

Cos. Must Prepare For Growing ESG Enforcement

By Sara Holzschuh, Randy Bregman and Gail Lione (February 1, 2022)

As part of the increasing focus on environmental, social and corporate governance, or ESG, issues, human rights and anti-corruption enforcement priorities have been ramped up across the U.S. government's investigative and enforcement agencies in recent months.

Across the U.S., Canada, U.K. and European Union, we are seeing an expansion and enforcement of laws and regulations aimed at stopping human rights abuses and corruption, testing companies' ESG compliance programming and supply chain diligence.

The impact on companies could be significant as they look to grow and finance their businesses; operate and manage supply chains; and protect against heightened risk from government enforcement, shareholder lawsuits and consumer objections.

There are opportunities, however, for companies to create viable ESG strategies to get ahead of these issues. But rather than building a new ESG program from the ground up, companies could consider enhancing their current compliance procedures.

Overall heightened action will affect how companies operate.

Biden Administration

President Joe Biden has deemed the fight against corruption as a core U.S. national security interest and has directed 15 executive agencies with enforcement or intelligence capabilities to conduct interagency reviews of how they may work together to further this goal.[1]

Department of Justice

At the U.S. Department of Justice, Deputy Attorney General Lisa Monaco's recent memoranda and addresses, and Assistant Attorney General for the Criminal Division Kenneth Polite's interviews, describe a renewed emphasis on corporate and responsible individual enforcement; elimination of a presumption against corporate monitors; an emphasis on repeated misconduct; and an emphasis on proactive compliance programs and compliance expenditures.[2]

Historic cases involving the U.S. Foreign Corrupt Practices Act, kleptocracy and diesel emissions fraud already lay the groundwork for new ESG and FCPA investigations and actions.

Global Magnitsky Act

Under the Global Magnitsky Human Rights Accountability Act, which was signed into law in December 2016, more than 400 foreign persons and entities have been sanctioned.[3]

Those sanctioned cannot travel to the U.S. and, most significantly, cannot use the U.S.



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banking system to send or receive funds. They are also added to the Specially Designated Nationals And Blocked Persons List, which prohibits U.S. entities from doing business with them.

Canada has a law very similar to the Magnitsky Act. Additionally, the EU and U.K. passed their own versions in 2020, and Australia enacted similar legislation in December 2021. These laws sanction both human rights abuses and corruption, except for the EU's law, which covers only human rights abuses.

These regulators are actively coordinating their investigations and instituting mirroring sanctions.

At the end of 2021, the U.S. Office of Foreign Assets Control added 78 new violators to the list of Magnitsky Act prohibited parties.[4]

In addition, civil suits in the U.S. filed by or on behalf of plaintiffs who have suffered abuses, such as forced or child labor in the supply chain of companies under the jurisdiction of the U.S. or one of its states, are also becoming important tools against such abuses.

Last summer, the U.S. Supreme Court, though denying one such claim against U.S. companies in *Nestle USA Inc. v. Doe*, recognized that under the right law and facts, such suits are potentially winnable.

SEC

The U.S. Securities and Exchange Commission created an ESG enforcement task force.

In addition, statements by SEC Chair Gary Gensler and former acting Deputy Director of Enforcement Kelly Gibson, as well as publicly reported sustainability disclosure investigations for so-called greenwashing, suggest a new emphasis on review of climate and ESG disclosures.[5]

FinCEN

The U.S. Department of the Treasury's Financial Crimes Enforcement Network notified financial institutions to include environmental crime as a basis for suspicious activity report filings, showing an emphasis on increased reporting that may support enforcement actions.[6]

China

The recently signed Uyghur Forced Labor Prevention Act[7] — the requirements of which are still being developed — generally places a difficult rebuttable presumption of forced labor being involved in the production of any items produced in the Xinjiang region of China.

Under the law, companies are responsible for rebutting that presumption should their supply chain include goods acquired from the region, as many do, given the prevalence of cotton, foodstuff and materials used in manufacturing.

Customs and Border Protection

U.S. Customs and Border Protection has recently been issuing withhold release orders[8] for products from violating countries in U.S. ports, focusing largely, though not exclusively, on

human rights issues in China. This is making supply chain problems significantly more expensive.

What does this mean for companies?

As a result of the expansion of sanctions, lawsuits and other legal remedies, shareholders and consumers have been paying close attention to the practices and monitoring efforts of the companies in which they hold shares or from which they buy products. This is also leading to increasing litigation by shareholders and consumers.

These actions carry both legal and reputational risks, particularly when related to human rights abuses and corruption.

This expanding U.S. enforcement environment, not to mention the ramping up of equivalent enforcement by other nations, should be a wake-up call to all business lawyers and compliance practitioners.

The message sent is clear: Resources are being directed to investigations and enforcement actions prioritizing ESG and anti-corruption components, and companies should have compliance programs in place to address these risks before the first round of new enforcement actions arise.

Warnings of increased enforcement and reputational risks, however, also create opportunities for companies in their growth and daily operations to protect against future legal and reputational risk proactively and cost-effectively, with minimal disruption to ongoing operations.

Businesses should ask: How does heightened enforcement risk affect how we finance and grow our business, continue existing operations and protect the company in this new enforcement era?

There is opportunity to enhance existing compliance models in a way that collectively addresses the newly prioritized risks under ESG, along with increasing anti-corruption risk.

How does heightened enforcement risk affect how we finance and grow our business?

Heightened enforcement risk not only presents legal risks associated with a potential criminal or civil enforcement action, it also creates challenges for how companies finance and grow their businesses.

For example, financial institutions in the U.S. and around the world have taken the lead in requiring full compliance with ESG commitments and, in particular, exhibiting no tolerance for human rights abuses and corruption.

Lenders, investors and insurers are demanding more attention to such issues as part of their own exposure to the legal and regulatory risks under banking regulations and practices.

To mitigate the ESG and anti-corruption risks inherent with financing and growing a business, consider the following actions:

- Design and actively pursue due diligence and monitoring of prospective acquisition targets, business partners and supply chain vendors. Existing due diligence programs and questionnaires already dealing with corruption issues can be expanded to address labor and human rights concerns.
- Include new ESG and enforcement priority considerations in your supply chain, business partner, and mergers and acquisitions due diligence.
- Where ESG or anti-corruption issues are flagged in due diligence, or where these components of due diligence could not be adequately performed prior to completion of the transaction, formalize integration steps to bring the business partner or new business into the company's compliance programs.
- Expand monitoring and auditing of company behavior in the U.S. and around the world, and conduct thorough and efficient review and analysis of what is observed. For many corporations, existing operations may only require some adjustments. For companies becoming more active outside the U.S., new programs and relationships will be necessary.
- Factor in expanded ESG and anti-corruption enforcement priority risks when reviewing your local and global enforcement risk profiles.
- Include the risks of scrutiny from consumer, employee and shareholder constituencies into the company's risk assessment. Remember, companies are no longer being watched by regulators alone.

How do we protect against the forecasted enforcement risks?

All businesses will need to protect themselves from new and existing risks resulting from the expanding legal regime covering human rights abuses, forced and child labor, and corruption.

The protection techniques start with a full understanding of the new risks and the compliance requirements in the U.S. and throughout the world.

Implementing these requirements must be done in a coordinated way throughout the company, so that the system is cost-efficient and fits with existing corporate culture and practices.

- Look at corruption risk companywide from a governance perspective.
- Monitor compliance plans, including supply chain performance, and report on their status to senior management and the board.
- Be prepared to address past corruption and enforcement, in addition to efforts taken to reduce those risks in operations and M&A scenarios.
- Institute procedures that allow the company to detect and respond nimbly to new risks — e.g., new entities sanctioned under the Magnitsky Act and enforcement agencies' increased focus on China — while still maintaining vigilance in historically high-risk areas like anti-corruption.
- Prepare your offices and business partners in far-flung places for increased ESG, local anti-bribery/anti-corruption, and Magnitsky Act scrutiny and joint enforcement actions.
- Using your updated risk assessment, apply resources to your most significant areas of risk when concerns do arise.

How do we operate legally and ethically?

Designing and implementing internal programs to protect against legal and compliance risks can significantly benefit business reputation and consumer choices.

- Review and update risk assessments and related company policies and trainings.
- Consider supplier codes of conduct and corresponding supplier contract terms that address anti-bribery and ESG risks, and include termination, indemnification and audit or investigation cooperation provisions to those terms and commitments. But note, when you have these in a contract, you must be prepared to exercise them when a violation or flag occurs.

- Conduct Magnitsky Act — human rights and corruption — assessments that extend to vendor relationships and your supply chain, in addition to traditional FCPA business partner risk reviews.
- Review your disclosures not only from an anti-corruption perspective, but also an ESG perspective.
- Consider additional company data that can be mined, shared or otherwise leveraged to support real-time monitoring and assessment of ESG and anti-bribery risks.
- Where you have audit rights, exercise them to test your suppliers' and business partners' compliance.
- Educate suppliers and business partners about the risks presented by ESG and anti-corruption enforcement, and why it should matter not only to you, but also to them.

Conclusion

Given the rapidly changing enforcement landscape and increased ESG scrutiny from an array of stakeholders, companies may want to consider a comprehensive review of existing compliance programming to incorporate new risks presented.

Fortunately, there are key indicators to help identify these risks, and frameworks off which to build, to help companies maintain effective and cost-efficient operations, be conscientious about growth, meet financing and investor obligations, and protect against expansive legal and enforcement risks.

Correction: A previous version of this article incorrectly identified the year the EU and U.K. passed their own versions of the Magnitsky Act. That error has been corrected.

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[1] See Presidential Memorandum by President Joseph R. Biden, Jr., "Memorandum on Establishing the Fight Against Corruption as a Core United States National Security Interest"

(June 3, 2021) (available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/06/03/memorandum-on-establishing-the-fight-against-corruption-as-a-core-united-states-national-security-interest/>).

[2] See, e.g., Lisa O. Monaco, Deputy Attorney General, Dep't of Justice, Keynote Address at ABA's 36th National Institute on White Collar Crime, Oct. 28, 2021 (available at <https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-gives-keynote-address-abas-36th-national-institute>); Memorandum from Deputy Attorney General Lisa O. Monaco, Dep't of Justice, "Corporate Crime Advisory Group and Initial Revisions to Corporate Criminal Enforcement Policies," Oct. 28, 2021 (available at <https://www.justice.gov/dag/page/file/1445106/download>); Kenneth A. Polite, Assistant Attorney General for the Dep't of Justice criminal Division, Interview with Law360, "New DOJ Crime Chief Talks 'Carrot and Stick' Enforcement," Dec. 8, 2021 (available at <https://www.law360.com/articles/1447069/new-doj-crime-chief-talks-carrot-and-stick-enforcement>) and "Corruption, Cybercrime in Crosshairs for DOJ Crime Chief," Dec. 10, 2021 (available at <https://www.law360.com/articles/1447705/corruption-cybercrime-in-crosshairs-for-doj-crime-chief>).

[3] See, Office of Foreign Assets Control Sanctions List Search tool, GLOMAG Program lookup results (available at <https://sanctionssearch.ofac.treas.gov/>).

[4] "United States Announces Targeted Sanctions; Human Rights First Calls on Other Nations to Act," Human Rights First, December 13, 2021 (available at <https://www.humanrightsfirst.org/press-release/united-states-announces-targeted-sanctions-human-rights-first-calls-other-nations-act>).

[5] See, e.g., Kelly L. Gibson, Chief of US Securities and Exchange Commission Climate and ESG Task Force, Interview with Law360 "SEC's SSG Unit Chief Says Existing Regs Key to Enforcement," April 9, 2021 (available at <https://www.law360.com/articles/1373422/sec-s-esg-unit-chief-says-existing-regs-key-to-enforcement>); US Securities and Exchange Commission, Press Release, "SEC Announces Enforcement Task Force Focused on Climate and ESG Issues" (March 4, 2021) (available at <https://www.sec.gov/news/press-release/2021-42>); US Securities and Exchange Commission, Speech by Chair Gary Gensler, "Remarks before the European Parliament Committee on Economic and Monetary Affairs," September 1, 2021 (available at <https://www.sec.gov/news/speech/gensler-remarks-european-parliament-090121>).

[6] See, e.g. FinCEN Notice "FinCEN Calls Attention to Environmental Crimes and Related Financial Activity," November 18, 2021 (available at <https://www.fincen.gov/sites/default/files/2021-11/FinCEN%20Environmental%20Crimes%20Notice%20508%20FINAL.pdf>).

[7] Pub. L. 117-78 (2021).

[8] See, US Customs and Border Protection, Withhold Release Orders and Findings List, <https://www.cbp.gov/trade/forced-labor/withhold-release-orders-and-findings>.