleblowers; and
  - avoid actual or perceived retaliation.
- **Effective in the long term.** The company should:
  - identify the violation’s cause; and
  - adjust policies and procedures and personnel and supply chain counterparty relationships accordingly.