THE RISE OF SUPPLY CHAIN TRANSPARENCY LEGISLATION

What is at stake for Canadian investors?

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Authors: Elise Dueck, Delaney Greig, Kevin Thomas
Editing and Review: Norah Murphy
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Executive Summary

Canada's trading partners abroad are expanding corporate reporting to address supply chain human rights due diligence, while here at home reporting remains voluntary and inconsistent leaving investors without consistent and reliable information on critical risk issues. These include,

- reputational risk related to adverse human rights impacts;
- operational risks of supply disruption or blocked shipments of goods made with forced labour; and,
- legal risk of court action by consumers, investors or workers.

Although voluntary initiatives have gone some way to address these issues, legislation helps to level the playing field creating a standard of disclosure for all companies.

This report reviews the *California Transparency in Supply Chains Act*, the US *Trade Facilitation and Trade Enforcement Act*, UK *Modern Slavery Act*, the French Due Diligence law, EU *Directive 2014/95* and other legislative initiatives in the US, Switzerland and Australia. While these initiatives vary in their operation and goal, they coalesce around a movement to mandatory reporting by corporations of their due diligence process to ensure forced labour and related labour rights abuses do not occur in their supply chains and business activities.

Requiring companies to publicly report on their supply chain due diligence efforts ensures all Canadian stakeholders, including investors, can access information relevant to them.

To date Canada has not required such reporting domestically; however, some Canadian companies are already captured by the reporting requirements in other jurisdictions. Others, who are not required to report directly, may be queried on their supply chain due diligence practices by buyers who must report.

In a global investment market where Canadian companies are compared to their international peers, and investors increasingly look for environmental, social and governance data with which to make investment decisions, domestically legislated supply chain disclosure would help both Canadian investors and Canadian companies keep pace with their global competitors.

A Canadian supply chain reporting regime that is both useful to investors and effective in addressing forced labour and related abuses should:

- Provide for consistent reporting, but allow policies and processes to vary by company;
- Ensure reporting is publicly available and easily accessible;
- Require reporting to be updated annually;
- Require reporting from both publicly-listed and privately held companies;
- Require reports to be signed-off by top company official;
- Provide guidance for broader human rights due diligence; and,
- Include mechanisms to ensure compliance.

Résumé

Les partenaires commerciaux du Canada commencent à exiger une divulgation accrue en matière de devoir de diligence relatif aux droits de l´homme dans les chaînes d´approvisionnement. Au Canada, cette divulgation reste volontaire et imprécise, laissant pour compte les investisseurs qui ne disposent pas d´information fiable et cohérente sur un nombre important de risques :

- Les risques d'atteinte à la réputation liés aux incidences négatives sur les droits de l´homme;
- Les risques opérationnels liés à la rupture d´approvisionnement ou le blocage des produits fabriqués par le travail forcé; et,
- Le risque de recours judiciaire intenté par les consommateurs, les investisseurs ou les travailleurs.

Même si les initiatives volontaires existantes ont répondu à ces questions de manière partielle, la législation aide à niveler et à créer une norme en matière de divulgation pour toutes les sociétés.

Ce rapport analyse la loi californienne sur la transparence dans les chaînes d´approvisionnement («California Transparency in Supply Chains Act ») , l´accord des États-Unis sur la facilitation des échanges («US Trade Facilitation and Trade Enforcement Act»), la loi contre l´esclavage moderne du Royaume-Uni (« UK Modern Slavery Act »), la loi française sur le devoir de vigilance, la directive européenne 2014/95 ainsi que les autres initiatives législatives aux États-Unis, en Suisse et en Australie. Bien que Le fonctionnement et les objectifs de ces initiatives varient, ces dernières convergent toutes vers la divulgation obligatoire des entreprises de leur approche en matière de devoir de diligence dans leurs chaînes d´approvisionnement afin de garantir une éradication du travail forcé et des violations des droits des travailleurs.

Le Canada n´a toujours pas exigé une telle divulgation pour les entreprises canadiennes. Cependant, un nombre d´entreprises canadiennes sont déjà soumises au devoir de déclaration obligatoire en vigueur dans d´autres pays.

D´autres, qui ne sont pas directement obligées de soumettre des rapports, peuvent être interrogées sur leur processus de diligence raisonnable dans leurs chaînes d´approvisionnement par les acheteurs qui, eux, doivent effectuer des déclarations.

Dans un marché de l´investissement mondial, les sociétés canadiennes sont comparées à leurs concurrents internationaux et les investisseurs s´intéressent de plus en plus à l´information environnementale, sociale et de gouvernance pour prendre des décisions en matière d´investissement. Une législation gouvernementale en matière de transparence dans les chaînes d´approvisionnement permettrait aux investisseurs et sociétés canadiennes de suivre leurs concurrents internationaux.

Un régime canadien de divulgation qui est à la fois utile aux investisseurs et efficace dans la lutte contre le travail forcé et les violations semblables doit :

- Prévoir une déclaration uniforme tout en accordant tout en reconnaissant les différents processus et politiques qui existent au sein des entreprises;
- Garantir une divulgation publique et un accès facile à l´information;
- Exiger une mise à jour annuelle des déclarations;
- Rendre obligatoire la divulgation pour les entreprises cotés en bourse et les entreprises à capital privé;
- Exiger une signature du rapport par un haut dirigeant de l´entreprise;
- Fournir des orientations sur le devoir de diligence relatif aux droits de l´homme en général; et,
- Inclure des mécanismes pour garantir la conformité.

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Supply chain labour risks

The UK *Modern Slavery Act*, California's *Supply Chain Transparency Act*, the EU *Directive on disclosure of non-financial and diversity information*, and new initiatives in Australia and France, among others: a growing consensus on the need for improved company reporting on human rights due diligence in global supply chains is resulting in a wave of regulation, which has not gone unnoticed in Canada.

These laws have arisen as consumers, investors and corporations across the world react to reports implicating them in the use of forced labour or modern-day slavery in supply chains abroad.

The International Labour Organization (ILO) reports that approximately 21 million people around the world are subject to forced labour ("work or service which is exacted from any person under the menace of any penalty and for which the said person has not offered himself voluntarily"),[1] 19 million of those by private enterprise.[2] Direct violence, coercion or intimidation may be used to extract work against a person's will, but forced labour can take many forms: an individual may become trapped in work through debt bondage, exorbitant recruitment fees, retention of identity papers, or fears of being reported to immigration authorities.

Canadians unwittingly use and consume products made with forced labour every day.

Canadians unwittingly use and consume products made with forced labour every day. For example, cotton from Uzbekistan is harvested under a system of state-mandated labour that forces citizens away from their regular employment to work for weeks with no pay in harsh conditions. Fears of harassment, criminal fines, expulsion from school, or the loss of regular employment and land prevent citizens from objecting to the work assignment. The practice violates Uzbekistan's own laws, international labour standards and fundamental human rights conventions ratified by the State. However, clothing manufacturers continue to use cotton produced in Uzbekistan — in many cases unknowingly.[3]

According to a 2014 study, at least 28% of workers in the electronics sector in Malaysia were working in conditions of forced labour, including being subject to excessive recruitment fees, having their passports retained by brokers or employers, and/or facing fines or prohibitions on changing employers.[4] Between November 2014 and October 2016 Canadian manufacturers and retailers imported electronics from Malaysia worth almost C$2.4 Billion.[5]

According to a recent report by World Vision Canada, over 1,200 companies in Canada import one or more good identified to be at risk of production with forced or child labour.[6] The study selected just 50 common items out of the 136 identified on the U.S. Department of Labour's 2014 List of Goods Produced by Child Labour or Forced Labour and found over $34.5 billion worth of the at-risk goods were imported to Canada in 2015.

What is at stake for Canadian investors in supply chain risk?

Canadian companies do not deliberately use forced or child labour, but without adequate due diligence the risk remains. With multiple tiers of suppliers in multiple jurisdictions, companies may not know where the products and materials they use come from or how they were produced. This creates risks for the companies and their investors, including:

- **Reputational risks:** Today's consumers have ready access to information on corporate behaviour that may unexpectedly come to surface. Their ability to act on information, including negative human rights reports, is the reason consumers are increasingly becoming part of the volatility companies must manage.[7]
- **Operational risks:** Increased regulatory attention to forced labour may disrupt supply chains. For example, on February 24, 2016 the US *Trade Facilitation and Trade Enforcement Act of 2015* came into effect, prohibiting the import of products made with forced or child labour, which could include products or components of products ultimately headed for Canadian markets. There have already been four instances where companies have had their imports refused at the US border.[8]
- **Legal Risks:** Loblaw Companies is currently facing a $2 billion claim from employees of garment suppliers in Rana Plaza and the families of over 1000 labourers who lost their lives in the 2013 factory collapse. They allege the company was aware of "significant and specific risk" and was negligent in addressing them.[9] Canadian mining company Nevsun Resources is also defending itself in Canadian courts from allegations that it exploited labourers forced to do construction by the Eritrean authorities at its mine site.[10] While the outcome of both actions is still to be determined, the cases illustrate the potential legal costs and uncertainty that can arise from conditions in the supply chain.

While leading Canadian companies have taken some steps to address concerns about labour rights abuses including child labour, egregious health and safety risks and/or forced labour in global supply chains, there is little consistency in corporate public reporting. Investors and consumers therefore have limited information to assess the extent of human rights due diligence conducted by Canadian firms, and no reliable means of comparing the practices of one company against its peers, especially in industries where public reporting on supply chain practices is in its infancy.

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Regulators in Canada have yet to adopt laws that require companies to publicly disclose to what extent they conduct due diligence on the use of forced labour in their supply chains, but some Canadian companies with international reach are already beginning to report under legislation passed in other jurisdictions.

So what are those international requirements? And should Canada adopt similar measures to create consistent reporting requirements for Canadian firms?

Supply chain transparency legislation: a global overview

We reviewed a range of supply chain transparency legislation in the U.S. and Europe to understand its form and impact, and to explore the question of whether Canadian investors would benefit from similar legislation at home.

The primary supply chain transparency legislation we reviewed included:

1. The *California Transparency in Supply Chains Act 2010*
2. US *Trade Facilitation and Trade Enforcement Act of 2015*
3. The UK *Modern Slavery Act and Transparency in Supply Chains Clause*
4. *Private Bill 501*: France's Due Diligence Law
5. *EU Directive on Non-financial Disclosure*

We also looked at a number of active proposals in other jurisdictions that are not yet enshrined in law.

California Transparency in Supply Chains Act of 2010

Affected companies carrying on business in California must report to the public on their efforts to "eradicate slavery and human trafficking from [their] direct supply chain for tangible goods offered for sale".

Consumers in California paved the way for the rise of supply chain transparency legislation by demanding more information on the source of goods they might choose to buy. In response, the State of California passed the *California Transparency in Supply Chains Act of 2010* ("California Act") to provide disclosure about which companies have policies and systems to eliminate forced labour in the supply chain and thereby to inform consumer and investor choices.[11]

Since the law came into force on January 1, 2012 affected companies carrying on business in California must report to the public on their efforts to "eradicate slavery and human trafficking from [their] direct supply chain for tangible goods offered for sale." Companies are required to create a direct link to a statement on their website homepage, the content of which must cover five areas: verification, audits, certification, internal accountability, and training:[12]

- The verification aspect requires companies to report to what extent, if any, they engage in verification of product supply chains to evaluate and address the risk of human trafficking and slavery. Companies are free to state they do not engage in any manner of verification. If verification is done, companies are further required to disclose whether or not the verification was done by an independent organization.
- The audit aspect requires companies to disclosure to what extent, if any, audits of suppliers are conducted to evaluate supplier compliance with company standards for trafficking and slavery in supply chains. As with the verification aspect, companies are required to specify whether or not the audit was conducted by a third party.
- The certification aspect requires companies to disclose to what extent they require direct suppliers to certify that materials incorporated into the product comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business. Direct verification and auditing efforts tend to focus on first-tier (i.e. direct) suppliers leaving poor labour practices in lower tiers in the supply chain unaddressed. The certification aspect suggests first-tier suppliers must take some responsibility for inputs.

- The internal accountability aspect requires companies to disclose to what extent they maintain internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.
- Lastly, the training aspect requires companies to disclose whether and to what extent they provide the company employees and management who have direct responsibility for supply chain management with training on human trafficking and slavery, particularly with respect to mitigating risks within the supply chains of products.

To which companies does the *California Act* apply?

The disclosure requirements in the *California Act* are limited to companies that file taxes as manufacturing and retail businesses in California, with annual worldwide gross receipts of more than US$100 million.[13] This industry-specific application aims to avoid placing a disclosure burden on those businesses that are not at high risk of using forced labour in their supply chains. Civil society groups, however, have objected to the unequal application as it allows for certain companies to avoid due diligence reporting based solely on their tax classification, despite having similar supply chains (and risks) to the companies that are covered by the law.

What impact has the *California Act* had?

The *California Act* is the first supply chain transparency legislation of its kind. There have been several challenges with implementation of the new regime. The law was criticized by many for being unclear. The Attorney General of California, who is responsible for enforcement of the *Act*, did not issue any guidance for companies on how to comply with the requirements until April 2015.[14] Civil society groups have speculated that, as a result, for the first several years that the *California Act* was in force, rather than focus on the substance of their statements, corporations directed attention to interpreting the law.[15]

*To date, reporting under the **California Act** has not been adequate to meet the legislation's stated purpose of providing consumers with the information needed to make more educated purchasing decisions, in part because consumers do not know which companies fall under the reporting requirements.*

To date, reporting under the *California Act* has not been adequate to meet the legislation's stated purpose of providing consumers with the information needed to make more educated purchasing decisions, in part because consumers do not know which companies fall under the reporting requirements.[16] California's Franchise Tax Board provides the Attorney General with an annual list of companies affected by the Act, but the list is not publically released due to privacy concerns. The Attorney General provided its 2015 compliance guidance to 2,600 companies subject to the law, but it did not disclose the list of companies.[17] KnowTheChain, a coalition of anti-trafficking organizations, has been able to identify 500 of the companies it believes fall under the *California Act*. The organization published a 5-year review in 2015 noting that only 31% of these companies had a disclosure statement available that was in compliance with all the requirements.[18] Critics have also noted that consumers will be left in the dark about any progress in addressing forced labour or changes to the risks faced by a company because the *California Act* does not require companies to update their statements once published.

While the Attorney General is responsible for enforcement of the law and has authority to prosecute non-compliance, a number of class action lawsuits have been filed against specific companies for misleading and deceptive advertising under the *Business & Professions Code* and for unfair and deceptive practices under the *Consumer Legal Remedies Act*.[19] These suits allege that the supply chain disclosures made by the defendant companies were deceptive

or misleading. Three cases have already been dismissed, in two instances the decisions note that the disclosures under the Act are protected by California's safe harbour doctrine.[20]

Although these lawsuits suggest the potential for additional legal risk with the imposition of supply chain disclosure requirements, the risk of class actions based on consumer protection claims pre-dated the *California Act* and therefore the new law cannot be considered to have increased the risk materially. The first wave of claims were against Gap and Nike in the 1990s based on labour practices alleged to be in conflict with their published Codes of Conduct.[21]

US *Trade Facilitation and Trade Enforcement Act of 2015*

Section 307 of the US *Tariff Act of 1930* (19 U.S.C. § 1307) prohibits the importation of merchandise mined, produced or manufactured, wholly or in part, in any foreign country by forced or indentured child labour; however, until recently US Customs and Border Protection was limited in its ability to enforce the prohibition due to a "consumptive demand" clause in the legislation. The clause allowed the import of goods produced using forced labour provided that the goods were not also produced "in such quantities in the United States as to meet the consumptive demands of the United States."[22]

Each year, US Customs and Border Protection must report to Congress on its enforcement of the rule. Since coming into force in early 2016, Customs has detained shipments from a number of manufacturers.

In February of 2016, the US *Trade Facilitation and Trade Enforcement Act of 2015* came into effect, removing the "consumptive demand" clause and allowing US customs to restrict the import of goods produced using forced labour. Anyone with reason to believe that goods produced by forced labour are being, or are likely to be imported into the United States can file a complaint with US Customs officials.[23] If, after investigating, Customs officials determine that there is reasonable, but not conclusive information to indicate that the goods were produced using forced labour, they can detain the goods and require the importer to, within three months, either remove the goods from the United States or furnish documentation to prove that the goods were not produced using forced labour. If Customs officials determine conclusively that the goods were produced using forced labour, they can additionally publish this information in the Federal Register and, if the importer does not prove that the goods are free of forced labour, seize the goods.[24]

Each year, US Customs and Border Protection must report to Congress on its enforcement of the rule. Since coming into force in early 2016, Customs has detained shipments from a number of manufacturers.[25]

At this stage there is little guidance on the scope of the rule. For example, it is not clear whether prohibition applies only to the first tier suppliers of an importer or if it applies further down the supply chain. Nor is it clear what information would be sufficient to either make a complaint that goods were made with forced labour or prove the contrary. The only guidance provided by Customs and Border Protection to date is that a complaint must provide "probable cause" that the goods were made with forced labour, and in turn an importer must produce "a certificate of origin and a detailed statement demonstrating that the subject merchandise was not produced with forced labour, e.g. a supply chain audit report."[26] Customs states the evidence will be evaluated on a case-by-case basis.

Although the *Trade Facilitation and Trade Enforcement Act of 2015* is not itself a transparency requirement, compliance with the *Act* does require adequate due diligence for human rights

abuses in global supply chains. The *Act* is indicative of a continuing trend towards rigorous enforcement of human rights standards for companies reliant on overseas manufacturing.

UK *Modern Slavery Act* Transparency in Supply Chains Clause

In July of 2015 the UK enacted its own supply chain transparency requirements as part of the efforts to combat human trafficking and forced labour. The *Modern Slavery Act*, addresses trafficking and forced-labour through a number of initiatives including new criminal offences and enforcement, an anti-slavery commissioner, and victim support. Section 54 of the *Modern Slavery Act*, known as the Transparency in Supply Chains clause, establishes a regime for supply chain transparency reporting by companies in the UK.[27]

The Transparency in Supply Chains clause builds on the model set by the *California Act*, but differs both in origin and scope. Unlike the *California Act*, which was responsive to consumer demand, the Transparency in Supply Chains clause was introduced in response to business and investor pressure. The UK *Companies Act*, beginning in October 2013, required the directors of listed companies in the UK to release an annual strategic report that includes information on human rights "to the extent necessary for an understanding of the development, performance or position of the company's business".[28] When consulting on the drafting of the Transparency in Supply Chains clause both businesses and NGOs argued that the existing rule under *Companies Act* created an environment of unfair competition and was not sufficiently comprehensive of the scope of business activity subject to supply chain risk because it only required reporting by select publicly listed companies.[29]

*Under the **Modern Slavery Act** all companies of a certain size that carry on business in the UK must make an annual disclosure statement that outlines the steps it has taken during the year to ensure that slavery and human trafficking are not occurring in any of its supply chains or in any part of its own business.*

The *Modern Slavery Act* seeks to balance real transparency with reduced administrative burden and contains less prescriptive disclosure requirements than the *California Act*. Under the *Modern Slavery Act* all companies of a certain size that carry on business in the UK must make an annual disclosure statement that outlines the steps it has taken during the year to ensure that slavery and human trafficking are not occurring in any of its supply chains or in any part of its own business.[30] Rather than mandating disclosure across the five areas required by the *California Act*, the *Modern Slavery Act* gives businesses the flexibility to determine, demonstrate and explain the approach that best fits its circumstances. The business community expressed preference for this form while the bill was being drafted, arguing that it would allow them to focus resources on dealing with supply chain issues rather than navigating unclear reporting requirements.[31]

Unlike the *California Act*, the *Modern Slavery Act* requires companies to publish an annual statement on the company website, or if a company has no website make the statement otherwise accessible. The Government and stakeholders hope that with annual disclosure, published statements will change from year to year to reflect the efforts and progress achieved by each company. The annual statement must be approved by a company's board of directors, partnership, or equivalent governing body and signed by a director or partner.[32] This requirement places responsibility for a fully integrated due diligence plan at the highest level of a company, and aims to avoid siloing the issue in a corporate responsibility or public relations department.

A private members bill has been passed by the House of Lords that would expand the scope of the Transparency in Supply Chains clause of the *Modern Slavery Act* in several ways. If

passed by the House of Commons and enacted into law, the bill would require the Secretary of State to publish a list of the companies that must prepare annual slavery and trafficking statements; require companies to include their slavery and human trafficking statements in their annual reports; exclude from public procurement opportunities any company that is required to produce a statement and has not; and, require public sector entities to also prepare annual slavery and human trafficking statements. [33]

To which companies does the *Modern Slavery Act* apply?

Under the *Modern Slavery Act*, any commercial organization that meets a minimum global revenue threshold, regardless of listed status, must publish a slavery and human trafficking statement if it supplies goods and services and carries on business, or part of a business, in the UK.[34] This scope of application is broader than that of the *California Act*, which targets only the producers and retailers of certain goods. The minimum revenue threshold is determined by the Secretary of State annually with the aim of capturing businesses that can best influence conduct in their sector. The current global annual revenue threshold of £36,000,000 (approximately C$59,000,000) affects approximately 12,000 companies, a significantly larger number of companies than are covered by the *California Act*.

As of the beginning of 2017, over 1,230 statements had been filed, of which 178 are from companies domiciled outside the UK including four from Canada.

Companies with a financial year ending March 31, 2016 were the first to be required to issue statements in compliance with the new law; however, many other businesses began voluntarily reporting in advance of their annual deadlines. As of the beginning of 2017, over 1,230 statements had been filed, of which 178 are from companies domiciled outside the UK including four from Canada.[35]

The first year of reporting is still underway, so it is not yet clear how many Canadian companies will be required to prepare statements covering their own business activities in the UK. However, because the UK is Canada's third largest export destination,[36] Canadian firms may also be part of the supply chain of British companies conducting due diligence under the *Modern Slavery Act*. These British companies are already or will soon be assessing these Canadian suppliers and their supply chains to ensure the inputs are free from modern slavery.

French Due Diligence Law

During his election campaign, French President François Hollande committed to implement an ambitious corporate due diligence plan that would include reporting requirements on a range of human rights and environmental issues and the establishment of transnational liability for French companies implicated in labour issues at home or abroad.[37]

In November 2016, the French National Assembly passed the bill "*Devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*" (Due diligence requirements for parent and contracting companies bill), which would require companies registered in France that employ more than 5,000 persons in France, or more than 10,000 employees in France and abroad, to exercise human rights due diligence for their own operations, their subsidiaries, and their sub-contractors or suppliers.[38] The French legislation would require an affected company to establish and disclose a due diligence plan that includes a risk assessment; a regular process to evaluate subsidiaries, sub-contractors and suppliers for human rights risks; a process to address or prevent human rights risks; and a mechanism to receive notification or complaints about human rights risks.

Failure by a French company to establish or appropriately implement a due diligence plan could result in a fine up to 10 million euros. In addition, an incident involving the violation of basic labour or environmental laws at a facility in a company's supply chain could result in liability and a fine up to 30 million euros against the French company, where it cannot prove due diligence in monitoring its supply chain.[39] The strength of these enforcement mechanisms signal that France is taking human rights violations in international supply chains seriously.

The French legislation was sent to the Senate for final approval in November 2016 and is expected to be passed by the Senate in early 2017. If passed into law, it will affect the 150 to 200 largest companies in France.[40]

European Union *Directive 2014/95/EU*

EU *Directive 2014/95/EU* regarding disclosure of non-financial and diversity information is intended to improve company disclosure of social and environmental information in order to identify sustainability risks and increase investor and consumer trust.[41] EU member states were required to incorporate the Directive into national legislation by December 2016.

*EU **Directive 2014/95 EU** regarding disclosure of non-financial and diversity information is intended to improve company disclosure of social and environmental information in order to identify sustainability risks and increase investor and consumer trust.*

The *Directive* requires large companies (those with more than 500 employees) listed on EU markets to disclose relevant environmental and social information in their annual report. The first reports, regarding the 2017 fiscal year, are to be published in 2018.

The information required under the *Directive* includes:

- A description of the company's business model;
- A description of the company's policies and due diligence processes related to environmental, social and employee matters, respect for human rights, and anti-corruption and bribery matters;
- The outcomes of those policies;
- The principal risks related to those matters in its operations and business relationships (i.e. supply chain) and how it manages those risks;
- Relevant key performance indicators; and
- A description of the company's diversity policy for board and management, how it has been implemented and the results in the reporting period.

If a company does not have policies related to these matters, it should explain why it does not (a "comply or explain" model).

To which companies does the *Directive* apply?

Although the *Directive* applies only to EU-listed companies, and should not therefore directly impact Canadian companies (other than those within the supply chains of EU companies), it does signal a growing consensus internationally on the type of disclosure expected from companies. As this disclosure becomes more commonplace amongst global firms, investors will come to expect comparable disclosures from Canadian companies to assist in making investment decisions.

Other legislative initiatives

Australia has announced that it is considering requiring large-scale businesses to publicly report on their actions to address supply chain labour exploitation.[42] The announcement came in response to recommendations of a multi-stakeholder Supply Chains Working Group convened by the Australian Government to advise it on how to address the issue of forced labour and human trafficking in supply chains. The working group recommended implementing legislation similar to the UK *Modern Slavery Act*.[43]

In October 2016 a Swiss citizens' coalition filed a federal popular initiative, a citizen-proposed amendment to the Federal constitution, having collected more than the 100,000 signatures required for popular initiatives to go to vote. The initiative would require a Swiss company to conduct due diligence to ensure internationally recognized human rights and environmental standards are respected by the company itself and any companies under its legal or de facto control, and impose liability where internationally recognized human rights and environmental standards are violated and the company does not prove due diligence.[44] The initiative has been submitted to the Federal Council (Executive) and the Parliament who can either accept or reject the amendment or draft a counter-proposal. If it is not accepted the initiative will be put to a popular vote. Approval by majority of the electorate and the majority of the cantons is required for an initiative to pass.[45]

In 2015, a federal initiative was proposed in the United States that mirrored the scope and requirements of the *California Act*. The *H.R. 3226 US Business Supply Chain Transparency on Trafficking and Slavery Act of 2015* was sponsored by members of both parties and referred to the House Financial Services committee for consideration. The Bill sought to amend Section 13 of the *Securities and Exchange Act* to require an issuer with annual global receipts of $100 million or more to disclose if it has a policy in place to address forced labour, slavery, human trafficking, and the worst forms of child labour; if it has made efforts to assess trafficking and forced labour risk; and what it has done to identify and eliminate any risks.[46] Unlike California's law, the proposed Act would apply to publicly traded companies from all industries that have annual global receipts of $100 million. Given the new administration and Congress, the Bill is unlikely to go any further, but does again indicate the growing consensus on the type of disclosures that will be expected from companies with global supply chains.

Would Canadian investors benefit from domestic supply chain transparency legislation?

Canadian investors could benefit from the adoption of a supply chain due diligence reporting legislation at home and should take the lead in pushing for the eradication of forced labour.

Although Canadian issuers are already required to report material information to investors, issuers have discretion in determining what is material to the business, and many do not report information on supply chain working conditions either because the details are unknown to them or they do not deem the information material to investors.

However, the potential materiality of supply chain information is clear to investors; companies in Canada and internationally have already experienced reputational, operational and legal impacts due to supply chain labour and human rights issues.

While Canadian companies are accustomed to benchmarking their reporting to Canadian sector peers, in a global investment universe Canadian companies are increasingly compared to international sector peers in investment decisions. As human rights-related information becomes available to investors from issuers in other jurisdictions, Canadian firms that are not providing this information in a reliable form will be seen to be lacking.

The appetite is growing steadily amongst asset owners and managers in Canada for environmental, social and governance-related information from companies as these issues become incorporated into investment models and decision-making. Canadian issuers would do well to take heed.

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For investors, the advantage of legislated supply chain disclosure, of course, is that it provides consistency and comparability between the information provided by each issuer. In addition, legislation can be drafted to harmonize with existing human rights standards and the reporting requirements in other jurisdictions to standardize reporting. For example, legislation can align reporting with labour and human rights standards set out in international conventions, such as:

- the *UN Guiding Principles on Businesses and Human Rights*, which affirm the responsibility of businesses to respect human rights throughout their operations;[47]
- The *OECD Guidelines for Multinational Enterprises*, which call on businesses to contribute to the elimination of all forms of forced labour and take adequate steps to ensure that forced labour does not exist in their operations;[48] and
- internationally accepted basic labour rights set out in the ILO's *Declaration on Fundamental Principles and Rights at Work*.

For issuers, the advantage to legislated supply chain disclosure is that all publicly-traded and privately-held companies that meet the minimum threshold are required to report similar information, removing any concerns about competitive disadvantages for first-movers on increased transparency.

Best practices for due diligence

Much can be learned from best practices already adopted for supply chain due diligence by other companies. The UK's Ethical Trading Initiative, for example, identifies the following four elements of a strong due diligence framework:[49]

1. Assess actual and potential human rights risks

Companies should be able to map their supply chains back to raw materials and review employment type, country, and specific risks. They should also consult key stakeholders and actively engage with the most relevant stakeholders, including trade unions or worker representatives, civil society organizations and other buyers to review risk, and identify direct and indirect o causes and impacts

2. Identify leverage, responsibility and action

Companies should consider how their actions directly or indirectly contribute to risk. They should assess their relationships with suppliers and where possible support capacity building instead of enforcing top-down compliance or threatening termination of the relationship. They should decide on what constructive action will be taken if risks or human rights violations are found.

3. Mitigate risk and provide remedy for workers

Companies should identify which working practices, such as recruitment methods or payment systems, drive rights abuses. They should ensure a grievance and remediation system is in place for workers who have been harmed.

4. Monitor, review, report and improve

Companies must explore meaningful ways of monitoring working conditions that allow them to both act on findings and monitor results. Business should be careful when relying on audits, as there is strong evidence that they often fail to pick up serious labour rights abuses. Companies should be encouraged to use participatory monitoring that uses input from key stakeholders so that the realities of risk are best made known.

What should due diligence reporting look like in Canada?

In order to develop a supply chain transparency reporting regime that is useful for investors, the following principles should be considered:

Reporting should be consistent, but policies and processes can vary: Reporting requirements should encourage companies to approach their supply chain due diligence effectively and consistently while at the same time giving companies the flexibility to develop a program that makes the most sense for their circumstance. While itemized disclosure runs the risk of reporting becoming a "box-ticking" exercise, some guidance is needed both to improve comparability of data and to assist companies in focusing on the content of the report rather than trying to determine what is being asked of them. The UK *Modern Slavery Act* and the Dodd-Frank-related Conflict Mineral Reporting regime in the US[50] both appear to have achieved that balance, offering a framework for reporting but allowing for variation in the contents of policies and practices. The EU *Directive* provides additionally for a "comply or explain" approach, which allows a company to provide a clear and reasoned explanation of why a specific policy area or reporting requirement is not relevant to its operations. A clear reporting framework and detailed guidance should prevent companies from making blanket declarations that due diligence is unnecessary in their supply chain.

Reporting should be publicly available: Requiring companies to publicly report on their supply chain due diligence efforts ensures all Canadian stakeholders, including investors, can access information relevant to them. Posting a statement in a prominent position on a firm website and/or including it in annual reports will achieve this purpose. Alternately, an online public registry may be appropriate.

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Reporting should be updated annually: Effective due diligence requires companies to evaluate risk in an ongoing manner. They should report on progress or changes each year to reflect the dynamic nature of supply chains. Publicly-traded companies already produce disclosures related to material risks on an annual basis under securities regulations, on the understanding that specific risks can change over time. While policies themselves may not change annually, procedures, specific risks and outcomes may.

Reporting should be required from both private and public companies across all sectors, excluding SMEs: Applying a disclosure law to both public and private companies ensures the law has the greatest impact and levels the playing field. At the same time SMEs should not be expected to meet the same requirements as a large-cap public company. Some issues to be determined include:

- A minimum threshold for application of the reporting requirement should be determined through multi-stakeholder consultation, but should aim to cover only companies large enough to conduct due diligence without it negatively impacting overall business operations. The threshold could be based on annual revenue or number of employees. Guidance on how to determine the threshold can be taken from the example of the UK and California, where the percentage of total commerce that should be covered by the laws to make them effective was determined at 80%-90%. In those instances, the law was set to apply to large companies according to their annual revenue rather than number of employees to ensure consistency with existing standards.

- The UK *Modern Slavery Act* applies to entities doing business in the jurisdiction, rather than companies that are listed or incorporated in the country's market. The advantage to this approach is that it avoids competitive disadvantages for local businesses *vis a vis* international competitors also doing business in the country.
- Human rights risks within a company's own operations and that of its subsidiaries and franchisees can be just as relevant as the risks found down the supply chain at sub-contracting or purchasing levels. For investors to have assurance that all salient human rights risks are addressed, the legislation should clearly define the business relationships that fall within reporting requirements and the scope of such relationships should be determined in light of actual and potential human rights risks. The scope of business activities covered by the French due diligence law or the EU *Directive* capture this reality.

Reporting should be signed by senior company officials: Best practices for due diligence requires an approach that is fully integrated in business operations. Requiring sign-off from a company representative adds accountability and ensures that the drafting of a disclosure statement is not just a task for the public relations department. From a shareholder perspective, sign-off by the board of directors is usually preferable due to the representative nature of the board, but sign-off by the CEO or COO may also be sufficient.

Reporting guidance should open the door for broader human rights due diligence: Although the UK *Modern Slavery Act and the California Transparency in Supply Chains Act 2010* focus on forced labour and human trafficking, international standards such as the UN Guiding Principles on Business and Human Rights identify a corporate responsibility to respect a wider range of human rights. Further, a company's legal, operational and reputational risks are not limited to forced labour. Investors have an interest in understanding the full range of relevant risks and practices to prevent or mitigate those risks. In practice, most companies that develop supply chain due diligence policies and practices do not limit those policies and practices to forced labour concerns. Even if a reporting requirement is focused narrowly on forced labour, guidance documents should also identify standards such as the ILO Core Conventions, or more general human rights documents like the UN Guiding Principles, as relevant standards for supply chain due diligence systems.

Reporting should come with mechanisms to ensure compliance: To ensure compliance, a list of companies required to report should be made publicly available, and fines for failure to report should be established. While companies ought not to be subjected to frivolous lawsuits based on reporting under the legislated requirement, reporting should be subject to no lesser legal standards than the material reporting currently required of publicly-listed companies.

Resources on supply chain due diligence and reporting

Ropes & Gray: The UK Modern Slavery Act – Resources for Compliance
https://www.ropesgray.com/newsroom/alerts/2017/01/The-UK-Modern-Slavery-Act-Resources-for-Compliance.aspx

Know The Chain: Practical Resources
https://knowthechain.org/resources

Ethical Trading Initiative: Resources
http://www.ethicaltrade.org/resources

Business & Human Rights Resource Centre: UK Modern Slavery Act & Registry
https://business-humanrights.org/en/uk-modern-slavery-act-registry

Notes

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[13] *Ibid*.

[14] KnowTheChain, *Five Years of the California Transparency in Supply Chains Act*, Insight Brief (2015), online at: https://www.knowthechain.org/insights-brief.

[15] *Ibid*.

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[17] KnowTheChain, *supra* note 14.

[18] KnowTheChain, *supra* note 14.

[19] Francisca Mok, "January 1, 2012 Deadline for Large Companies Doing Business in California to Publicly Disclose Efforts to Eradicate Slavery and Human Trafficking in Supply Chain", *JDSupra* (08 November 2011), online at: http://www.jdsupra.com/post/documentViewer.aspx?fid=b44cecbf-b29f-4cfe-a107-a5b60bb2506d.

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[35] Business and Human Rights Resource Centre, *UK Modern Slavery Act and Registry*, (Accessed 4 January 2017), online at: https://business-humanrights.org/en/uk-modern-slavery-act-registry.

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SHAREHOLDER ASSOCIATION
for RESEARCH & EDUCATION

Box 11171, Royal Centre, 26th Floor,
1055 West Georgia Street
Vancouver, BC V6E 3R5

T: 604 408 2456
F: 604 408 2525
E: info@share.ca

www.share.ca