

Professional Perspective

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# Due Diligence and Best Practices to Avoid Forced Labor in Supply Chains

*Contributed by Olga Torres, Maria Alonso, and Donna Wedgeworth, Torres Law*

The sad fact of forced labor in global supply chains cannot be denied. There are many indicators that forced labor is taking place, including restriction of movement and isolation, intimidation and violence, withholding of wages, retention of identification documents, reporting to immigration authorities, debt bondage, abusive working and living conditions, and excessive work schedules.

Statistics published by the International Labour Organization (ILO), a tripartite United Nations agency on global labor standards, reported that in 2017 there were approximately over 25 million people facing forced labor exploitation in the production of merchandise and services, with a global economic impact of over \$150 billion, and the numbers continue to rise.

In response to this growing human rights concern, the U.S. has enacted regulatory controls, including import and export laws, economic sanctions, and regulations impacting U.S. government contracts, to encourage due diligence and responsible business conduct in global supply chains.

This article will provide an overview of the recent developments in regulatory requirements governing forced labor prevention in global supply chains and recommended due diligence protocols. Recent developments in U.S. regulatory controls involving forced labor include the following.

## Import Restrictions

Although the Tariff Act of 1930 has long prohibited imports of forced labor goods into the U.S., a loophole existed in the law that permitted the importation “if the goods were not produced in such quantities in the United States as to meet the consumptive demands of the United States.” This loophole was repealed by the Trade Facilitation and Trade Enforcement Act of 2015.

U.S. Customs and Border Protection has recently developed priority protocols specifically aimed at combating the importation of goods produced with forced labor. For example, CBP may issue a withhold release order to detain the goods at the port of entry until a conclusion regarding the forced labor concerns is reached. A WRO can have a devastating effect on a company's supply chain, effectively terminating one or multiple product lines in an instant.

Further, the newly signed United States-Mexico-Canada Agreement likewise has introduced formal elements to incentivize companies to improve their labor practices, including a novel mechanism in which private parties can file claims against individual companies in Mexico claiming certain labor rights have been violated. The USMCA Forced Labor Enforcement Task Force has also been established to lead U.S. enforcement activities to prohibit import of goods produced by forced labor, under both the USMCA and the Tariff Act of 1930.

## Export Restrictions

The U.S. Department of Commerce Bureau of Industry and Security will block exports of commodities and technology to certain companies involved in human rights violations and add companies to the Entity List. For example, in July 2020, BIS added 11 Chinese companies that were implicated in human rights violations and abuses, including forced labor, targeted at Muslim minority groups from China's Xinjiang Uyghur Autonomous Region.

As a result, parties on the list are prohibited from receiving exports or transfers of certain items subject to the Export Administration Regulations without a license. Most recently on Oct. 6, 2020, BIS amended its existing licensing policy to consider human rights concerns in licensing determinations of certain items controlled under the EAR.

## Economic Sanctions

The U.S. Department of the Treasury Office of Foreign Assets Control has the authority to impose economic sanctions by adding companies and individuals who have been involved in forced labor practices to the Specially Designated Nationals and Blocked Persons List. U.S. persons are prohibited from directly or indirectly engaging in transactions or dealings with such SDNs and any entities owned 50% or more by one or more SDNs, unless an OFAC authorization is available.

## Government Contracts

Of particular importance to businesses that engage in contracts with the U.S. government is compliance with the Federal Acquisition Regulations that were recently revised to strengthen the elimination of human trafficking in U.S. government contracts. Federal contractors and subcontractors are prohibited from engaging in any trafficking in persons and exploitation activities and should engage in recruiting practices that fully comply with local labor laws within the U.S. or other countries, to name a few. The new amendments also inform contractors that information about subcontractors relating to trafficking will be posted to the prime contractors records in the Federal Awardee Performance and Integrity Information System.

## Penalties

In August 2020, CBP concluded the first civil enforcement action against a U.S. importer for forced labor goods in the supply chain. The importer, Pure Circle U.S.A., Inc., paid fines totaling \$575,000 for unlawful imports involving the use of forced labor in the production of stevia leaf extracts from China. CBP subsequently issued the first official finding on a WRO authorizing automatic seizure of the subject goods at U.S. ports and forfeiture of any previously seized shipments.

In 2020, CBP actions to address the use of forced labor have increased and the civil penalty against Pure Circle is one example of the many CBP actions that are expected to continue. Since September 2019, CBP has issued 11 WROs to prevent products made with forced labor from being imported into the U.S., including four WROs on products from China.

Given the intensified international focus on eliminating forced labor, child labor, and human trafficking, improving labor rights conditions at factories, and avoiding facilitating imports and exports from and to countries known for committing human rights violations, companies cannot self-blind on the matter of human exploitation in supply chains. Businesses should have protocols in place to ensure compliance with applicable regulatory controls and to mitigate the risk of enforcement actions and penalties should violations be discovered.

## Due Diligence and Best Practices

U.S. companies should closely scrutinize their supply chains for forced labor goods and terminate those business relationships and product lines immediately upon detection. Putting that succinct statement into actual practice can be very challenging. Companies operating globally can have thousands of entities in their supply chains. Typically, a company only has a direct relationship with its first-tier suppliers and little or no visibility beyond that first level.

Forced labor exploiters work very hard to keep their offenses concealed so a cursory examination will not likely reveal any wrongdoing. Due diligence investigations can also be quite costly and therefore prohibitive to companies investing the time and capital to address forced labor supply chain issues. At the bottom line, U.S. law mandates that goods produced with forced labor cannot enter the U.S. and those who knowingly benefit from forced labor exploitation are culpable. Therefore, a significant amount of supply chain due diligence should occur sufficient to support the regulatory requirements.

There are multiple sources available that provide guidelines for responsible business conduct to avoid human exploitation and forced labor in supply chains. Recommendations can vary by industry sector as some sectors, such as garments and textiles, agriculture, automotive, and minerals are most susceptible. Following are some essential elements to consider in conducting supply chain forced labor due diligence and management.

### ***Understand and Identify Relevant Risks***

Risks associated with forced labor should be outward facing; meaning identifying the potentially adverse impacts a company may cause, contribute to, or be linked to, regarding human exploitation. The level of due diligence conducted should commensurate the likelihood and severity of the associated risks and follow these steps:

- Review the ILO's Indicators of Forced Labor to better understand what indicators to look for in determining risk
- Delve into how the company's goods are produced, by whom, and under what labor conditions, from obtaining raw materials to the finished goods
- Once any potential and actual risks are identified, prioritize the most significant risks for first actions

### ***Prevention, Primary Objective of Due Diligence***

Fostering business relationships with suppliers that are transparent, cooperative, and forthcoming in providing information about their sourcing is paramount. The purpose of conducting supply chain due diligence is to avoid engaging in business transactions with suppliers that may be causing or contributing to unlawful activities or exposing the company to civil and criminal penalties for knowingly benefiting from the violative actions.

Companies should establish processes for reliably vetting suppliers and vendors for forced labor risks. As a starting point, they can review the WROs listed on CBP's forced labor web page to determine if any of the listed manufacturers are in the supply chain. Moreover, the U.S. Department of Labor publishes a list of goods believed to be produced using forced labor and child labor and the source countries. The DOL list is a good resource for identifying high risk products and countries in a company's supply chain.

### ***Ongoing Process, Not Static Exercise***

Due diligence activities should be progressive and agile, responsive to changes in the outward-facing risk profile, industry, and regulatory changes.

### ***Engage Stakeholders***

In the context of forced labor, the stakeholders are the workers and the collective bargaining or other organizations that represent them. Where possible, companies should engage with the workers and their representatives directly to get a bona fide understanding of the workers conditions and circumstances, rather than just accepting the first-tier supplier's statement that no forced labor is present in the product sourcing.

### ***Embed Responsible Practices Into Procedures***

- Develop a social compliance system—a comprehensive set of policies establishing a code of conduct and addressing supply chain due diligence
- Embed those policies into existing day-to-day operations with applicable business functional areas
- As with any effective compliance program, the policies should follow on seamlessly with standard transactional activities
- Flow down the obligations for responsible business practices to suppliers and other business relationships by including requirements in contracts that set an expectation of commensurate supplier behavior, transparency, and cooperation with regard to visibility into lower levels of the supply chain

### ***Track Implementation and Monitor Effectiveness***

- Perform periodic self-evaluations to determine if internal controls are being implemented accurately and at relevant functional areas within the business enterprise
- Engage third-party auditors who have specialized knowledge and skills in performing supply chain forced labor investigations and audits to assess internal control plans
- Generate corrective actions from assessment findings and include feedback on lessons learned to improve future due diligence processes

### ***Develop Procedure For Reporting and Investigating Claims***

- Publish a statement to the business enterprise from the executive level that clearly states the company's position on prohibiting business relationships that are associated in any way with forced labor and the intention to fully comply with U.S. laws and regulations regarding forced labor
- Include instructions for individuals to anonymously report suspected or actual forced labor indicators and provide assurance of no repercussions for making such reports

### ***Initiate a Stop/Hold Mandate When Needed***

- Once possible forced labor indicators are identified in the supply chain, take any actions necessary to stop all activities with suppliers who source products created with forced labor

### **Conclusion**

Effectively preventing the presence of forced labor in supply chains can be challenging but can also present an opportunity for positive impacts to a business enterprise. Promoting avoidance of forced labor can help to improve business relationships and protect company reputation. Closer scrutiny of the business supply chain can reveal opportunities to create value and reduce costs by identifying alternative sourcing.

At a minimum, preventing forced labor in supply chains is a legal requirement and performing due diligence can help to meet those legal requirements and potentially mitigate the adverse effects of non-compliance.