THE REMEDY PROJECT

Enforcing Human Rights Regulation

BORROWING FROM THE FCPA ENFORCEMENT PLAYBOOK

Introduction

Over the past decade, the U.S., Europe, Australia and other jurisdictions have taken legislative action towards ensuring human rights protection in the global supply chain.[1] Many of these laws focus on supply chain transparency by setting disclosure requirements. The European Commission ("EC") also recently proposed a Corporate Sustainability Due Diligence Directive, which takes the further step of requiring certain companies to conduct human rights (and broader sustainability) due diligence throughout their supply chains. While this is a welcome trend for human rights observers, some also see legislative action alone as insufficient; enforcement efforts need to mirror legislative progress to translate into actual change. This is especially true where forced and indentured labor, oppressive working conditions, and other human rights abuses are prevalent in countries where upstream suppliers operate. Not unexpectedly, enforcement agencies have started to step up their efforts. For example, the U.S. Department of Homeland Security banned imports of products made by Top Glove and YTY Group into the U.S. market out of concerns around forced labor. The import ban has a significant business impact on brands purchasing from these suppliers. Companies can also be exposed to civil litigation as a result. This could be the beginning of a broader trend towards increased enforcement activity.

In response to these developments, there are some important questions for the private sector to consider: to what extent will proactive efforts, like disclosure and due diligence, be required? Approaches for assessing and mitigating human rights risks can run a broad range, and there is no one-size-fits-all process suitable across different sectors, markets, and business models. Relatedly, how will human rights regulators view a company's efforts on human rights compliance in the course of an investigation, and how will regulators decide on appropriate penalties? These questions are critical to informing businesses about how to properly comply with new laws and regulations.

One way to consider these questions is to draw parallels with anti-bribery enforcement. In particular, the U.S. Foreign Corrupt Practices Act's ("FCPA") enforcement policy serves as an interesting model for how authorities could enforce human rights regulations. The FCPA shares parallels with new human rights legislation—both have overarching policy goals of stemming unethical conduct (bribery versus human rights abuse) that are often endemic and prevalent in certain geographic markets. Both must consider complexities brought about by varying legal, business and cultural risk factors across various sectors, markets, and business models. Most notably, the EC's recent Corporate Sustainability Due Diligence Directive and the FCPA, as reflected in its enforcement policy, both impose expectations on companies to proactively design and implement internal procedures for assessing the risks of violations at the company level. As such, both regimes focus not only on penalizing specific violations, but also on encouraging the development of strong internal compliance systems.

1 Examples include the California Transparency in Supply Chains Act, the U.K.'s Modern Slavery Act of 2015, Australia's Modern Slavery Act 2018, Germany's Supply Chain Due Diligence Act, the U.S.'s Uyghur Forced Labor Prevention Act.

The FCPA's Enforcement Policy And Record

The FCPA was first enacted 45 years ago in 1977. The FCPA's antibribery provisions prohibit companies and individuals with certain connections to the U.S. from paying or offering bribes to non-U.S. government officials in exchange for business advantages. The legislation was inspired by newfound concerns at the time that U.S. companies were often bribing foreign government officials in the course of international business activities. While such activities may have been arguably consistent with local "culture," where giving lavish gifts to government officials is part and parcel with doing business, the U.S. legislature nonetheless acted to prohibit such conduct (and not surprisingly, enforcement agencies generally do not accept a "do-as-the-Romans-do" defense).[2]

The FCPA's enforcement history has changed significantly over the past 15 years. Its enforcement was sporadic until the 2000s, when the law saw a significant uptick in enforcement activity. Since then, major, billion-dollar enforcement settlements have followed (see figure 1), and a number of household-name companies have made headlines in turn.

Incentivizing Sound Internal Compliance Programs

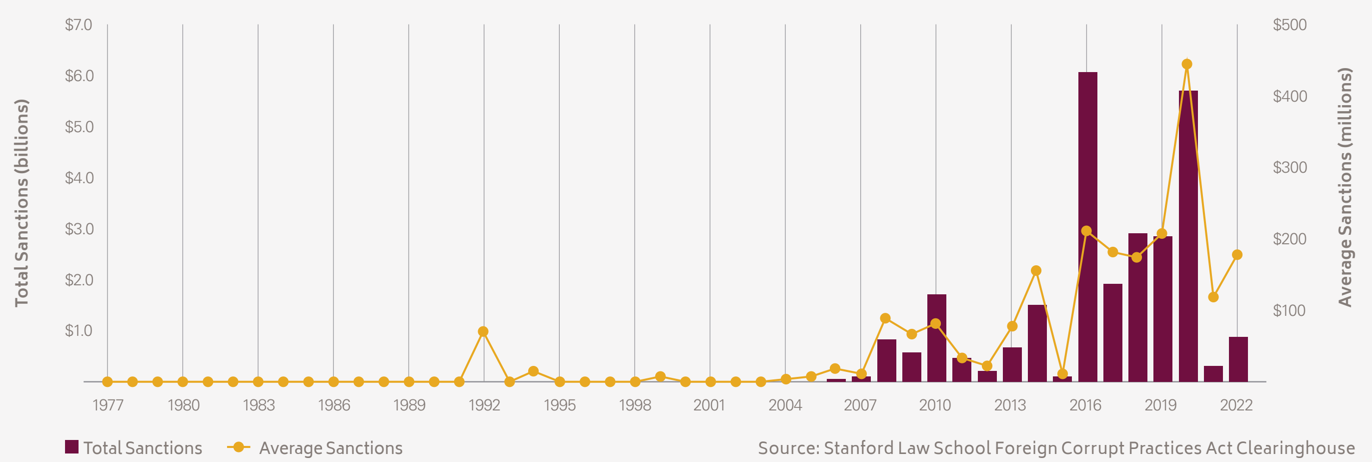
In the enforcement process, a company under an FCPA investigation can argue for a lesser penalty by showing that it has in place a well-designed antibribery compliance system. Such a system would include, for example, clear policies and effective communication of those policies, real implementation of internal controls and monitoring mechanisms, comprehensive third-party due diligence and audit procedures, continuous system assessment and enhancements to address newfound risks, and appropriate and timely "post hoc" action to penalize malfeasant employees and managers.

A particularly important factor that regulators consider when assessing a company's penalty is whether, when the violation occurred, the company already had in place adequate compliance systems to effectively deter (*e.g.*, clear policies, training and internal controls), detect (*e.g.*, through monitoring processes and reporting channels with antiretaliation protections), and remedy improper conduct (*e.g.*, established protocols for thoroughly investigating root causes of improper conduct and terminating relationships with problematic employees, managers and business partners). A company able to demonstrate such a strong compliance system may be able to avail of "credits" that translate to a lesser penalty in case of an enforcement action. In contrast, a company that is deemed to have disregarded its compliance system or "put its head in the sand"—for example, porous internal controls, omitting due diligence steps when dealing with risky business partners, and/or a lack of procedures to identify and resolve compliance weaknesses—will be looking at heavy monetary fines and extensive compliance enhancements obligations.

Interestingly, there is no specific regulation setting the standard on what exactly is an "adequate" and "effective" compliance program. The U.S. Department of Justice ("DOJ"), which is one of the main entities

2 While the FCPA has a "facilitation payment" exception, the exception is interpreted narrowly in actual enforcement.

Figure 1: Total and Average Sanctions Imposed on Entity Groups per year



Source: Stanford Law School Foreign Corrupt Practices Act Clearinghouse

charged with prosecuting FCPA violations, has noted that an effective program can take various designs and approaches. Such a program can be bespoke for the company's business model, its size, the markets in which it does business, and a myriad of other factors. Hence, in the enforcement process, regulators and companies engage in a dialogue regarding the compliance program's adequacy and effectiveness, through which the DOJ will determine appropriate enforcement action against the company. Over time, this process has driven the development of informal standards for antibribery compliance programs. While no two companies' antibribery compliance programs are exactly the same, certain compliance program ideas and features have become "common denominators." Specific expectations and "soft" standards have developed at the sector level and for certain markets. One example is the acceptance of risk-based approaches to designing antibribery compliance programs, whereby resource deployment and stricter internal controls are shifted towards higher-risk business lines and geographical markets. Regulators also "benchmark" a company's compliance system by comparing it with those of its peers. For example, a company missing a system feature common to other companies in its field will draw a regulator's attention. This has led to organic development of "soft law" standards. One could contemplate the development of similar standards and/or responses in the context of the Corporate Sustainability Due Diligence Directive that would serve to recognize limitations in current due diligence systems and reporting (*e.g.* excessive reliance on social audits) and provide ways and means of addressing these. In particular, creating legislative "safe harbor" risks incentivizing technical adherence over addressing real and clearly identified limitations in due diligence systems. Such a legislative approach is not likely to bring the desired level of change to meaningful corporate behaviour.

In line with the enforcement focus on the state of a company's compliance program, the DOJ can require a company to undergo a monitorship process. If the DOJ finds that a company has serious system-level compliance failures—where the compliance program is so ineffective that egregious bribery can go undetected and unchecked—it can require that the company engage an independent monitor (usually at its own expense) to periodically and broadly review the company's compliance program. This process can include review of financial records, communication records and documents, and interviews up and down the organizational chart. The scope of the monitorship could span a number of geographic markets where the company does business. Over the course of the monitorship, the monitor will identify weaknesses and recommend enhancements to bring the company's compliance program up to par. At the conclusion of the monitorship, the monitor will report its findings to the DOJ. If the monitor deems that the company failed to make adequate improvements, the DOJ could extend the monitorship or take further prosecutorial action. Such extensive requirements are not uncommon—the DOJ has imposed monitorships on a number of multinational companies over FCPA issues. From a regulator's perspective, a monitorship is an effective way to gain confidence that a company has appropriately remedied systemic failures and has an adequate compliance program going forward. Moreover, the potential risk and burdens of a monitorship serves as a strong reminder to companies to invest in its internal compliance programs. As the EU contemplates the development of the Forced Labour Regulation and the engagement with corporates ahead of a market ban of products manufactured with forced labour, there are some lessons that can be learned from the mentorship process under the FCPA regime, particularly at the investigation and remediation stage.

Incentive to Self-Detect, Investigate and Self-Report Violations

Just as companies can lessen their risk of harsh penalties through the implementation of strong compliance programs, the DOJ's FCPA enforcement policy also encourages companies to self-report violations to authorities. In certain circumstances, the DOJ can choose not to prosecute a company that timely self-reports the matter to the DOJ, cooperates in an investigation, and properly remediates the violations in the process. To fully avail of these benefits, disclosure must be truly "voluntary" (*i.e.*, it must take place before the company believes that a regulatory or enforcement agency has become aware of the improper conduct) and fulsome (*i.e.*, the company cannot pick-and-choose certain facts to disclose or withhold). Hence, a company's ability to self-detect and internally investigate a potential violation is critical to availing itself of this voluntary disclosure and cooperation credit. It incentivizes companies to devote resources to protocols that identify risks and misconduct quickly and effectively, such as active monitoring, accessible reporting channels, and antiretaliation protection mechanisms for whistleblowers.

In addition to incentivizing companies to improve self-detection and internal investigations, the DOJ's FCPA enforcement policy also confers practical benefits from an enforcement authority's perspective: it shifts the onus of identifying and investigating potential violations on the company and relieves the authority from having to devote significant resources to do so.

Focus on Remediation and Continual Improvements

Beyond voluntary self-disclosure, the DOJ also expects companies to take timely and appropriate remedial action in response to identified misconduct and risks. Remediation requires not simply addressing the particular wrongdoing (e.g., termination of culpable employees or disgorgement of ill-gotten profits), but also analyzing the root causes and addressing them. That typically means updating policies and enhancing procedures to mitigate the risk of recurrence. In the context of remediation, the DOJ's FCPA enforcement policy pushes companies to continuously uplift their compliance programs and thus better self-regulate.

Enforcement Policy Translating to Change

In several respects, the FCPA's enforcement approach has been effective. First, the focus on compliance systems has elicited a change in approach from the private sector—corporate management has responded by investing resources to improve their companies' antibribery compliance programs, in-house Legal and Compliance departments have taken on antibribery compliance as a big part of their remit, and there has been an increase in overall antibribery awareness across the private sector. These changes at the system level have arguably had a more profound impact on preventing bribery behavior than prosecuting individual violations.

Second, this enforcement approach sidesteps the challenge of setting specific regulatory standards on compliance programs. Given the varying circumstances that different businesses face, broadly legislating specific standards can result in vague rules that are difficult to interpret or burdensome regulatory obligations that are ineffective nonetheless. The FCPA's enforcement approach instead fosters organic development of compliance best practices and allows flexibility for companies to tailor their program to their risk profile. At the same time, companies are still accountable to demonstrate the effectiveness of their program when sitting across from enforcement authorities.

Finally, the policy achieves the above goals cost-effectively. The focus on incentivizing self-regulation, self-detection and voluntary disclosure, and remediation puts the burden of day-to-day prevention and detection on the companies themselves. The regulator avoids having to earmark significant budget and resources towards investigating individual violations. The growing headlines of FCPA enforcement cases drew the attention of the corporate world, and the policy approach steered an uplift in compliance awareness and practices in the private sector.

Overlaying FCPA Enforcement Policy In The Human Rights Compliance Context

The FCPA's enforcement policy translates well into the human rights compliance context. Both share the broad policy goal of stemming unethical behavior largely occurring in foreign markets outside a company's home jurisdiction (in the case of human rights, suppliers based in varying geographies). Often those practices have become prevalent and deeply rooted in local business cultures, and strong incentives are required to overcome the status quo. The FCPA's enforcement approach can offer a model for influencing private sector decision-makers to invest in systemic-level improvements on human rights. That could in turn change the broader culture and expectation on how business is done vis-à-vis human rights issues.

Also importantly, both antibribery and human rights enforcement regimes need to consider the practical challenge that different businesses face varying risks and have distinct compliance needs. Legislating standards directly is difficult in such situations. Deferring the assessment of what are indicators of an "adequate" and "effective" compliance program to the enforcement phase can be an eloquent solution. It allows the flexibility for companies to implement cost-effective systems tailored for their business and industry, while keeping them accountable to demonstrate that it actually works.

Finally, the FCPA enforcement policy's success in changing corporate behavior without overburdening enforcement resources is worth consideration by human rights regulators. A purely prosecutorial enforcement approach could be slow, protracted, and risky (if an enforcement action fails, it can potentially embolden would-be violators). At the same time, the development of social sustainability laws and regulations would have little meaning without capable and sustained enforcement pressure closely in tow. Shifting detection and investigation on the companies and incentivizing them to self-regulate could ease resource constraints that regulators often face (though each jurisdiction would likely adapt its own flavor to align with its own enforcement procedures and jurisprudence). A much needed focus on remediation and the need to address systemic causes of violations is necessary in order to see a change in corporate behavior and to truly manage the adverse impact that business can have on the human rights of affected rights holders.

Looking Ahead

As human rights regulation develops, regulators and the private sector will have to take increasingly active and novel steps to fairly and effectively protect human rights. From the regulator's standpoint, focusing on system-level improvements rather than narrowly investigating violations has shown to be effective at altering behavior. While monetary penalties and criminal prosecution can generate attention, incentivizing systemic-level improvements is more likely to bring about broader impact. Beyond imposing monetary fines and import restrictions, human rights enforcement agencies may consider crediting companies that demonstrate a track record of adopting compliance best practices, while requiring companies that fail to do so to remedy those failures. The FCPA's enforcement history offers insight into creating a system of successful and sustainable enforcement, which in turn better ensures that laws on the books bring about real-world impact. Human rights regulators may look to it for inspiration and extrapolate the learnings to complex areas of monitoring and remediation.

From the private sector's perspective, companies in the short term would do well to pay close attention to the developing trends in human rights legislation and enforcement actions. Management can protect their companies by examining their internal human rights compliance infrastructure now. A simple way to start is by clearly charging human rights risk management to a specific team or department, and also empowering them to lead a coordinated effort across legal, compliance, sustainability, procurement and business operations teams to drive human rights initiatives. Ultimately, management should actively engage with human rights issues and put themselves in the best position when interfacing with not only enforcement bodies, but also their customers, shareholders, and employees.

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