Corporate Social Responsibility and the Supply Chain

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This Practice Note discusses corporate social responsibility (CSR) trends affecting the supply chain. This Practice Note defines CSR, describes why CSR should be important to companies, identifies relevant CSR legislation and outlines the different approaches that companies can take to address CSR in their supply chains.

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A company risks legal, reputational and economic damage if its suppliers:

- Engage in illegal or inhumane employment practices.
- Violate human rights.
- Cause environmental harm.
- Engage in bribery or corruption
Empowered by new technology and encouraged by recent successes, now more than ever, consumers are holding companies accountable for unethical behavior within the companies' supply chains. For example, during the first half of 2012, Apple Inc. was the focus of public outcry when news reports revealed that one of its main suppliers, Foxconn Technology Group, subjected its workers to inhumane working conditions. Apple’s subsequent investigations revealed a wide variety of violations and a high incidence of non-compliance at Foxconn and across its supply chain. Apple has since gone to great lengths and incurred great expense to improve the working conditions at Foxconn and address its pervasive supply chain problems in an effort to preserve the company's popularity with consumers. Similarly, in July of 2012, Apple announced that its products were no longer registered with EPEAT, an environmentally friendly electronics registry. After complaints from customers and environmentalists, Apple placed its products back on the registry, a decision that may require the redesign of certain products.

In response to shifting societal sentiment, governments, legislators and regulators have acted to hold companies accountable for engaging in unfair labor practices or causing environmental harm. For example:

- On January 1, 2012, the California Transparency in Supply Chains Act of 2010 (Supply Chains Act) became effective in the State of California.

- In August, 2011, the Business Transparency on Trafficking and Slavery Act (BTTSA) was introduced into the US House of Representatives and then referred to the House Committee on Financial Services.


Therefore, companies doing business in the US face increasing pressure to develop and maintain effective, comprehensive, and legally compliant corporate social responsibility (CSR) policies and mandates. With a sound CSR policy, companies have a better chance of avoiding legal, reputational and economic risks. This Note:

- Defines corporate social responsibility in the supply chain.

- Explains why companies should treat CSR as a priority and imperative.

- Identifies and summarizes enacted, pending and proposed CSR laws and regulations.

- Gives an overview of the types of CSR policies and programs that companies adopt.
Presents the challenges that companies face when adopting a CSR policy or program.

**What is CSR?**

CSR, often referred to as corporate responsibility, corporate philanthropy, sustainability, business ethics, stakeholder theory or corporate citizenship, has been defined differently by various international organizations and industry groups (see Box, Widely Recognized Definitions of CSR). Generally, the adoption of CSR policies and practices requires companies to address the effect of corporate activities on diverse stakeholders in the following areas:

- **Society.**
- **Environment.**
- **Governance.**

**Why Should CSR Be Important to a Company?**

CSR has become an increasingly critical factor in how a company should organize and implement a variety of business functions, including sales, human resources, compliance, legal, marketing, communications, and investor relations. An effective CSR policy can:

- **Reduce the risk of lawsuits and non-compliance (see Reduced Risk of Lawsuits and Non-compliance).**
- **Create reputational capital and competitive advantages (see Reputational Capital and Competitive Advantages).**

**Reduced Risk of Lawsuits and Non-compliance**

With an effective CSR policy, a company can:

- **Better comply with emerging CSR-related laws and regulations.**
- **Preempt costly lawsuits and non-compliance actions.**
- **Address the source of non-compliance by installing cultural mechanisms and fostering corporate alignment around the relevant issues.**
If a CSR policy is carefully and comprehensively drafted and properly enforced, the government may be less likely to intervene, both at the company level and in a broader sense by means of regulation.

**Reputational Capital and Competitive Advantages**

Companies that define their corporate culture with reference to CSR imperatives can leverage that commitment to forge powerful and lasting relationships with important stakeholders. CSR policies can differentiate a company’s brand, culture, and corporate identity and positively influence the decision making of consumers, partners, investors and talent. With reputational capital, a company can:

- **Earn consumer loyalty.** Consumers increasingly rationalize buying decisions with reference to the corporate values of the manufacturer and its supply chain practices.

- **Attract top talent.** A company’s commitment to CSR can serve as a selling point to executives and other job candidates who increasingly demand a committed and coherent culture of concern for CSR-related issues.

- **Strengthen employee morale and commitment.** Staff can be rallied to common causes to improve morale, efficiency and loyalty in the midst of a highly mobile talent market.

- **Aid its business development.** Investors and partners are increasingly including environmental, social and governance criteria in their investment and screening processes.

**Relevant Legislation**

Existing and pending legal requirements impose disclosure obligations that are intended to encourage companies to address CSR-related issues in their operations, but these requirements do not mandate that companies take affirmative steps to adopt particular policies regarding their:

- Own supply chain practices.

- Suppliers' practices.

Companies subject to these requirements are only required to disclose their policies regarding certain activities that have been deemed offensive to human dignity. These disclosures include:

- Supply chain verifications.

- Information on supply chain audit activities.
Supplier and third-party certifications.

Training provided to affected employees and contractors.

Information on compliance with local laws and the company's CSR policies.

State Legislation

One US state, California, has passed two types of CSR legislation:

- Supply Chains Act (see Supply Chains Act).
- California Senate Bill 861 (SB 861) (see SB 861).

Supply Chains Act

The Supply Chains Act applies to a company if it:

- Is a retail seller or manufacturer as indicated on its California tax return (see Article, California Transparency in Supply Chains Act of 2010: Definition of Retail Seller and Manufacturer (www.practicallaw.com/3-506-8314)).

- Does business in California (see Article, California Transparency in Supply Chains Act of 2010: Definition of "Doing Business in California" (www.practicallaw.com/3-506-8314)).

- Has worldwide gross receipts in excess of $100,000,000 (see Article, California Transparency in Supply Chains Act of 2010: Definition of Gross Receipts (www.practicallaw.com/3-506-8314)).

A business covered under the Supply Chains Act must disclose to what extent, if any, that it:

- Verifies product supply chains to evaluate and address risks of human trafficking and slavery, and specifies if the verification was not conducted by a third party.

- Audits suppliers to evaluate compliance with the company's standards for trafficking and slavery in supply chains, and specifies if the verification was not an independent, unannounced audit.

- Requires direct suppliers to certify that materials incorporated into the product comply with laws regarding slavery and human trafficking of the country or countries in which they are doing business.

- Maintains internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.
- Provides training to company employees and management (those who direct responsibility for supply chain management) on:
  - human trafficking and slavery; and
  - mitigating risks within the supply chains of products.

(Cal. Civ. Code § 1714.43(c)(1)-(5) (2011).)

The information has to be disclosed either:

- On the homepage of covered firm's website. On its face, the statute does not permit the information to be placed on a CSR-related landing page.

- If the covered business does not have a website, in written copies to a requesting customer within 30 days of receiving the written request.

A California Attorney General's action for injunctive relief is the exclusive remedy for a violation of the Supply Chains Act. While private plaintiffs have no right of action under the Supply Chains Act, they may be able to bring claims under other statutes, such as the California Unfair Competition Law or the Consumer Legal Remedies Act.

For more information about the Supply Chains Act, including liability for violations of the Supply Chains Act, see Article, California Transparency in Supply Chains Act of 2010 (www.practicallaw.com/3-506-8314).

**SB 861**

A few months before the SEC issued its proposed Conflict Minerals Rules Implementing Section 1502 of the Dodd-Frank Act (Section 1502), California passed SB 861, which requires any public company contracting with the State of California to comply with the following pending SEC final rules:

- Business Transparency on Trafficking and Slavery Act (BTTSA) (see BTTSA).

- Section 1502 (see Section 1502).

**Federal Legislation and Guidance**

**BTTSA**

The BTTSA is the federal analogue to the Supply Chains Act. If passed, the BTTSA would amend Section 13 of the Securities and Exchange of 1934 to mandate reporting companies to disclose their efforts to address human trafficking and slavery in the supply chain. The BTTSA, as proposed, would be significantly more burdensome than the Supply Chains Act because:

- In addition to the five disclosure pillars of the Supply Chains Act, a business covered under the
BTTSA must disclose to what extent, if any, that it:

- maintains a policy aimed at identifying and eliminating supply chain risks concerning human trafficking and slavery;

- assesses its suppliers’ management and procurement systems to verify whether each supplier has in place appropriate systems to identify human trafficking and slavery risks within that supplier’s supply chain;

- requires its suppliers to have recruiting practices that comply with the company’s standards for eliminating exploitive labor practices contributing to exploitation; and

- prohibits the use of its corporate products, facilities, or services to obtain or maintain persons under exploitive conditions.

In addition to website disclosure, reporting companies would have to include the information in their annual reports.

Significantly, all reporting companies are covered by the BTTSA, and therefore, its reach is not limited to manufacturers and retail sellers.

**Section 1502**

In December of 2010, as part of the Dodd-Frank package of reforms, the SEC proposed rules regarding the disclosure by reporting companies of their use of conflict minerals. The sale of these minerals, which Section 1502 defines collectively as conflict minerals (regardless of their origin), is believed to be financing conflict in the Democratic Republic of the Congo (DRC). The minerals covered by the rules, which are included in many common products but that are particularly common in electronics components, include:

- Cassiterite.

- Columbite-tantalite (coltan).

- Gold.

- Wolframite.

- Derivatives of these minerals (including tin, tantalum and tungsten).

- Other minerals the Secretary of State may designate in the future.

Although Section 1502 requires the SEC to adopt final rules requiring specialized disclosure and
diligence relating to conflict minerals by April of 2011, the SEC has repeatedly pushed back that deadline. For information on the expected timing of the final rules and the effective date of Section 1502's disclosure requirements, see PLC Corporate & Securities, Practice Note, Conflict Minerals Due Diligence (www.practicallaw.com/0-510-6930) and Checklist, Conflict Minerals Disclosure Requirements Checklist (www.practicallaw.com/3-504-6973).

As proposed, companies subject to the rules will find compliance with the rules to be extremely time-intensive and expensive. The rules would require that any company subject to the rules for which conflict minerals are necessary to the functionality of a product manufactured, or contracted to be manufactured, to disclose in its annual report whether those conflict minerals originated in the DRC or adjoining countries (DRC countries).

If a company's conflict minerals originated in a DRC country, or their origin is unknown, the company must prepare and furnish as a separate exhibit to its annual report a conflict minerals report describing:

- The measures the company took to exercise due diligence on the source and chain of custody of the company's conflict minerals.
- Those products that contain conflict minerals and that:
  - benefited from, or are directly or indirectly financed by, a DRC country armed group that has perpetrated serious human rights abuses, as identified in the State Department's Annual Country Reports on Human Rights Practices; or
  - have an unknown source.

The company must identify these products as not DRC conflict free. If applicable, the company may state that it is making this disclosure because the source of the minerals is unknown.

- To the extent known, the smelter or refinery used to process any conflict minerals identified as not DRC conflict free, the country of origin of the minerals and the efforts used to determine the mine or location of origin with the greatest possible specificity.

For a discussion of the diligence and disclosure required by the proposed rules, and a checklist of suggested action items for companies preparing to comply, see PLC Corporate & Securities, Practice Note, Conflict Minerals Due Diligence (www.practicallaw.com/0-510-6930) and Checklist, Preparing for Conflict Minerals Compliance: Company Action Items Checklist (www.practicallaw.com/0-510-7468).

Other Federal CSR-related Legislation and Guidance

While not specifically impacting the supply chain, other recent SEC measures underscore the increasing legislative trend favoring the advent of CSR-related legal requirements, including:

- January 2012 SEC interpretative guidance regarding the applicability of existing disclosure
requirements to risks associated with climate change.

- December 2011 SEC final rules requiring issuers that operate mines in the US to disclose particular information regarding compliance with health and safety standards.

- October 2011 SEC disclosure guidance regarding the applicability of existing disclosure requirements to cybersecurity risk and cyber incidents in the wake of several large-scale cyberattacks.

Enforcement

The shift in societal sentiment regarding the CSR-related activities of companies is relatively recent, and so existing laws are new, and enforcement actions have not yet been brought. Enforcement will, however, likely increase in the near future. For example:

- Pursuant to the Supply Chains Act, the Attorney General must deliver to the California Secretary State a list of companies that are subject to the act by November 30, 2012. The provision of this list to the California Secretary of State could prompt enforcement actions.

- Given their complexity, the rules issued under Section 1502, once effective, will likely give rise to SEC enforcement actions.

Creating a CSR Policy

A company's CSR program should be shaped by:

- Law.

- Corporate values.

- Market, industry and societal norms.

A company's CSR program is often designed to respond to existing mandatory and voluntary regimes:

- **Mandatory.** Mandatory CSR regimes refer to enacted, pending or proposed CSR-related laws or regulations. Companies design CSR programs that are responsive to mandatory regimes to ensure compliance with the law. The number of CSR issues that are governed by mandatory regimes will likely increase dramatically in the coming years.

- **Voluntary.** Voluntary CSR regimes are non-binding programs of corporate action or disclosure that companies choose to pursue primarily for reasons other than statutory or regulatory
compliance. Historically, voluntary regimes have played a much greater role in driving the adoption of CSR programs and are still used frequently today as frameworks and benchmarks for CSR programs.

Employing voluntary regimes alongside mandatory regimes offers the following benefits:

- Adopting existing frameworks means that companies need not reinvent the wheel.
- Reporting content and format is standardized and therefore easily digestible by customers, partners, investors and employees.
- Well-known voluntary regimes are highly visible, and therefore use of those regimes can be a conduit for marketing, branding and communications efforts.
- Voluntary regimes can often serve as useful starting places for companies that have little experience with CSR initiatives.

Companies should consider the following when developing and implementing a CSR program:

- All applicable enacted, pending and proposed legislation.
- Existing and current:
  - governance policies, codes of conduct, corporate values, mission statements and goals;
  - budget, resources, management and accountability structures; and
  - prevailing thoughts, opinions, activities, and commitments of employees and other stakeholders.
- Synergies that can be obtained from coupling the development of a CSR program with marketing, branding, communications, and investor-relations efforts.

Elements of a Legally Compliant CSR Program

A legally compliant CSR program should:

- Ensure compliance with all enacted, pending and proposed legislation.
- Effectively and efficiently reduce the risk of litigation.
- Provide for adequate responses to internal and external investigations and audits.
Cohere with other related corporate governance policies (code of conduct, FCPA policies, data security policies).

Support the attainment of CSR-related operational goals.

A number of international organizations, non-governmental organizations (NGOs) and industry groups have developed model CSR policies (see Box, Model Voluntary CSR Policies).

**Challenges in Developing CSR Programs**

When complying with legislation and developing and implementing CSR programs, companies often face obstacles that can be time-consuming or expensive to overcome. These include:

- **Unclear legislative mandates.** Existing and pending legislation is unclear on certain key terms. For example, companies and industry groups have complained that the terms "human trafficking and slavery," "certification," and "verification" are not clearly defined under the Supply Chains Act.

- **Supply chain complexities.** Supply chains are often long, complex and difficult to define. In most cases, a manufacturer purchases goods and services from a number of suppliers (direct suppliers), who in turn may have their own suppliers (indirect suppliers). Even where voluntary or legal obligations apply only to direct suppliers, companies can face significant logistic and legal challenges, for example, with respect to oversight, audit and enforcement, especially in the context of international sales.

- **Implementation difficulties.** It may be difficult for companies to impose CSR obligations on its existing direct and indirect suppliers. Doing so may require companies to amend existing vendor contracts, which in turn may require renegotiation of economic or other terms of the relationship.

- **Challenging supplier audits.** It is challenging for a company to determine whether its direct and indirect suppliers are complying with CSR obligations. Supplier audits can be costly and unsuccessful because of limited record access, transparency, consistency and clarity.

**Widely Recognized Definitions of CSR**

The European Union (EU) and the World Business Counsel for Sustainable Development (WBCSD) published commonly used definitions of CSR:

- The WBCSD defines CSR as "the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large."
The EU defines CSR as a "concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."

Model Voluntary CSR Policies
To standardize corporate CSR activities and communications and induce greater adoption, a number of international organizations, non-governmental organizations (NGOs) and industry groups have developed model CSR policies. For example:

- Since 2000, Global Reporting Initiative has published globally applicable social and environmental sustainability reporting guidelines called the Sustainability Reporting Framework.

- In 2000, the United Nations launched the UN Global Compact, which is a leadership platform for the development, implementation and disclosure of responsible and sustainable corporate policies and practices in the areas of human rights, labor, environment and anti-corruption.

- Since 2009, the Electronic Industry Citizenship Coalition has published a number of standard supply chain-specific compliance documents that have been adopted by some of the biggest information and communications technology firms in the world.

- In 2010, the International Organization for Standardization approved ISO 26000, which attempts to standardize implementation of social responsibility practices in organizations, both public and private.

- In 2011, the Organization for Economic Cooperation and Development updated its Guidelines for Multinationals for the fifth time since they were first adopted in 1976. The Guidelines for Multinationals consist of recommendations for responsible business practice that are adopted by governments, which then in turn encourage their domestic enterprises to adhere to these recommendations.

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Resource history

Changes made to this resource
We will record here any changes to this resource as a result of developments in the law or practice.

Related content

Topics

Commercial (http://us.practicallaw.com/topic3-500-0084)

Practice Note

Conflict Minerals Due Diligence (http://us.practicallaw.com/topic0-510-6930)

Checklists

Conflict Minerals Disclosure Requirements Checklist (http://us.practicallaw.com/topic3-504-6973)

Article: know-how

California Transparency in Supply Chains Act of 2010 (http://us.practicallaw.com/topic3-506-8314)