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ESG: Rise of the New Corporate Compliance Framework

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PRIVATE AND CONFIDENTIAL

Contents

Executive summary

Environmental, Social and Governance ("ESG") covers a broad range of often overlapping issues that have become increasingly significant in recent years. This is especially the case for Environmental concerns as awareness of the impacts of climate change and the interdependency of human and natural systems has continued to grow. Global crises such as the COVID-19 pandemic have further sharpened the focus on the importance of good Governance, supply chain management and collaboration across borders. As global warming will likely accelerate the emergence of new viruses[1], societal change is becoming necessary and imminent, and ESG represents an unavoidable part of this movement.

As businesses respond to both these changes and the movement in legislation from "soft law" to "hard law", a number of compliance risks are inevitably triggered in areas such as product regulation, waste management policies, carbon pricing measures, ethical supply chain sourcing and compliance issues relating to Governance such as bribery and corruption.

Provided that ESG compliance risks are dealt with rigorously and proactively, this developing landscape presents a unique moment for innovation and renewal. In this article, we explore some of the key ESG challenges and opportunities, and conclude that organisations that take a 'connected' approach to compliance across these risk areas are likely to receive the greatest return and minimise risks in the most meaningful way. We also note that, in putting in place their ESG connected compliance programmes, companies should nonetheless be mindful of managing other compliance risks that may arise as part of taking such steps, such as the friction that can be created with ESG goals on one hand, and compliance with ABC and competition laws on the other.

[1] As discussed, for example, by the World Health Organization here: https://www.who.int/globalchange/summary/en/index5.html

1. Introduction

1.1 What is ESG?

ESG refers to the three main factors that are considered when assessing a company's sustainability and societal impact. This set of standards is increasingly being taken into account in investment processes and in decisions surrounding business strategy, supply chain management and Social responsibility. While businesses and investors may have considered several of the factors described below on an individual basis, it is only relatively recently that people have begun to approach these factors on a connected basis.

The three elements of ESG can broadly be broken down as follows:

(a) Environmental: The Environmental element of ESG generally refers to a company's impact on the planet. This is typically illustrated by factors such as a company's carbon footprint and emission goals, energy efficiency policies, use of green products and infrastructure, and waste management practices such as recycling and safe disposal. We consider the Environmental and regulatory aspects of ESG compliance in Section 2 below.

(b) Social: The Social component assesses issues that impact a company's employees, consumers and other members of its supply chain, such as manufacturers and suppliers. It is usually measured in relation to a company's employee and labour standards, diversity and inclusion principles, human rights and ethical supply chain sourcing, data protection and privacy policies as well as its stances on Social justice issues. We consider the Social considerations and supply chain management aspects of ESG compliance in Section 3 below.

(c) Governance: The corporate Governance aspect of ESG relates to the board of directors and company oversight, focusing on how a business is operated and managed. Governance is principally measured in relation to a company's board composition and diversity, bribery and corruption policies, whistle-blower schemes and transparency in communicating with shareholders. We consider the management and Governance aspects of ESG compliance, in particular bribery and corruption, in Section 4 below.

1.2 The Rise of ESG and Compliance Considerations

The term ESG was first coined in the early 2000s when the then-United Nations secretary general launched the "Global Compact" initiative to encourage integration of Environmental, Social, and corporate Governance into capital markets.

Since then, ESG has evolved rapidly, becoming not just an essential factor for asset managers and institutional investors, but also for companies themselves as they look to integrate ESG into aspects of their business strategy, codes of conduct and supply chain management.

At the start of the 2010s, ESG was seen as a way to restore trust in capital markets following the financial crisis of 2008 and Governance factors were particularly significant developments. Intensified pressure from investors led to corporate Governance codes, accompanied by increasing regulation in this area.

In 2015, the Paris Agreement established a significant universal[2] and legally binding global climate change agreement, and by the end of the 2010s, Environmental and Social aspects of ESG were also gathering momentum. A number of significant events, such as Environmental crises, concerns over data ownership and the #MeToo and BLM movements have since prompted greater calls for more ethical and sustainable business practices.

Having laid the foundation for ESG principles in the previous decade, the 2020s will be about putting these frameworks into action, as calls for more rigorous due diligence, reporting and enforcement practices

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[2] Although note that, on 4 November 2019, the US gave a formal notice of its intention to withdraw from the Paris Agreement, which takes 12 months to take effect.

increase. Indeed, 2020 began with an unprecedented focus on climate change and sustainability at the World Economic Forum in Davos, with its theme "Stakeholders for a Cohesive and Sustainable World", and has continued to be a focus throughout the COVID-19 crisis. As ESG continues to gain momentum into this decade, the evolution from "soft law" to "hard law" will be a dominant theme, as regulators across the globe introduce more focused ESG legislation and guidelines.

1.3 Evolution: From "Soft Law" to "Hard Law"

The attention that ESG frameworks have steadily garnered from businesses and investors has been accompanied by a heightened regulatory environment. Legal instruments aimed at enforcing ESG standards have progressively moved from "soft law" requirements such as voluntary Corporate Social Responsibility ("CSR") to hard law obligations such as those on the level of reporting or disclosure that companies must provide to investors or consumers and the development of corporate due diligence. We expect that this trend towards hard law obligations will continue and accelerate in the coming years.

The "hard law" concept of corporate due diligence, specifically in relation to measuring a company's impacts on human rights and Environmental issues, was first introduced by the UN in its Guiding Principles on Business and Human Rights and incorporated into the Organisation for Economic Co-operation and Development's Guidelines for Multinational Enterprises ("OECD Guidelines") in 2011. The Guidelines took a broader view of responsible business conduct, including other areas such as the environment and climate change, conflict minerals, labour rights, bribery and corruption, and consumer interests. This broad view of what constitutes responsible business conduct has subsequently been reflected in part in legislation such as the UK's Modern Slavery Act 2015, France's "Duty of Vigilance Law" 2017 and the Australian Modern Slavery Act 2018, which impose mandatory due diligence requirements for human rights and Environmental impacts.

These more focused examples of national law have in recent years been followed by calls for more rigorous and widely-applicable legislation. In 2018 the European Commission ("Commission") Action Plan on Financing Sustainable Growth contained an action to assess "*the possible need to require corporate boards to develop and disclose a sustainability strategy, including appropriate due diligence throughout the supply chain, and measurable sustainability targets*."[3]

A European Parliament ("EP") Report on Sustainable Finance also called for a "*legislative proposal for an overarching mandatory due diligence framework including a duty of care*".[4] This was crystallised in the 2019 Commission announcement that it would introduce new EU legislation on mandatory human rights and Environmental due diligence for companies by 2021.

As voluntary adherence moves to mandatory compliance, the potential for enforcement and litigation risk increases. Such ESG compliance considerations will be viewed by stakeholders, business partners and regulators as minimum standards. Companies that have not already made the shift to assess and update their systems, controls and compliance programmes should therefore consider making this a priority.

1.4 Supply Chain Management

One example of how companies can be proactive in the face of this changing legislative landscape is understanding the importance of taking a connected and flexible approach to ESG. This means not just appreciating the overlaps between Environmental, Social and Governance compliance in practice, but also the importance of effective supply chain management.

As globalisation has grown, so has the reliance on global supply chains, making companies much more vulnerable to unpredictable global events such as pandemics, trade wars or climate change. It also opens companies up to compliance ESG risks that are inherent in doing business in certain jurisdictions, such as bribery and corruption risks.

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[3] Action 10.
[4] Paragraphs 6 and 11.

The way in which rapid change that results from these events can impact supply chains, and subsequently increase compliance risk, is evident in the large-scale disruption caused by COVID-19. At the outbreak of the pandemic, thousands of factories in China closed in an attempt to contain the spread of the virus. With many multinational companies dependent on Chinese manufacturing and exports, this quickly led to concerns regarding shortages of labour, goods and raw materials. In this situation, reactive shifts to quickly move manufacturing outside of China in order to mitigate financial impacts had the potential to exacerbate compliance issues. For example, by sourcing from suppliers or regions where labour or other human rights abuses are more common and less regulated, or decreased bribery and corruption due diligence as a result of the quick change.

One way of mitigating these impacts is by having flexible supply chains that are capable of dealing with short-term changes in demand or supply, as well as other external disruptions, but simultaneously ensuring robust diligence. Businesses should bear in mind, when adapting supply chains, the importance of adequate due diligence to mitigate associated ESG compliance risks. Proactively building greater Environmental, Social and Governance compliance checks into supply chains will enable businesses to streamline compliance programmes, build consumer trust and seize the opportunity to stay ahead of the trend.

2. Compliance Issues Linked to Environmental Aspects and Regulatory Responses

Companies' Environmental practices are coming under an increased amount of review as the impacts of climate change move up the global agenda. There are many recent instances of businesses across various sectors caught out by this heightened level of scrutiny, including industrial and Environmental disasters, engaging in polluting practices, and fraudulently claiming compliance with Environmental legislation, all of which have led to enforcement activity and damaging consequences on share price and reputability.

For the Environmental side of ESG, future obligations will primarily include the need to comply with (i) increased product regulation, (ii) waste management practices and (iii) other measures such as carbon tariffs.

2.1 Increased Product Regulation

The most transformative development in this area was the launch in 2019 of the European Green Deal, a set of policy initiatives which aim to make Europe climate neutral by 2050 ("Green Deal"). As part of the Green Deal, the EU recently announced its new Circular Economy Action Plan, ("Action Plan") marking a decisive shift towards increasing requirements around sustainable products in the EU over the next decade. Whilst the UK would not be subject to the new EU legislations under the Action Plan, as it will be introduced after the current Brexit transition period has ended on 31 December 2020, it is likely to face pressure to pass similar domestic legislation. Indeed, the UK government's new consultation on due diligence law related to forest risk commodities is indicative of the direction it may take following its departure from the EU.

The Action Plan forms a central pillar of the Commission's strategy for a climate-neutral, resource-efficient EU economy, building on the 2015 Circular Economy Action Plan that delivered a range of initiatives and legislation to address, to a certain extent, sustainability aspects of products. It signals increasing attention from legislators in terms of: Environmental due diligence; sustainable product design and the types of information that should be made available to consumers.

Due Diligence

As mentioned above in Section 1.3, in April 2020 the Commission announced that it would introduce ground-breaking new EU legislation on mandatory human rights and Environmental due diligence for companies in 2021. This potential legislation represents an obvious overlap between the Environmental and Social components of ESG and the human rights elements addressed at Section 3.2 below, and shows how ESG needs should be considered from a connected compliance perspective.

The proposed new legislation will form part of the Commission's 2021 Work Plan and its strategy to achieve carbon neutrality under the Green Deal. The briefing paper on this proposal, prepared for the European Parliament Human Rights Subcommittee in July 2020 set out some early indications of what this legislation might look like, including suggestions that:

(a) the scope should cover all human rights and apply to companies (and their supply chains) regardless of size and sector;

(b) it should adopt a substantive due diligence model with various implementation mechanisms that will result in penalties sufficient to have a deterring effect;

(c) company-level monitoring should be supplemented by monitoring by independent bodies at Member State and EU level, statutory review and monitoring by third parties; and

(d) it should require the establishment of effective grievance mechanisms and require Member States to provide not only for penalties for breaches but also effective means of remedy and redress for victims.

These steps follow other moves that indicate a tightening of due diligence requirements in this area. For example, the EU Non-Financial Reporting Directive requires large companies to disclose certain information on the way they operate and manage Social and Environmental challenges. This was supplemented in 2019 for corporate climate-related information reporting.

The move towards more onerous Environmental due diligence models is also reflected in sector-specific regulations such as the EU Timber Regulation ("EUTR"). The EUTR not only requires timber importers to use a due diligence system to assess whether timber has been logged or traded illegally, but also regards failure to carry out due diligence as an offence, even if the wood itself is shown to be legal.

As the ESG landscape continues to develop, many businesses themselves are pushing for greater regulatory clarity in this area and consistency in standards across jurisdictions. The Commission's study on options for regulating due diligence requirements through the supply chain ("EC Study"), published on 20 February 2020, found that the majority of business respondents were in favour of mandatory EU due diligence laws. This was also demonstrated in 2019 when a coalition of some of the biggest cocoa companies called on the EU to strengthen Environmental due diligence requirements in the cocoa sector. These sorts of joint initiatives are likely to increase as companies move to scale up their Environmental policies and will help to create a level playing field. In this regard, companies should feel empowered to have these types of conversations with other members of their industries, however care must be taken to avoid falling foul of global competition or antitrust laws, as discussed below in Section 5.2.

Product Design

Another aspect of Environmental legislation that companies should be aware of is regulation surrounding product design. Eco-design (which, in this context, refers to the integration of Environmental protection criteria over a service or a product's lifecycle, with the goal of minimising its negative Environmental impacts) is one such example of this.

Historically, the eco-design regime in EU law has focused on energy efficiency requirements, for example the EU Ecodesign Directive aimed at a number of household product groups and the EU Energy Labelling Regulation. However, in recent years, eco-design has been recognised as a tool that can also be used to promote other aspects of the circular economy.

Under the Action Plan the Commission will, by 2021, propose legislation for a "Sustainable Product Policy Initiative". Its aims will be to ensure that products placed on the EU market last longer, are easier to reuse, repair and recycle, and incorporate recycled material instead of primary raw material as far as possible. New legislation will also limit premature product obsolescence and ban the destruction of unsold durable goods. Producers will be incentivised to keep ownership of the product (the "product-as-a-service" model) or to be responsible for product performance throughout its lifecycle.

This trend can also be observed as the global focus shifts towards avoiding single-use plastics, with many economies introducing bans on products such as plastic bags and food packaging. In March 2019, the EU voted to ban single-use plastic cutlery, cotton buds, straws and stirrers. The Single-Use Plastics Directive came into force on 2 July 2019, and Member States have until 3 July 2021 to transpose the Directive into national law. The impact of COVID-19 has interfered with the timeline of some of these measures, with the UK pushing back its single-use plastics ban from May to October 2020. However, in line with the EU Single-Use Plastics Directive, Germany announced in June 2020 its plans to ban the sale of single-use plastic straws, cotton buds and food containers by 3 July 2021, demonstrating that increasing legislation in this area is unlikely to dissipate any time soon.

This trend can also be seen in relation to product packaging, in studies carried out by consumer groups such as the UK organisation Which?. The organisation recently called out several UK grocery brands for using non-recyclable product packaging, and for including inadequate recycling information on the packaging. Which? called upon the UK Government to make recycling labelling mandatory in order to enable shopped to know how to dispose of packaging. We discuss recycling in the context of ESG further in the next section.

2.2 Waste Management, Recycling and Safe Disposal Practices

Waste management, recycling and safe disposal practices also fall into the scope of Environmental compliance. As is the case generally with ESG, in recent years there have been a number of steps towards increasing regulation in this area.

In 2018, the UK Government published its Resources and Waste Strategy which builds on its 25 Year Environment Plan and sets out a framework for ensuring that resources are used more efficiently in the UK economy and that waste is minimised. Elements of the strategy include sustainable production, resource recovery and waste management, waste crime, food waste and data monitoring and will require businesses and manufacturers to pay the costs of recycling or disposing of their packaging waste. It further includes a commitment to review extended producer responsibility ("EPR") schemes, which the UK Government confirmed in July 2019 when it announced that it would progress its policy proposals relating to packaging and introduce an extended EPR scheme for packaging in 2023. This was bolstered by the Government's budget announcement in March 2020 which included a GBP 700,000 commitment to establish a UK EPR scheme, designed to encourage producers to increase the recyclability of their packaging and reduce the amounts of unnecessary packaging used for their products. The budget also established that the UK would be investing GBP 7.2 million in developing a national system to track the movement of waste across the economy.

In the EU, the Action Plan mentioned above - formally adopted by EU institutions in the first half of 2018 - is also particularly relevant. One important aspect of the circular economy concept is that it refocuses waste as an input into the supply chain. It is therefore a significant part of the Circular Economy package which aims to achieve greater circularity in production processes. This has obvious overlaps with product design as discussed above, with a significant emphasis on designing products that last longer or can be recycled more easily, thus being able to be put back into the supply chain and reduce the amount of waste.

Aspects of the Action Plan particularly relevant to these concepts are:

(a) Packaging - The Commission will review the Packaging and Packaging Waste Directive to reinforce essential requirements for packaging. This will focus on reducing over-packaging and packaging waste, driving design for re-use and recyclability of packaging, and reducing the complexity of packaging materials;

(b) Plastics - Companies will have to comply with new mandatory requirements for recycled content, as well as labelling, standardisation, certification and regulatory measures on unintentional release of microplastics. There will be a new policy framework coming in 2021 for bio-based plastics and plastics with biodegradable properties;

(c) Textiles - The Commission will propose an 'EU Strategy for Textiles' in 2021, which will aim to incentivise business and private consumers to choose sustainable textiles, boost the re-use and recycling of textiles and achieve high levels of collection of textile waste.

(d) Construction - In 2021 the Commission will launch a 'Strategy for a Sustainable Built Environment', promoting circularity principles throughout the lifecycle of buildings. Companies may also have to comply with recycled content requirements for certain construction products, as part of a revised 'Construction Product Regulation'; and

(e) Food services - The Commission will consider specific measures to increase the sustainability of food distribution and consumption. There will also be a new legislative initiative on reuse to substitute single-use packaging, tableware and cutlery for reusable products in food services.

This year or next the Commission also proposes to introduce a 'Circular Electronics Initiative' to promote longer product lifetimes, which will include the following actions:

(a) Manufacturers will have to design electronics, such as mobile phones, tablets and laptops, for energy efficiency and durability, reparability, upgradability, maintenance, reuse and recycling;

(b) Companies will have to meet new regulatory measures on chargers for mobile phones and similar devices, including the introduction of a common charger to prevent premature obsolescence; and

(c) The Commission will explore options for an EU-wide take-back scheme to return or sell back old mobile phones, tablets and chargers.

A new regulatory framework will also be introduced for batteries, designed to improve collection and recycling rates, and introducing sustainability and transparency requirements for all batteries.[5]

2.3 Carbon Pricing Measures

Another example of additional Environmental regulations on the horizon is carbon pricing measures in the form of emissions trading systems and/ or carbon tariffs.

The EU emissions trading system ("EU ETS"), set up in 2005, imposes a cap on emissions for all large carbon emission sources and is a major pillar of the EU energy policy. Recently, it has again been the centre of legislative focus following the publication of details of the UK's plans to implement its own ETS ("UK ETS"), following its withdrawal from the EU in 2021. What is notable about the UK ETS is that, whilst it covers the same greenhouse gases and sectors as the EU ETS, it initially sets a cap 5% lower than the EU ETS cap, in recognition of the UK's own net zero emission target.

Indeed, the UK ETS is part of a broader policy framework to deliver the UK's net zero target by 2050, which includes a GBP 315 million Industrial Energy Transformation Fund to support industry to invest in energy efficiency and decarbonisation technologies. The Committee on Climate Change is expected to advise the UK Government later this year on a cost effective pathway to reach its emissions goal, and if further alignment on the UK ETS is needed.

In addition to emission trading systems, carbon tariffs are also becoming increasingly likely. The Commission is considering levelling the playing field between EU companies and foreign competitors, namely by means of a carbon-pricing measure on imported products. The design of the carbon-pricing mechanism remains unclear for now, however it has been suggested that it could be based on the calculation of the "carbon price difference" between EU and imported products. A concrete legislative proposal is expected to be announced in 2021. Whilst initially controversial, the possibility of a carbon border tax is gaining increasing approval. Europe’s biggest business lobby group, BusinessEurope, announced in 2019 that it was now actively discussing a carbon tariff at the EU’s border in order to restore a level playing field with countries like China or the US, to the extent that they do not impose an equivalent pollution constraint on their industries.

2.4 Conclusion

The major shift towards "hard law" in the area of Environmental compliance is evident in the recent legislative developments surrounding product regulation, waste management practices and other measures such as carbon tariffs. It is also crucial to take into account that businesses themselves are adapting to these shifts and are joining the calls for more clarity in this area. As climate change becomes an increasingly important item on the agenda, it will inevitably impact business models, compliance programmes and due diligence models.

[5] https://www.bakermckenzie.com/en/insight/publications/2020/03/strictly-sustainable-products-only

3. Compliance Issues Linked to Social Considerations and Supply Chain Management

The "Social" component of ESG is increasingly facing the scrutiny of lawmakers and regulators, especially in relation to compliance issues and supply chain management. Supply chains are longer and more global than ever before and, while complex supply chains bring about a host of benefits, it can become more difficult to effectively monitor exposure to unethical practices such as the sourcing of conflict minerals and human rights abuses. Further, we see a challenge for corporates who are expected to adopt "Western" standards throughout their supply chains which may cause tensions with local laws or customs.

These challenges have not only been acutely apparent during the COVID-19 pandemic and the resulting pressures on global supply chains, but given wider shifts in globalisation, uncertainty around trade war tensions, and ongoing Brexit negotiations. This underlines the importance of diverse and flexible supply chains as well as effective due diligence and adequate compliance programmes.

3.1 Ethical Supply Chain Sourcing

Ethical sourcing is the process of ensuring that the products a company are sourcing are obtained in a responsible and sustainable way, that the workers involved in manufacturing these products are treated fairly, and that Environmental and Social impacts are taken into consideration throughout the process. There is a clear overlap here with the Environmental elements of ESG, demonstrating why in practice it is beneficial to take a holistic view of supply chain management from an ESG perspective.

How companies manage their supply chains in light of global events is coming under increased scrutiny. One fast fashion retailer that continued to operate at full capacity throughout the COVID-19 crisis had been attributed with doubling Leicester's coronavirus infection rate after a Sunday Times investigation found that employees were working in unethical conditions, paid below minimum wage and forced to come in even when sick with the virus. The reports saw the brand lose more than a fifth of its value amid questions around the company's relationship with its suppliers.

The importance of responsible supply chain sourcing is also demonstrated by the issue of conflict resources. Resources from conflict or high-risk areas may provide funding for armed groups that then lead to human rights abuses and Environmental degradation. The most common are gold, tin, tungsten, and tantalum - minerals essential in the manufacture of a variety of devices, including computers, smartphones and tablets.

There may be notable tensions between the issue of conflict resources and other ESG goals: for instance while the shift to electric cars reflects a broader shift towards green technology, a key component of the rechargeable batteries on which electric cars run is cobalt, over half of which comes from the Democratic Republic of Congo which is a particularly high-risk jurisdiction in relation to working conditions and child labour.

However, it is not just upstream suppliers that can be the source of potential ESG issues. In 2011, it was discovered that US authorities were using a prominent pharmaceutical company's products to perform lethal injections for capital punishment. There was widespread media coverage and public backlash that ultimately led to the company placing restrictions on the use of its products downstream in its distribution network.

To shed light on these issues, there is an increasing movement towards mandatory due diligence as discussed in more detail at Section 2 in relation to Environmental impacts and below at Section 3.2 in relation to human rights abuses. More specifically, in relation to conflict minerals, in 2017 the Commission adopted the EU Conflict Minerals Regulation on mineral imports from conflict-affected areas. The Regulation seeks to prevent the import of conflict minerals and metals into the EU, the use of such materials by smelters and refiners, and the abuse of mine workers. By 2021, affected EU companies will be required to prove that the "3TG" minerals and metals they import are from responsible sources.

3.2 Human Rights in Supply Chains

Human rights is an inextricable element of ethical supply chain sourcing. How human rights abuses can infiltrate supply chains, especially in the context of global crises such as COVID-19, is evidenced by the fashion retailer case mentioned above, and also recent instances of Uyghur forced labour and human rights violations in China that have been linked with both the sale of face masks during the pandemic and the global fashion industry. Similar concerns have also caused certain films to be boycotted after shooting in areas and with support of parties allegedly connected to the mis-treatment of Uyghur Muslims.

As mentioned above, many of the calls for further regulation in this space are coming not just from civil society organisations and trade unions, but increasingly also from businesses calling for additional specific regulation to provide clarity and a "level playing field for all".

While the elevated importance of human rights considerations is reflected in certain trade sanctions measures deployed against human rights abusers by both the US and UK governments in recent months (for example the US Uyghur Human Rights Policy Act of 2020[6] and the recent UK sanctions measures imposed under the UK Sanctions and Money Laundering Act 2018 (SAMLA)[7]), most EU jurisdictions currently do not impose a general duty on companies to undertake human rights due diligence of their supply chain. Indeed, the EC Study showed that only one in three businesses in the EU undertake such due diligence.

When asked about the primary incentives for undertaking such due diligence, survey respondents selected the same three incentives: (1) reputational risks; (2) investors requiring a high standard; and (3) consumers requiring a high standard. In addition, the respondents all generally agreed that the current legal landscape did not provide sufficient legal certainty about companies' human rights and Environmental due diligence obligations, and was not perceived as efficient, coherent and effective.

Moves towards mandatory human rights due diligence in the EU have been underway for a number of years now, such as through the European Parliament Resolution on corporate liability for serious human rights abuses in third countries (2016), Resolution on the impact of international trade (2017), Resolution on sustainable finance (2018) and the EU's Non-Financial Reporting Directive mentioned above. There are clear overlaps here with the Environmental due diligence measures described at Section 2.1. As well as the recent EU proposals for mandatory human rights due diligence, the UK Government has committed to consult on strengthening its modern slavery due diligence requirements for supply chains and the UK House of Commons and House of Lords' Joint Committee on Human Rights published reports recommended that reporting on due diligence be compulsory for all relevant human rights (not just modern slavery), and the introduction of a "failure to prevent" offence relating to human rights abuses.

These moves are aligned with shifting international trends, exemplified by the Business Roundtable Statement on the Purpose of a Corporation signed by 181 chief executive officers in 2019. This statement attracted international public attention, because it moved away from the shareholder primacy in its Principles of Corporate Governance which it had endorsed since 1997, towards a commitment "to lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders".

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[6] The Act holds accountable perpetrators of human rights violations and abuses such as the systematic use of indoctrination camps, forced labour, and intrusive surveillance to eradicate the ethnic identity and religious beliefs of Uyghurs and other minorities in China.

[7] On 6 July 2020, the UK Government designated for sanctions 49 individuals and organisations involved in some of the most notorious human rights violations and abuses in recent years, including two high-ranking Myanmar military generals involved in the systematic and brutal violence against the Rohingya people and other ethnic minorities and two organisations involved in the forced labour, torture and murder that takes place in North Korea's gulags.

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3.3 Conclusion

Effective due diligence and oversight in relation to supply chain management is crucial, as consumers, regulators and shareholders expect to take more proactive stances on responsible sourcing and human rights abuses. Companies should consider how to build transparency and control into supply chains, allowing for greater facilitation and oversight of supplier relationships and logistics. Having clear and updated accounts of such information combined with clear compliance programmes will enable companies to identify areas of potential vulnerability more quickly and respond to them more effectively.

4. Compliance Issues and Risks Linked to Management and Governance

4.1 Anti-Bribery and Corruption, Anti-Money Laundering and Tax Evasion

Alongside the compliance risks linked to Environmental and Social aspects sits the long-standing element of corporate Governance. The "Governance" element of ESG gives rise to more traditional compliance challenges and looks at a company's code of business conduct, systems and procedures and reporting of breaches, tax strategy, and corporate Governance, among others. Compliance in this area will therefore include a consideration of how a company deals with issues such as anti-bribery and corruption ("ABC"), money laundering and prevention of tax evasion risks.

In recent years, there has been a seismic shift globally towards offences aimed at combatting corruption, fraud, tax evasion and money laundering. Increasing international pressure on countries to strengthen ABC programmes and improve enforcement methods is reflected in the OECD putting in place a framework for monitoring and periodically reporting on how well signatories to its Anti-Bribery Convention are performing in implementing the Convention's requirements.

In the UK, the new Corporate Criminal Offence ("CCO"), introduced in the Criminal Finances Act 2017 and designed to combat the failure to prevent the facilitation of tax evasion, is an example of a targeted tool being employed by the UK government to sit alongside existing ABC and money laundering offences, for which many of the mitigation and compliance steps overlap.

At the EU level, Member States are required to transpose the 6th Anti-Money Laundering Directive into national law by 3 December 2020, with relevant regulations having to be implemented by businesses by 3 June 2021. While the 5th Anti-Money Laundering Directive, which came into force earlier in 2020, was mostly aimed at increasing transparency, the 6th lays down minimum requirements for the definition of the crime of money laundering, effectively setting an EU-wide minimum standard for Member States to combat money laundering using criminal law.

In addition, by December 2021, all EU Member States will have to meet the minimum standards provided by the new EU Whistleblower Protection Directive. Currently, less than half of all EU countries have whistleblower protection legislation in place and therefore it is likely that many organisations across Europe may have to set up new, or revise their existing, whistleblowing systems and policies, particularly given the anticipation in a rise in whistleblower numbers off the back of the COVID-19 pandemic and given the general rise in transparency across sectors.

4.2 Impact of COVID-19 on Governance compliance

The management of risks relating to ABC, money laundering and tax evasion has been tested by the COVID-19 outbreak and the ensuing financial stress and economic uncertainty for companies across all sectors. Events such as these often lead to a higher risk of non-compliant behaviour. In particular:

(a) Cultural impact and compliance programme strain: Commercial pressures to quickly generate revenue (which may lead to riskier business practices), coupled with a compliance framework that has been deprioritised (in terms of budget and human resources) will result in instances of compliance misconduct that companies will need to guard against and resolve.

(b) Logistical challenges in the implementation of compliance programmes: Companies will find that the pandemic has an immediate and lasting impact on the operation of their compliance programmes. In-person due diligence, in-person training, audit and investigations are all examples of activities that will need to evolve during and post-pandemic.

(c) Compliance risks arising from the COVID-19 crisis: The crisis has led to new and complex risks, such as risks arising from:

    (i) supply chain delays that need to be resolved;

(ii) administrative challenges arising from Government closure or delay, and the risk of improper payments to speed up processes;

(iii) applications for government loan and subsidy schemes (e.g. pressure to submit falsified supporting materials to meet the thresholds);

(iv) Governments looking to establish or accelerate significant infrastructure projects to stimulate economies;

(v) pressure to bypass product quality approval processes or testing/licensing requirements to meet increasing market demand; or

(vi) push to falsify accounting entries of profits and losses to meet sales targets and investor expectations.

In mitigating these risks, communication is key: employees and third parties need to know that compliance continues to be a priority and sits at the heart of the company's values.

One sector particularly vulnerable to these types of risk is the pharmaceutical sector. The suspension of many non-COVID-19 research and clinical trials may lead to heightened pressure on sales of certain products, whilst companies reliant on pharmaceutical ingredients produced overseas when global supply chains are disrupted will put greater strain on resourcing and regulatory compliance. Indeed, a 2015 report shows that prior global health emergencies such as the outbreak of Ebola, triggered wide-ranging corruption in the countries that it impacted the most. In the US, this has been reflected by the Treasury's Financial Crimes Enforcement Network issue of advice on medical scams related to COVID-19.

4.3 Conclusion

In the current climate, it is important for companies to use their precious resources wisely to identify risk areas in higher risk markets, raise awareness and reinforce the need for adherence to the company's compliance framework. Companies should ensure that middle/senior management buy in and continuously deliver the message that compliance continues to be a driving priority. In this regard, taking a holistic approach to ESG elements is also particularly relevant. An issue that raises a human rights issue may also flag corruption or Environmental breaches and therefore act as an early warning sign for more integrated compliance risks. Effective supply chain management, due diligence and coordinated approaches are therefore useful tools across the different elements of ESG.

5. Risk Linked to Implementation of ESG Compliance Measures

5.1 ABC Risks Linked to Implementation of ESG Measures

Based on the trends identified above, namely the global shift towards heightened scrutiny and regulation surrounding ESG principles, it is imperative for companies to take proactive steps to ensure their programmes and systems are built to manage and mitigate ESG risks efficiently and robustly. Companies should nonetheless ensure that they consider and manage compliance risks that may arise as part of taking such steps or more broadly pursuing an ESG agenda.

For example, implementing certain ESG policies is likely to lead to interactions with governments and public officials, such as when obtaining certifications around ESG compliance, participating in Environmental or health and safety assessments, or trying to access key sustainable government-controlled resources. With this increased exposure to public officials comes a potentially heightened corruption risk.

An example of this is an investigation in 2018 which found that packaging from UK manufacturers that had originally been exported as recycling had actually been discarded at multiple illegal waste sites in Malaysia. The news came as the UK's Environment Agency embarked on a major investigation into claims of fraud and corruption in the UK's recycling exports system, with data showing a substantial discrepancy between the amounts of packaging exports recorded by UK customs compared to the amount exporters claim to have shipped.

Renewable energy and green infrastructure projects are as prone to corruption risks as other extractive projects have been in the past and corporates need to be conscious that the pursuit of legitimate and commendable Social and sustainable objectives will not in itself protect companies from the application of ABC and other laws. This is not to discourage companies from pursuing an ESG agenda, but to ensure that ABC and other compliance risks are recognised, managed and mitigated where necessary. It is important to seek input from legal and compliance teams who can ensure that ESG initiatives are designed and implemented in a manner which reduces risks, avoids undue scrutiny, and does not distract from a vital ESG agenda.

5.2 Competition Risks Linked to Implementation of ESG Measures

As well as ABC risks that arise when pursuing ESG measures, there also exists a friction between competition law and ESG goals.

Often companies can pursue and implement ESG initiatives on their own, but this is not always possible. A joint initiative may be needed to achieve change on a scale which would be impossible for a company to achieve on its own. Combined efforts across an industry also avoid the "first mover disadvantage" which can arise if a company could not switch to, for example, more Environmentally-friendly (but more costly) products or processes without losing market share.

It is the prospect of competitors working together that can raise issues under global competition/antitrust laws. Competition laws capture agreements and arrangements between competitors which may affect prices, customers, output, quality etc. and some ESG measures and initiatives are likely to have such an effect. Not every agreement between competitors is going to create an issue under antitrust rules. For example, loose commitments to contribute to the attainment of a sector-wide Environmental target or agreements which relate to a product or process which is only marginal for influencing the buyers' purchase decision are unlikely to raise substantive competition law concerns. However it is the case that some sustainability projects are going to increase costs and, even in a competitive environment, these might be passed down the supply chain meaning that consumers pay more for the more sustainable products.

Further, it is important to understand that laudable, Social objectives (and even Government knowledge/encouragement) will not in themselves insulate companies from the application of antitrust laws.

It is clear, therefore, that competition law is a factor that should be borne in mind by companies when considering ESG initiatives involving competitors. But there are steps which can be taken to ensure that antitrust laws do not stand in the way of legitimate goals.

For instance, the setting of standards is a common way for companies to drive more sustainable and ethical outcomes. Standards might cover how workers are paid, which inputs can be used, manufacturing methods and can even play a role in making recycling more efficient. Many such standards will not raise competition law issues and antitrust agencies recognise that standards can generate benefits. Companies nonetheless need to ensure the standards are not developed in a manner which disadvantages or excludes others. In particular, companies participating or developing in standard setting initiatives should ensure that:

- the standard is voluntary which companies are free to exceed;
- participation in the standard-setting process should be as unrestricted as possible with a fully transparent procedure;
- access to the standard should be given on fair, reasonable and non-discriminatory terms;
- suppliers/customers who do not assist with initiatives or participate in schemes are not boycotted or other penalised; and
- participants do not discuss or agree on whether and/or how to pass on costs of any initiative to customers.

A related risk comes from the fact that companies engaged in sustainability initiatives and standard-setting will often need to share information. Companies may want to work together to pass-on best practices and know-how to help smaller firms in difficult economic or Environmental circumstances higher up the supply chain. Antitrust agencies recognise the potential efficiencies of information exchange and efforts by industry members to share best practices are unlikely to raise antitrust concerns. It is important to recognise that there are certain topics and discussions that remain off-limits from a competition perspective, such as discussions on prices, costs, volumes and matters relating to individual suppliers or customers. To the extent that competitors want to measure and compare progress in relation to sustainability efforts (on a "like for like" basis), the sharing of such information should be avoided. Where there may be a legitimate reason for sharing such information - for example, to show that extra volumes being produced on a more sustainable basis - companies should use a third party to aggregate data, avoid reporting on granular or identifiable data, and ensure that a sufficient number of firms are involved so that no one contributor is able to reverse engineer information about its competitors.

Regardless of the nature of engagement between competitors when pursuing ESG initiatives - such as joint lobbying, standard-setting, collective engagement of upstream suppliers or joint purchasing - some particular factors to consider include:

(a) ensuring that those responsible for corporate sustainability initiatives are linked up with in-house antitrust counsel so that there are no surprises down the line. Consider whether training is required to remind committed employees that good intentions (or even Government knowledge/involvement) may not insulate the company from antitrust risks;

(b) focusing on why an arrangement or initiative has to be carried out by competitors working together: what is it about the project (in terms of risk and cost) which means that it could not be achieved in some less restrictive manner? Ensure that other options have been considered and rejected for principled reasons, and document this decision-making process;

(c) making sure that there is as much room for competition as possible – e.g. if there is some kind of standard or commitment to an industry target, then try to keep as much latitude as possible for companies to decide independently how they will meet that standard or target;

(d) trying to identify, quantify and document the benefits of the initiative as well as who will benefit and when;

(e) ensuring that each initiative has safeguards in place, such as information barriers, dedicated training and, if necessary, the use of a third party to avoid the sharing of competitively sensitive information. Keep a close eye on the project to avoid ‘scope creep’ which can lead to unforeseen risks and discussions; or

(f) considering the pros and cons of approaching a Government body and/or antitrust agency about a contemplated project. That is unlikely to provide cast -iron guarantees worldwide but may be a good option where major investments are contemplated.[8]

[8] https://viewpoints.bakermckenzie.com/post/102g97t/sustainability-and-competition-law-so-what-is-allowed

6. Conclusion

Major shifts towards "hard" law in the area of ESG are evident in not just recent legislative developments but also within businesses themselves as they adapt to these changes and join the calls for level playing fields within industry sectors. Looking at these issues in the round, what becomes clear is that effective due diligence and oversight in relation to supply chain management is crucial, as consumers, regulators and potential competitors move towards more proactive stances on ESG as the new normal in corporate culture.

Having transparent and updated accounts of supply chain information combined with clear compliance programmes and strong ESG cultures will enable companies to identify areas of potential vulnerability more quickly and respond to them more effectively in times of crisis. In this regard, taking a connected approach - working in a collaborative, agile and effective manner - to ESG elements is key. An issue that raises a human rights issue may also flag corruption or Environmental breaches and therefore act as an early warning sign for more integrated compliance risks. However, in putting in place their ESG compliance programmes, companies should nonetheless ensure that they consider and manage other compliance risks that may arise as part of taking such steps, such as the friction that can be created with ESG goals on one hand, and compliance with ABC and competition laws on the other.

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