What Is Meant by Supply Chain Risk?

Historically, focus on:
- Anticorruption and trade regulations
- Traceability initiatives

Now, a much broader range of legal and voluntary standards govern supply chain considerations:
- There is an open question regarding what the responsibility actually is.
- How far down the supply chain do you have to go?
What Has Changed and Where Are We Going?

- Lines increasingly blurred between voluntary standards and legal requirements
- Proactive shift: Private sector is voluntarily stepping in to spaces where, ordinarily, government would be driving the conversation
- Recognition that this is not just managing risk, it is good business as well; demands to be proactive coming from consumers, shareholders, investors and fund managers
- Increasingly integrating more traditional enforcement-based compliance and risk management programs, such as those related to sanctions or Foreign Corrupt Practices Act (FCPA) with corporate social responsibility concerns; not efficient to consider separately
What Are the Laws and Standards?

- U.S. and international laws related to anticorruption and bribery, sanctions, money laundering, export controls, and consumer protection laws
- Efforts to set industry standards from multilateral organizations (such as the OECD) and industry groups (such as the Defense Industry Initiative)
LEGAL RISKS
Trade Controls

- **Anticorruption:**
  - FCPA: antibribery provisions and accounting provisions
  - U.K. Bribery Act and other local laws

- **Anti-Money Laundering (AML):**
  - Multiple laws and agencies: Money Laundering Control Act (DOJ), Bank Secrecy Act (FinCEN), USA Patriot Act (FINRA) and non-U.S. jurisdictions

- **Sanctions:**
  - U.S. country-based programs: Comprehensive embargoes (Cuba, North Korea, Iran, Syria, Crimea) or more limited sanctions (Venezuela, Russia, etc.)
  - U.S. list-based programs: Names of people, companies and entities
  - U.N. and EU sanctions

- **Export Controls:**
  - Restrictions on the transfer of goods, software, technology and services
  - Export Administration Regulations (EAR)/International Traffic in Arms Regulations (ITAR), other U.S. export controls, non-U.S. laws

- **Antiboycott**

- **Import/Customs**
U.S. Customs – Supply Chain Considerations for Imported Merchandise

- **Prohibitions:**
  - Goods made with forced labor/North Korean labor
  - Counterfeit or piratical merchandise

- **Certifications:**
  - Lacey Act
  - CITES/Endangered Species Act
  - Duty preference claims
  - Admissibility of merchandise

- **Declarations:**
  - Country of Origin
  - Tariff classification
  - Value
Lacey Act and Wildlife Trafficking:
- Prohibits the import, export, sale, acquisition or purchase of fish, wildlife and plants that are taken, possessed, transported or sold in violation of U.S. or Indian (Native American) law
- Covers all animals and plants that are protected by CITES and others protected by state laws
- 2008 amendment expanded law to include the import (into the U.S.) of illegally logged woods:
  - Criminal and civil penalties

Case Examples:
- October 2015, Lumber Liquidators criminal enforcement action based on illegally logged Russian timber imported via China; $13.15 million penalties, plus civil forfeiture of timber
- 2012 Gibson Guitar criminal enforcement action on imports of wood from India and Madagascar; $300,000 in fines
Forced Labor and North Korean Labor

- Customs and Border Protection (CBP) prohibits the importation of goods mined, produced, or manufactured, wholly or in part, in any foreign country by forced labor, including convict labor, forced child labor, and indentured labor.

- CBP regulations allow issuance of withhold release orders, requiring detention of goods at ports of entry, when it reasonably believes that an importer is attempting to enter goods made with forced labor.

- CBP’s Reasonable Care Informed Compliance Publications and related Fact Sheets provide guidance, including asking whether importers know how their goods are made, have established procedures for internal audits, and conduct vetting of suppliers and vendors.

- Countering America’s Adversaries through Sanctions Act (CAATSA) passed in August 2017, increases CBP scrutiny of imported merchandise that it believes was produced with North Korean labor.
Regulatory and State-Level Certification and Transparency Measures

- Litigation:
  - California Transparency in Supply Chains Act of 2010
  - Consumer class action suits filed in Massachusetts Federal District Court
  - Investor suits
  - Alien Tort Statute and potential corporate liability

- Federal Acquisition Regulations, Defense Federal Acquisition Regulations Supplement and Anti-Trafficking

- Dodd-Frank and Conflict Minerals

- Extractive Industries Transparency Initiative/Extraction Payments Disclosure Rule
Growing International Scope

- Trajectory – expand the net, reporting, penalties
- French “Vigilance Law” (2017)
- EU Conflict Minerals Regulations (2017)
- Indian Corporate Social Responsibility Legislation
Why Focus Beyond Legal Risks?

- Why are these efforts important?
  - Reputational
  - Financial
  - Branding

- Industry Taking the Lead
- Stakeholder Engagement
- Increasing Business Value and Improving Operations
Multistakeholder Initiatives

- **Multilateral Standards:**
  - U.N. Global Compact and its universal principles
  - Global Reporting Initiative
  - International Finance Corporation (IFC) Performance Standards
  - Increased platform, given the status of regulatory state and public demand

- **Sector-Specific Initiatives (e.g., varying tools and codes of conduct):**
  - Fair Labor Association
  - Voluntary Principles on Security and Human Rights
  - Defense Industry Initiative
  - Alliance for Bangladesh Worker Safety

- **Traceability Issues**

- **U.S. Government Resources:**
  - Department of Labor’s Bureau of International Labor Affairs
  - Department of State Verite tool
ADDRESSING SUPPLY CHAIN RISK
What Are the Risks in Not Addressing Supply Chain Issues?

- Civil and Criminal Penalties
- Loss of Ability to Engage in Certain Transactions
- Litigation
- Reputational Considerations
- Impact on Bottom Line
Diligence Basics

Must obtain full information about the transaction—must know:
- Who is involved in the transaction (including agents and ownership/control of business partners)
- Commodities/technology involved
- Flow of goods/funds/technology/services
- End use/end user

Integrate diligence and compliance assurances into business process:
- Marketing/sales collect information from customers and understand transaction
- Legal/finance/accounting review contracts and documents to identify parties and spot issues
- Customer service/program managers have ongoing relationships and gather new/additional information throughout the life of the transaction
- Automation

Efforts must be robust:
- Identify and pursue “red flags”
- Cannot structure transactions to limit information—do not “self-blind”
- Have ongoing obligation to conduct and renew diligence
Conducting Diligence

- Analyze the information obtained about the transaction
- Screening tools/services: Software and services that cross-check the names you enter against list-based sanctions, money-laundering entities, entities with reputational risks, etc.
- Third-party diligence provider (as appropriate)
- Identify which of the regulatory regimes apply, and determine whether the transaction is allowed—there will often be multiple regulatory issues and jurisdictions:
  - E.g., in export controls, you may have to obtain a license or agreement prior to engaging in activities
  - Transactions that are allowed may still pose risks or raise greater diligence concerns
- Use questionnaires and request additional information
Addressing Risk

- Create documentation to support evidence of due diligence
- Provide representations/warranties
- Obtain licensing (as needed)
- Provide disclosure/reporting
- Compliance programs are essential:
  - Compliance programs may be required by regulations/laws.
  - Evidence of a compliance program mitigates fines/punishments.
  - Thoroughness/robustness of compliance program matters greatly—high-level policy alone or limited, outdated procedures are insufficient.
  - Training must be documented.
- Perform ongoing due diligence
What Is the Role of a General Counsel? Other Actors?

- Socializing considerations beyond the compliance/counsel’s office:
  - Advising vs. doing
  - Coordination
- In-house vs. third party roles—when do you need to go outside your own capabilities; what is the process?
- Preserving privilege
BEST PRACTICES: A CASE STUDY

A U.S. manufacturer is setting up a supplier in Malaysia. During the diligence process, the manufacturer identified that a series of complaints had been lodged by employees of the supplier regarding the location of employee housing in an unsafe part of Kuala Lumpur. The CEO of the supplier company also happens to live next door to and socialize with an individual recently placed on the SDN list for North Korea sanctions. The CEO also claims to not have any documents on his sources of raw materials, and refuses to allow third-party inspectors entry to the facilities because “that’s not how we do things around here.”
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