

International Trade Alert

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Human Rights Due Diligence: Increasing Regulatory Pressure for Clean Supply Chains

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Key Points:

- There is increasing regulatory, commercial and media attention in the U.K. and the EU regarding the role of human rights in company supply chains.
- The U.K. and the EU are introducing specific measures around human rights, of which companies and investors should be aware.
- To the extent that companies and investors are not doing so already, businesses should focus on what is expected and/or required of them in terms of identifying and mitigating modern slavery and human rights related risks in their supply chains or portfolios.

Background

Online fashion giant, Boohoo, has made the headlines for facing a modern slavery investigation conducted by U.K. government authorities into allegations of poor working conditions at factories in Boohoo's supply chain. Reports indicate that the short-term response of certain investors and other retailers was to distance themselves from Boohoo, pending the outcome of the U.K. government's investigation and the independent review launched internally into its supply chain. The attention this has received highlights a larger momentum in terms of corporates and investors assessing their supply chains and portfolios for compliance with human rights standards and related risks.

This focus should serve as a reminder to corporates and investors alike about the importance of conducting human rights and modern slavery risk assessments, and proactively dealing with any risks in advance and in the aftermath of investment decisions. This should be part of a corporate due diligence and risk mitigation strategy that encompasses wider environmental, social and governance ("ESG") factors.

Whilst this is particularly critical for funds with responsible investment mandates, this should not obviate concerns for investors that are less immediately tied to ESG objectives. For example, the acquisition of assets derived (in whole or in part) from criminal conduct creates risks for acquirors and investors alike under the U.K.'s Proceeds of Crime Act 2002, as amended ("POCA"). Even where the criminality

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threshold under POCA is not met, suspicions of problems or potentially criminal conduct should trigger further internal due diligence and risk assessments. In addition, it is important to consider the need for possible regulatory reach-out, the contractual apportionment of liability between transactional parties and the development or enhancement of compliance and risk-mitigation processes going forward. A lack of due concern being paid to these matters could lead to serious harm to corporate reputation and share price, as well as customer, investor and regulatory trust.

Recent Developments

The U.K. government's and the EU's commitment to the deterrence of and accountability for human rights abuses is on the rise. Recent legislative developments and investigation activity should be considered in the context of increasing acquisition and financial restructuring activity triggered by COVID-19.

The U.K. government published guidance in April 2020 (the "Guidance") regarding the slavery and human trafficking statements that certain businesses are obliged to publish annually under Section 54 of the Modern Slavery Act 2015. Such statements must document the actions that companies have taken to assess and address the modern slavery risks in their supply chains in the past year. The Guidance allowed companies to delay publishing their statements by up to six months without penalty, if necessary, due to COVID-19 related pressures. However, it also reinforced that the U.K. government continues to prioritize combatting modern slavery risks. The Guidance also identifies specific areas in which workers may be exposed to increased risks, from a modern slavery perspective, due to COVID-19.

More recently, in early July 2020, the U.K. implemented its new Global Human Rights sanctions regime targeting those individuals and entities involved in some of the most well-known human rights violations in recent years. This marks the U.K.'s first autonomous sanctions regime launched under the U.K.'s Sanctions and Money Laundering Act 2018, and could set the groundwork for the U.K. taking a more proactive approach to human rights monitoring and enforcement going forward. Our recent client alert setting out details on this sanctions regime is available [here](#).

In April 2020, EU Commissioner for Justice, Didier Reynders, announced that the European Commission will introduce mandatory human rights due diligence legislation in early 2021. Whilst draft legislation is yet to be published, the proposed measures are likely to include a duty of care on companies to conduct mandatory due diligence to identify, prevent, mitigate and account for adverse impacts on human rights. The requirements are expected to apply cross-sector to companies incorporated in the EU as well as foreign companies conducting business in the EU.

How This Affects Your Business

The developments that we note above indicate that both the U.K. and EU are becoming increasingly serious about implementing ESG legislation that focuses on the role of corporate actors and holds them accountable. Moreover, such initiatives suggest that the days are numbered for corporates who have to date operated on a light touch basis regarding such legislation.

It is critical from a commercial, legal and reputational standpoint for companies to conduct thorough and regular diligence and monitoring on their supply chains to assess risk, identify possible non-compliance and determine where improvements can

be made. This applies not only to goods produced in a corporation's own manufacturing sites but also to their counterparties, subcontractors, suppliers and the suppliers of their suppliers, all the way down the supply chain.

In the acquisition, financial restructuring and investment funds contexts, investors should treat ESG initiatives as a gating issue for any new investment opportunity. Transactions relating to assets derived (in whole or in part) from actual or suspected criminal conduct can create risks under POCA, as well as significant reputational issues. Even where the criminality threshold under POCA is not met, suspicions of problems or potentially criminal conduct should trigger investors to conduct detailed due diligence, consider risk assessments, and assess the need for regulatory reach-out.

Buyers should also insist on robust contractual protections focusing on modern slavery, human rights and wider ESG initiatives within deal documentation, with any material deficiencies being addressed as a condition of a deal proceeding or as part of any post-acquisition integration. At this stage, buyers should be consulting on compliance and reporting obligations, as well as the implementation of various processes covering ESG factors, for example, modern slavery, human rights and ESG risk assessments and audits, whistleblowing frameworks, codes of conduct and the need to 'flow down' such compliance requirements onto counterparties across the supply chain.

Besides the above, a failure on the part of corporates and investors to address ESG concerns could lead to serious harm to corporate reputations and share prices, as well as customer, investor and regulatory trust.

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