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Managing supply chain risks: **human rights considerations**



As supply chains become increasingly globalised and complex, they are attracting greater scrutiny from consumers, businesses and regulators alike. A growing awareness of the human rights risks and emerging 'hard' and 'soft' laws in this area are changing the way that clients are monitoring and managing their supply chain risks.

A growing trend towards more active supply chain management

Forward-thinking companies are now looking beyond more traditional methods of supply chain management, which have tended to focus on the commercial aspects of procurement and on supply contingency planning, with a view to ensuring favourable supply terms and business continuity.

Amongst other things, ethical sourcing and supplier compliance with human rights standards are rapidly attracting greater scrutiny from a range of stakeholders, including investors, customers and NGOs.

This follows a number of high profile cases where oppressive or unsafe working conditions have been exposed in supply chains, attracting significant media attention, particularly in the garment and electronics manufacturing industries.

An area of increasing regulatory scrutiny

Recent years have seen the introduction of a range of regulations requiring companies to audit and report on ethical aspects of their supply chains and this trend looks set to continue into the future.

Human trafficking: Californian legislation requires businesses to disclose information about their efforts to eradicate slavery and human trafficking from their direct supply chains and in the past calls have been made for similar laws at a federal level.

In the UK, the Modern Slavery Act will require businesses with a turnover above a certain threshold (which has yet to be set) supplying goods and services publish an annual statement describing the steps they have taken to ensure that slavery and human trafficking are not taking place within their own business or their supply chain. Given the complexity of modern supply chains, disclosures are likely to identify areas for further work in respect of high risk materials supplied indirectly.

Conflict minerals: U.S.-listed companies whose products use conflict minerals are required to conduct a 'reasonable country of origin inquiry' followed by due diligence and the publication of an audited report if they know or have reason to believe that those minerals originated in the DRC or certain neighbouring countries.

In the EU, a voluntary scheme is currently being considered under which any importer of conflict minerals could choose to self-certify as a 'responsible importer', provided it has undertaken due diligence consistent with relevant OECD guidelines and introduced other measures such as mechanisms to track the origin of the minerals purchased, risk management and auditing procedures, and met certain disclosure requirements.

Non-financial reporting on supply chain matters: the recently adopted Directive on the disclosure of non-financial and diversity information will require certain large companies to disclose annually, to the extent necessary for an understanding of their development, performance, position and impact of their activities, information relating to environmental, social and employee matters, respect for human rights and anti-corruption and bribery matters.

This will apply both in respect of the company's own operations and, where relevant and proportionate, its supply chain, and many companies will need to start to consider how they might gather relevant information to ensure future compliance with this requirement. The new rules will apply to financial years starting on or after 1 January 2017.



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The emergence of 'soft' laws as compliance matters

Stakeholder expectations have also been raised through the emergence of 'soft' laws governing this area. These are not legally binding, but the availability of non-judicial complaints review mechanisms means that they can often be used as a meaningful benchmark against which a company's conduct is publicly measured.

In particular, there has been widespread business convergence around the **UN Guiding Principles on Business and Human Rights**. While the Principles are not alone in governing this area, they are now setting the standard for international corporate best practice, and with courts and regulators using them as a reference point with increasing frequency. See our briefing: *'Implementing the UN Guiding Principles on Business and Human Rights: challenges for businesses'*.

The Principles require companies to assess through due diligence the actual and potential human rights impacts arising from either: (i) their own activities; or (ii) those to which they contribute, or are directly linked through their business relationships.

Companies are expected to integrate and act upon the findings, take action to avoid or mitigate adverse impacts, track the effectiveness of their efforts and communicate how impacts are addressed, particularly to affected stakeholders.

> Where adverse human rights impacts are identified in a company's supply chain, the company will be expected to consider what actions it can take to mitigate or eliminate that impact, and will wish to think about how it might evidence these

- > Actions might range from encouraging or assisting with training and capacity building, to enforcing contractual provisions to bring about change
- > In each case, actions will clearly depend on the extent of the company's leverage over the relevant supplier and the nature of its relationship with them

In a number of sectors, industry associations and stakeholder groups have published guidelines which supplement the more general requirements of the Principles, taking into account the particular issues and complexities of that area. Businesses find themselves under increasing pressure to adopt and implement these to keep pace with their peers and demonstrate they are 'in the pack' rather than lagging behind it.

What can businesses do to mitigate human rights risks in their supply chain?

In response to developments in both 'hard' and 'soft' law, human rights-related supply chain risks are increasingly being treated by businesses as a priority compliance issue. Companies might consider, amongst other things:

- > publishing clear procurement policies and supplier codes of conduct, which are aligned with 'hard' and 'soft' law standards setting and explaining their minimum expectations of suppliers
- > including protections in standard supply contract terms, clearly documenting compliance requirements and seeking transparency in the form of audit and reporting obligations thereby increasing their leverage in supplier relationships
- > expanding existing compliance and risk management programmes to include human rights considerations, with a view to facilitating the prompt identification, management and mitigation of risks and impacts
- > including human rights-related 'red flags' into supplier selection processes, to ensure suppliers with known human rights problems or operating in difficult jurisdictions can be easily identified
- > establishing robust supply chain due diligence and audit processes to facilitate the identification and prompt resolution of human rights issues
- > undertaking comprehensive human rights impact assessments as high risk parts of their supply chain to ensure actual and potential impact of the business and its suppliers as others have been properly identified and so can be managed, mitigated or eliminated
- > reviewing their approach to communications, to ensure clear and accurate messages on their approach to human rights and ethical sourcing are being given, promoting their efforts as a business and brand enabler

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