

Sills Egsgard LLP Bulletin

Risks Arising from Violation of CSR Norms: Litigation, Social Licence and Reputational Damage

Evolving norms of Corporate Social Responsibility (“CSR”) reflect changing expectations for corporate behaviour, often exceeding the requirements of applicable laws. Companies that violate these expectations potentially now face serious repercussions ranging from loss of reputation and market share to risk of litigation.

1. What is Corporate Social Responsibility?

While CSR once referred primarily to a corporation’s voluntary philanthropic efforts, today the term refers more broadly to the various impacts a company’s operations may have on its stakeholders in the economic, social and environmental spheres, as well as their relationships in the workplace, the marketplace, the supply chain, the community and the public policy realm.

By way of example: CSR spending by a mining company in the past may have involved building a school for a community near a mine site, but would not necessarily have considered the impacts of the actual mining operations on the larger community. Increasingly however, a comprehensive approach to CSR will take into account all the impacts that the mining operation may have on the community from an environmental, social and financial point of view, and would seek to address negative impacts to the extent possible.

2. What Standards Apply?

CSR standards are derived from a number of sources, many of which are becoming increasingly uniform, including international treaties, voluntary principles, national legislation, and private contractual requirements and practices. The standards may be general, industry, geographically or issue-specific. Underlying many of them are the concepts established in the *UN Guiding Principles on Business and Human Rights* (“*Guiding Principles*”)¹, which is a focus of this bulletin. It is important, however, that companies be aware of the many other standards relevant to their operations.

i. UN Guiding Principles on Business and Human Rights

The *Guiding Principles* were endorsed by the UN Human Rights Council in 2011. The core principle is that businesses have a responsibility to respect all international recognized human

¹ Available online at: http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

rights. This means that they should avoid infringing on the human rights of others and should address adverse human rights impacts which may arise out of their operations.² To accomplish this, the *Guiding Principles* provide that companies should have: policy commitments to respect human rights; human rights due diligence processes to identify, prevent, and mitigate adverse human rights impacts; and processes to remediate adverse human rights impacts caused or contributed to by the company³.

The *Guiding Principles* have been widely endorsed, indicating a growing consensus on expectations for corporate behaviour. They have been incorporated into the International Finance Corporation's Sustainability Framework, the new social responsibility standard adopted by the International Organization for Standardization, ISO 26000, and the *OECD Guidelines for Multinational Enterprises*. Many governments have indicated their support for the *Guiding Principles*, including those of Canada, the US, and UK as well as the Council of Europe. Industry associations such as the Prospectors and Developers Association (PDAC) and the International Council on Mining and Metals also have expressed their support.

Overall, the *Guiding Principles* have significantly impacted CSR considerations. While they are not themselves binding, their content incorporates certain inherently legal principles of rights and duties and therefore potentially introduces new legal risks for companies with transnational operations.

b. Legislation

The last several years have seen an increase in national legislation in various jurisdictions aimed at encouraging business to act in a socially responsible manner, particularly when operating in countries with a weak or non-existent tradition of the rule of law. It is important to be aware of these laws as non-compliance with these obligations can have serious consequences.

For instance, foreign anti-bribery and corruption laws have proliferated in many jurisdictions, with massive penalties and incarceration possible upon conviction. There are numerous other examples. In the US, the so-called conflict minerals laws require companies to conduct extensive due diligence on their supply chains to determine whether certain minerals in their products were sourced from conflict-ridden areas of the Democratic Republic of Congo or surrounding countries, and to publicly report on the results.⁴ The EU has proposed a similar law⁵.

² Principle 11.

³ Principle 15.

⁴ Section 1502 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

⁵ European Commission, "Proposal for a Regulation of the European Parliament and of the Council setting up a Union System for supply chain due diligence, self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas", 2014/0059 (COD), available online at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152227.pdf

In California, companies of a certain size are required to publish audits respecting ethical supply chain practices, and similar US Federal legislation has also been introduced. The US has also required that US companies investing more than \$500,000 in Myanmar report publicly on their human rights policies and procedures.

3. Risks of Ignoring CSR Standards

Many CSR standards, such as the *Guiding Principles*, are non-binding in a strictly legal sense yet awareness of them may still be important to a company's bottom line. Risks of non-compliance include:

a. Reputational Damage

Violation of CSR principles, including by third parties in the supply chain, can result in serious reputational damage and therefore ultimately financial harm. Decreased market share can result from consumer boycotts when rights abuses become public, particularly in the clothing and consumer goods areas. An example is the negative publicity for clothing retailers in the wake of the Bangladesh Rana Plaza factory collapse. Loss of reputation with stakeholders can lead to future difficulties in doing business with impacted groups such as employees, shareholders, joint venture partners and local communities with adverse consequences for a company's bottom line.

b. Loss of business opportunities

Many large corporations are increasingly implementing supplier codes of conduct based on CSR principles, meaning that companies without adequate CSR systems may be disqualified from significant contracts. Wal-Mart, for instance, recently terminated one of its major seafood suppliers following reports of poor working conditions at processing facilities⁶. Similarly, many governments, such as the US government, require proof of adherence to certain CSR standards to be submitted when companies submit bids on government procurement contracts.

c. Security risks/social unrest from failing to earn social license to operate

Failing to ensure proper CSR systems are in place can lead to conflict with populations living in the vicinity of a company's foreign operations. Aside from legal risks and actual harm resulting from these types of conflicts, protests and labour strikes can be extremely expensive. For instance, in Peru a recent suspension of work at a mine site stemming from local resident protests

⁶ "Walmart Suspends Supplier of Seafood", *New York Times*, June 30, 2012, available online at: http://www.nytimes.com/2012/06/30/business/wal-mart-suspends-seafood-supplier-over-work-conditions.html?_r=0

about mine-related water pollution led to estimated losses of \$2.1 million per day.⁷ Ensuring better relationships with local populations through human rights due diligence and monitoring can help prevent these types of disruptions and ensure that the company’s “social licence” to operate in a particular jurisdiction remains intact.

d. Proof of CSR compliance required for financing

Businesses are increasingly confronted with demands from banks and institutional investors to demonstrate respect for human rights in all aspects of their business activities. These requests frequently occur pursuant to the revision of the International Finance Corporation’s Sustainability Framework to reflect the *Guiding Principles*, compliance with which is a condition of IFC financing. Similar compliance requirements exist for many export credit agencies, and the 70-odd private sector banks that subscribe to the Equator Principles. As a result, compliance with the *Guiding Principles* is already a *de facto* prerequisite for doing business in many countries.

e. Loss of right to investor actions

Another potential risk of failing to ensure compliance with corporate social responsibility principles is the possible loss in certain circumstances of a company’s rights to investor-state dispute settlement procedures before international arbitral tribunals. These dispute mechanisms are often a company’s primary recourse in the event of expropriation or other investment interference by a foreign government.

f. Litigation

Companies that have not adequately addressed CSR concerns may face litigation risk. In the past, companies have been able to rely on arguments relating to jurisdiction and corporate structure to protect themselves from liability for harm allegedly caused by foreign subsidiaries in their foreign operations. However, recent decisions by courts in a number of jurisdictions including the UK, US and Canada suggest that these arguments may be weakening. Most recently in Canada, a court found that there may be a new duty of care owed by a Canadian mining company to plaintiffs that were allegedly harmed by security personnel hired by a foreign subsidiary⁸, such that the Canadian company might be liable to pay damages. Two cases against mining companies have since been filed using similar arguments.⁹

⁷ “Newmont Cutting Jobs at Suspended Peruvian Gold Project”, Bloomberg, March 14, 2012, available online at: <http://www.businessweek.com/news/2012-03-14/newmont-cut-jobs-at-suspended-conga-project-santa-cruz-says>

⁸ *Choc v. Hudbay Minerals*, 2013 ONSC 1414

⁹ *Adolfo Garcia v. Tahoe Resources Inc.*, concerning a claim against a Canadian parent company for mining activities conducted through a foreign subsidiary in Guatemala; *Araya v. Nevsun Resources Ltd.*, concerning allegations of slave labour used by the Canadian company in its Eritrea operations.

In another case, *Yaiguaje v. Chevron Corporation*,¹⁰ the Ontario Court of Appeal also indicated interest in looking beyond corporate structures to consider using a Canadian company's assets to satisfy an Ecuadorean judgment against a related company.

The *Chevron* case is being appealed to the Supreme Court of Canada, and the former cases have yet to reach trial, so the law is still unclear. Nevertheless it is significant that courts in a number of common-law jurisdictions appear newly willing to entertain parent company responsibility for actions of related companies overseas..

4. Risk Management and Compliance Strategies

The emergence of legal risk described above means that CSR strategies can no longer simply be confined to public relations initiatives or philanthropic endeavours. Rather, prudent practice for corporate counsel would be to develop corporate CSR programs in accordance with emerging legal norms, in order to protect companies from new forms of legal and other risks.

a. Policy statements

The *Guiding Principles* provide that companies should establish policy commitments to respect human rights setting out human rights expectations of employees, business partners and other parties directly linked to its operations, products or services. More detailed internal policies should deal with issues such as lines of accountability, procedures for raising concerns, monitoring human rights impacts and relationships with third parties. All CSR policies should be integrated into already existing policies the company may have in place.

b. Due diligence

The *Guiding Principles* require that companies carry out human rights due diligence in order to identify, prevent, mitigate and account for how they address their adverse human rights impacts. The process should include a review of company operations to assess actual and potential human rights impacts caused, or contributed to by the company through its own operations or business relationships, drawing on human rights expertise and consultations with affected groups.¹¹ Companies should prioritize areas where the risk of adverse human rights impacts is most significant, and be aware of issues of complicity with or contribution to a harm that may be carried out by an agent or third party¹², such as a supplier, joint venture partner or agent. The due diligence process can be incorporated within other risk assessment processes, for instance

¹⁰ 2013 ONCA 758

¹¹ Principles 17 and 18.

¹² Principle 17.

environmental and social impact assessments.¹³ Where a company finds that it causes or may cause an adverse impact, it should take steps to cease or prevent it, and should exercise leverage to prevent third parties from causing or contributing to abuses.¹⁴

c. Remediation

Finally, the *Guiding Principles* require businesses to cooperate in legitimate processes, to remedy human rights grievances that they have caused or to which they have contributed. Practically speaking, appropriate measures will vary in each situation.

5. Importance of legal counsel

The role of legal counsel in developing and implementing a CSR strategy is critical both in helping to understand the definition and scope of possible affected rights, as well as in assessing the causal relationship between the company's operations and adverse human rights impacts. The process of defining affected rights is inherently a legal one, and involves the application of specific definitions of rights affected under national and international law, as well as their interpretation through commentary of UN committees, international court cases, and domestic commentary and court decisions. Similarly, familiarity with legal concepts of causation and can be brought to bear by counsel on analysis of human rights impacts of corporate behaviour.

Lawyers can also assist in drafting contracts designed to avert or mitigate any risk to human rights resulting from third parties. For instance, when contracting with a government, a corporation can seek to add identification of human rights risks and management of those risks into investment project contract negotiations. Contracts with employees, third parties and agents can also establish expected standards of behaviour, and allow for termination of the contract by the client as well as other remedies if such standards are not met.

Finally, and of significant importance, is the fact that information turned up in the due diligence process may be sensitive or highly confidential. The involvement of legal counsel at this stage can allow for protection of the information by virtue of legal privilege.

Conclusion

The new CSR landscape, and related emerging legal liability requires an awareness of multiple domestic and international standards in all jurisdictions in which a company is operating. The considerations are complex, but a comprehensive approach to CSR issues including anti-bribery and human rights issues, provides companies with an opportunity to take a more measured

¹³ Commentary to Principle 18.

¹⁴ Commentary to Principle 20.



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approach to CSR spending. It will also help to better assess risks and prevent human rights abuses, and to improve relationships with a broad range of affected stakeholders, thereby ultimately adding shareholder value.