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## WHITE PAPER

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### Global Spotlight on Labor Trafficking in Corporate Supply Chains—Know Your Obligations

Human trafficking is a global problem that is receiving the attention of legislators and law enforcement. Legislative efforts are focused largely on increasing corporate responsibility in the eradication of human trafficking. New legislation requires corporations to identify, examine, and eliminate the use of forced labor in their production and manufacture supply chains. Corporations now face the threat of civil and criminal ramifications for failing to comply with these new and heightened requirements.

This Jones Day *White Paper* describes the recent legislation in this area, sets forth the possible ramifications for failing to know and understand the corporate obligations, and analyzes the possibility of future legislation and litigation.

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## A GLOBAL PROBLEM

The fight to end human trafficking is one of the most important legal and social causes of our time, and it is increasingly drawing the attention and inspiring the actions of a wide array of interested parties. Authorities in all branches of government, victims, lawyers, celebrities, community organizations, and the media are shining a spotlight on this global human rights issue. New and strengthened laws, allowing broader avenues for criminal prosecution and stiffer civil penalties, are being proposed and enacted on a regular basis in legislatures around the world.

Most recently, lawmakers have focused their attention on corporations. Lawmakers and law enforcement are seeking to hold corporate entities responsible for forced labor used in their supply chains. U.S. corporate entities supplying Americans with their goods have routinely used a chain of foreign-based companies in the production of their goods. Whether it be an ingredient used in a food product sold at a large grocery supplier or a piece of leather sewn into a pair of shoes, foreign-based supplies are often a necessary component to the manufacture, distribution, and sale of consumer goods. What is new and evolving is a corporation's legal obligation to examine its chain—from top to bottom—to ensure that neither forced labor nor substandard labor conditions have been used by any link.

This new focus is for good reason. The International Labor Organization estimates that, as of September 2017, as many as 24.9 million humans—adults and children—are the victims of forced labor across the world. The U.S. Department of Labor, as of September 2016, has identified 139 U.S. consumer products from 75 countries that were made with forced labor. No industry is immune—affected industries include cell phones, leather, shoes, cars, shrimp, and chocolate, among many others.

Given the scope of this problem and the potential for legal, financial, and reputational harm, all corporate entities should take steps to ensure that they are sufficiently aware of the nature and extent of any risks of forced labor in their supply chains and to responsibly address those risks as part of an overall compliance program. This *White Paper* sets forth: (i) legislative trends relating to combatting forced labor in supply chains; (ii) potential ramifications for failing to satisfy compliance requirements; and (iii) an assessment of possible future developments in this area.

## THE LAWS

### California

Laws and ordinances targeted at eradicating forced labor in corporate supply chains are being proposed and enacted at record speed. California was the first state to pass this type of legislation. The California Transparency in Supply Chain Act of 2010 (SB 657) went into effect on January 1, 2012.<sup>1</sup> The act requires retailers and manufacturers that conduct business in California and have annual worldwide gross receipts exceeding \$100 million to disclose on their websites the steps they have taken to eliminate labor trafficking from their direct supply chains.<sup>2</sup>

### Federal

The California Transparency in Supply Chain Act prompted action from lawmakers outside California (both elsewhere in the United States and globally). President Obama issued Executive Order 13627, titled “Strengthening Protections Against Trafficking in Persons in Federal Contracts,” in September 2012. The executive order was aimed at eliminating labor trafficking with respect to government contracts and requires all federal contractors and subcontractors to disclose antitrafficking efforts and cooperate fully with the federal government in investigations into whether forced labor was used in the companies' supply chains.<sup>3</sup>

The Federal Acquisition Regulatory Council (“FAR”) enacted final rules to implement the executive order in 2015. The “Ending Trafficking in Persons”<sup>4</sup> rule (“FAR Rule”) imposes requirements on all federal contractors, subcontractors, and their employees. First, the FAR Rule affirmatively prohibits covered entities from engaging in specific, trafficking-related activities, including destroying employees' identification documents, using misleading or fraudulent recruitment policies, providing housing that does not meet delineated standards, failing to provide employees with contracts in their native language, or failing to pay the cost of return transportation. The FAR Rule goes on to specify reporting requirements for all federal contractors. Federal contractors face additional reporting requirements if they become aware of credible violations of the above prohibitions. In such an instance, the contractor must notify (i) the agency inspector general; (ii) the agency official responsible for suspension and debarment actions; and (iii) if appropriate, law enforcement. The FAR Rule further requires contracting officers to report any allegations substantiated in

administrative proceedings regarding Executive Order 13627 or the Trafficking Victims Protection Act.<sup>5</sup>

There are additional requirements under the FAR Rule for federal contractors or subcontractors engaged in contracts or subcontracts abroad involving services or supplies exceeding \$500,000. The requirements include a compliance component and a certification component. The compliance component requires covered entities to create and implement compliance plans targeting trafficking activities. The entities must publish the plans, once created, at their respective workplaces and on their websites.<sup>6</sup> These entities must also certify, prior to accepting an award, that they implemented a compliance plan meeting the FAR Rule requirements and, after conducting due diligence, either determined that, to the best of the contractor's knowledge and belief, neither it nor any of its agents, subcontractors, or their agents are engaged in any trafficking activities, or the contractor took appropriate remedial and referral actions if any abuses were found.<sup>7</sup>

President Obama broadened the rules to government trade when he signed the Trade Facilitation and Trade Enforcement Act ("TFTEA") into law on February 24, 2016. Generally, the TFTEA relates to border protection, trade enforcement, and trade evasion. The TFTEA also reaches trafficking-related issues.<sup>8</sup>

The TFTEA strengthens prohibitions on the importation of goods produced by forced or trafficked labor. Upon its passage, the TFTEA eliminated a so-called "consumptive demand" exception to the prohibition against importing merchandise made by forced or indentured labor. The "consumptive demand" exception worked through a loophole that allowed the importation of such goods if the goods were not made in high enough quantities domestically to meet U.S. consumptive demands. Closing the loophole through TFTEA represents an effort to prevent goods produced through substandard working conditions from entering the United States, discouraging such conditions in working environments abroad.<sup>9</sup>

### Other State/Local Jurisdictions

With a goal similar to President Obama's executive order, Maryland enacted House Bill 425 just one month after the executive order was issued. While that bill was ultimately invalidated as written,<sup>10</sup> Houston has now followed suit with its own city ordinance, prohibiting any company with forced labor in its supply chain from doing business in Houston.<sup>11</sup>

Various attempts have been made to pass a federal equivalent of these state, local, agency, and customs laws in the U.S. Congress. The Business Supply Chain Transparency on Trafficking and Slavery Act of 2014 (H.R. 4842) was introduced in the House on June 11, 2014. The bill would have required public corporations that have annual worldwide gross receipts of over \$100 million to disclose steps they have taken to eradicate labor trafficking both on their website and in their annual filings with the Securities and Exchange Commission.<sup>12</sup> The bill was referred to a number of committees, but lost momentum and never made it to a vote in either house. The bill was introduced on two more occasions (S. 1968, H.R. 3226) in 2015, but again did not make it to a vote.<sup>13</sup>

### Foreign Governments

Even more aggressive laws are being pursued globally. The United Kingdom, France, and the European Union have all recently passed supply chain legislation. Leading the pack, the United Kingdom passed the Modern Slavery Act of 2015, which provided that an organization covered under the act must publish a slavery and human trafficking statement on its website each fiscal year, detailing the steps, if any, the organization has taken to eliminate slavery and human trafficking from any part of its business.<sup>14</sup>

The European Union's Non-Financial Reporting Directive (Directive 2014/95/EU) went into effect in January 2017, requiring large "public-interest"<sup>15</sup> companies operating in Europe to disclose certain nonfinancial information, including the company's policies relating to human rights.<sup>16</sup> France passed the Corporate Duty of Vigilance Law in February 2017, which requires that large companies publish, establish, and implement a "vigilance plan," describing the measures used to identify and prevent risks of serious infringements of human rights that result directly or indirectly from the company's actions.<sup>17</sup>

Both Australia and Hong Kong have announced plans to pass legislation requiring large corporations to issue a slavery and human trafficking statement.<sup>18</sup>

### RAMIFICATIONS

Companies that do not comply with the various supply chain transparency laws and do not take steps to prevent labor

trafficking are subject to significant legal consequences and related financial and reputational harm. Potential legal consequences include class actions, shareholder derivative suits, enforcement actions from local attorneys general, and the potential for criminal ramifications.

### **Private Plaintiff Class Actions**

Private plaintiffs began filing putative class actions against corporations for utilizing supply chains tainted with labor trafficking and for failing to notify their consumers in 2015.

In the first wave of suits, private plaintiffs brought putative class actions against large chocolate manufacturers, alleging violations of California's Unfair Competition Law, Legal Remedies Act, and False Advertising Law due to the companies' failure to disclose on product packaging that a product, or ingredients in the product, may have been sourced using forced labor.<sup>19</sup> Each of the claims was dismissed. The courts reasoned that the presence of labor trafficking did not pose safety concerns for consumers,<sup>20</sup> the California consumer statutes did not require the disclosure of such information,<sup>21</sup> and compliance with the California Transparency in Supply Chain Act created a "safe harbor."<sup>22</sup>

Private plaintiffs have also initiated litigation to scrutinize the online disclosures that corporations make under the California Transparency in Supply Chain Act. In a complaint filed against a large wholesale grocer, plaintiffs alleged that the grocer knew of labor trafficking in its supply chain and, therefore, the statement on its website that it had a corporate policy of prohibiting human rights abuses in its supply chain was false and misleading.<sup>23</sup> The plaintiffs claimed that the allegedly misleading statement violated California's Unfair Competition Law, Legal Remedies Act, and False Advertising Law.<sup>24</sup> The district court dismissed the claim, reasoning that the plaintiffs failed to establish reliance, since they did not claim to have read and relied on the grocer's statement on its website.<sup>25</sup> The Ninth Circuit upheld, but found that the disclosure was not required because it did not go to the "central functionality" of the product.

While none of these complaints survived the defendants' dispositive motions, new plaintiffs will likely continue to test legal theories to find means by which to recover damages from corporations that may have used labor trafficking in their supply chains.

One such suit is currently pending in the District of Massachusetts—a class action suit filed against a large chocolate manufacturer, seeking to hold the manufacturer accountable for the use of child labor in its production of cocoa.<sup>26</sup> Industry experts are watching this case closely, as it could be the first to survive the pleadings stage.

### **Shareholder Derivative Suits**

Corporations that fail to take appropriate steps to eliminate labor trafficking from their supply chains may also face shareholder derivative suits. In one such instance, the shareholders of another large chocolate manufacturer filed suit, demanding inspection of the company's books and records to determine whether the corporation's supply chain involved labor trafficking.<sup>27</sup> The court dismissed the complaint, finding that the shareholders failed to allege sufficient facts to provide a credible basis for the court to infer corporate wrongdoing.<sup>28</sup> The court found that although the shareholders alleged facts that suggested wrongdoing within the cocoa supply chain generally, the shareholders failed to allege facts suggesting illicit activity within the supply chain of the specific corporation at issue.<sup>29</sup> Although it resulted in a dismissal, this case demonstrates the viability of a derivative complaint directed at a company whose shareholders could allege facts sufficient to support an inference that the corporation facilitated human trafficking.

### **Attorney General Enforcement Actions and Debarment**

The California Attorney General has not yet initiated an action for failure to comply with the California Transparency in Supply Chain Act. Instead, the attorney general's office has focused on educating companies about best practices for compliance. For example, in April 2015, the attorney general issued a resource guide with information on the act and recommendations for how to comply with the act. The office also sent a letter to over 1,000 corporations, stating that they may be subject to the act's requirements and listing the type of information that must be disclosed. The UK Department of Justice, on the other hand, has taken a more aggressive approach to policing the Modern Slavery Act, initiating 51 prosecutions under the act in 2016.<sup>30</sup>

While there have been no public debarment actions, the prospect of debarment looms as a potential consequence for companies that work with or for government entities and fail to comply with applicable supply-chain laws. Even more importantly, companies that do not proactively deal with their supply chain issues will not receive federal contracts or subcontracts.

## WHAT'S NEXT

The focus on corporate supply chains is not going away. Additional countries, states, and local governments will no doubt pass new laws requiring action by corporations. It is quite probable that a federal supply-chain law will also be passed, resulting in the extension of compliance requirements to all U.S.-based companies. Plaintiffs' lawyers will continue to put forth legal theories in new suits against companies, alleging unlawful supply chain practices. Law enforcement has begun by taking action against corporate entities responsible for facilitating sex trafficking—and stepped up enforcement of labor trafficking will most certainly follow. And, of equally critical importance for companies, young consumers are paying close attention to matters of social responsibility and will make purchasing decisions heavily motivated by their understanding of the compliance practices and attitudes of prospective sellers.

What this means is that companies should assess their existing compliance programs, if any, and take appropriate action, as a matter of law, responsible governance, and good business. If no compliance program relating to forced labor is in place, one should be developed and implemented with dispatch. If such a compliance program is in place, it should be evaluated on a regular basis in light of relevant developments and updated with enhanced compliance measures where necessary.

Companies should be aware of the opportunities for assistance in navigating these areas from various nongovernment organizations, including the Responsible Business Alliance. Companies should consult with counsel and labor experts, including the nongovernment agencies, to fully understand the ramifications of this issue. Those that fail to understand the scope of the problem and fail to establish and tailor compliance efforts to these burgeoning legal requirements not only risk sanctions and legal action, but face real business concerns as consumers will increasingly demand an understanding of where their products came from and who worked to make them.

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## ENDNOTES

- 1 California Department of Justice, "The California Transparency in Supply Chains Act: A Resource Guide."
- 2 Cal. Civ. Code § 1714.43 (a)–(b).
- 3 Exec. Order No. 13627.
- 4 The FAR Rule is codified at 48 C.F.R. pts. 1, 2, 9, 12, 22, 42, and 52.
- 5 *Id.* at § 52.222-50(d).
- 6 *Id.* at 52.222-50(h).



- 7 *Id.* at § 52.222-56.
- 8 See generally 19 U.S.C. §§ 4311-4323.
- 9 See U.S. Customs & Border Prot., Trade Facilitation & Enforcement Act of 2015, available at <https://www.cbp.gov/sites/default/files/assets/documents/2016-Apr/tfea-repeal-consumptive-demand-clause-faqs.pdf> (last visited June 6, 2017) (describing impact of TFEA on the consumptive demand exception).
- 10 *Nat'l Ass'n of Manufacturers v. S.E.C.*, 800 F.3d 518, 530 (D.C. Cir. 2015)
- 11 See City of Houston Exec. Order No. 1-56 ("Zero Tolerance for Human Trafficking in City Service Contracts and Purchasing") (effective Oct. 19, 2017).
- 12 <https://www.congress.gov/bill/113th-congress/house-bill/4842?q=%7B%22search%22%3A%5B%22H.R.+4842%22%5D%7D&r=5>
- 13 <https://www.congress.gov/bill/114th-congress/senate-bill/1968/actions?q=%7B%22search%22%3A%5B%22Business+Supply+Chain+Transparency+on+Trafficking+and+Slavery+Act+of+2015%22%5D%7D&r=5>; <https://www.congress.gov/bill/114th-congress/house-bill/3226?q=%7B%22search%22%3A%5B%22Business+Supply+Chain+Transparency+on+Trafficking+and+Slavery+Act+of+2015%22%5D%7D&r=6>.
- 14 Modern Slavery Act of 2015, Part 6: Transparency in Supply Chains Etc.
- 15 "Public-interest companies" include banks, insurance companies, and other companies designated as "public-interest companies" by member states due to size, activities, and number of employees. European Commission, "Disclosure of Non-Financial and Diversity Information by Large Companies and Groups: Frequently Asked Questions," [http://europa.eu/rapid/press-release\\_MEMO-14-301\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-301_en.htm).
- 16 European Commission, "Non-Financial Reporting," [https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting\\_en#overview](https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en#overview).
- 17 European Coalition for Corporate Justice, "French Corporate Duty of Vigilance Law: Frequently Asked Questions," <https://www.business-humanrights.org/sites/default/files/documents/French%20Corporate%20Duty%20of%20Vigilance%20Law%20FAQ.pdf>.
- 18 Business & Human Rights Resource Centre, "Establishing a Modern Slavery Act in Australia," <https://www.business-humanrights.org/en/inquiry-into-establishment-of-a-modern-slavery-act-in-australia>; Business & Human Rights Resource Centre, "Hong Kong: Modern Slavery Law Proposed at Legislation Council, with Requirements for Companies to Publish Statements on Human Trafficking," <https://www.business-humanrights.org/en/hong-kong-modern-slavery-law-proposed-at-legislative-council-with-requirements-for-companies-to-publish-statements-on-human-trafficking>.
- 19 *Barber v. Nestle USA, Inc.*, 154 F.Supp.3d 954 (C.D. Cal. 2015), *aff'd*, No. 16-55041, 2018 WL 3358349 (9th Cir. July 10, 2018); *Tomasella v. Nestle USA, Inc.*, 18-CV-10269, (D. Mass. filed Feb. 12, 2018) (pending on defendant's motion to dismiss); *Robert Hodsdon v. Mars, Inc.*, 162 F.Supp.3d 1016 (N.D. Cal. 2016), *aff'd*, 891 F.3d 857 (9th Cir. 2018); *Wirth v. Mars Inc.*, CV 15-1470, 2016 WL 471234, at \*1 (C.D. Cal. Feb. 5, 2016), *aff'd*, No. 16-55280, 2018 WL 3358359 (9th Cir. 2018).
- 20 *Wirth*, 2016 WL 471234, at \*4.
- 21 *Hodsdon*, 162 F.Supp.3d at 1020.
- 22 *Barber*, 154 F.Supp.3d at 962.
- 23 *Sud v. Costco Wholesale Corp.*, 229 F.Supp.3d 1075, 1079–80 (N.D. Cal. 2017), *appeal filed* Feb. 21, 2017.
- 24 *Id.* at 1079.
- 25 *Id.* at 1083–84.
- 26 See *Tomasella v. Nestle USA, Inc.*, 18-CV-10269, (D. Mass. filed Feb. 12, 2018) (defendant filed a motion to dismiss on April 19, 2018).
- 27 *Louisiana Mun. Police Employees' Ret. Sys. v. Hershey Co.*, No. CV 7996-ML, 2013 WL 6120439, at \*3–4 (Del. Ch. Nov. 8, 2013).
- 28 *Id.* at \*1.
- 29 *Id.*
- 30 <https://www.compliancekristy.com/blog/2018/3/6/is-yours-one-of-the-6000-companies-that-failed-the-modern-slavery-act>.

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