



Best Practices in Supply Chains Research Findings IBA Special Project

BÄR
& KARRER

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Dr. Pascal Hachem

Supplier Qualification

Legal Implications

Challenges from Working with Suppliers

- Corporate Governance / Compliance System / Risk Analysis
 - Onboarding suppliers tests reliability of general risk analysis and its comprehensiveness
 - Supplier qualification and due diligence is relevant for assessment of proper organization of the company and its compliance structure
- Supplier might trigger vicarious liability under applicable law with respect to both civil and criminal liability
 - Dangerous combination of broad sphere of application in particular of FCPA and UK Bribery Act and theory of vicarious liability where company is liable for acts of its agents or third parties acting on its behalf
 - Depending on proximity between supplier and company, supplier might be regarded as agent of the company
 - Under UK Bribery Act supplier may be considered as person associated with company and company then needs to show that it has proper procedures in place

Supplier Qualification

Legal Implications

Challenges from Working with Suppliers

- Direct Criminal Liability of Company
 - Supplier may trigger liability of company under criminal law for lack of proper organization
 - Third parties with contractual or factual ties to company may qualify as offenders from within the company
 - Inadequate means to manage risks originating from suppliers may then indicate lack of proper organization
 - Supplier may cause misconduct within company
 - Direct instead of vicarious liability
 - Disruptive and additional legal and reputational risks
- Civil liability for losses caused by supplier
 - If losses sustained by company were caused by supplier misconduct, exposure of company board to allegations of insufficient supervision and organization of the company
 - Potential inability to recover from supplier due to solvency issues or difficulty to prove and calculate damages

Supplier Qualification

Legal Implications

Challenges from Working with Suppliers

- Supplier may trigger additional duties of supervision for company
 - Applicable, in particular, if supplier directly renders performance to customer together with company / within sphere of influence of company
 - Prime examples health & safety, environment protection, conduct in the workplace
- Reputational risks in case of insufficient supplier due diligence
 - Exposes company boards to allegations of insufficient diligence in conducting business / leading the company
 - Loss of business with customers
 - Exclusion from / no invitation to bidding for public projects
 - Damages difficult to prove and calculate, recourse against supplier is steep uphill battle

Supplier Management

Results from Experience and Review

General Observations

- Recognition of supplier management / legal supply chain management as business / legal subject matter
 - Widely accepted that issue cannot be ignored and is no longer a Public Relations exercise
 - Degree of proactive approach differs strongly, depending on
 - Size of company
 - U.S. exposure (FCPA, SOX)
 - Reputational situation of industry / product
 - Overall corporate culture
 - Legislative pressure
- Relationship between manufacturer and suppliers
 - Actual influence of manufacturer on supplier differs, depending on
 - Buying power of manufacturer
 - Market conditions (i.e. special know-how of supplier, number of suppliers with necessary size, geographic limitations due to needed materials)

Supplier Management

Results from Experience and Review

Industries Covered

- We looked at various industries:
 - Automotive, Pharmaceuticals, Tobacco, Cocoa, Commodities, Textile, Food & Beverages

Documents Reviewed

- In the process we reviewed different types of documents:
 - Codes of Conduct for suppliers (incl. implementation guides, auditing guides, remediation guides)
 - Supply Contracts
 - Franchise Agreements
 - Distribution Agreements

Persons Interviewed

- To enhance our understanding, we spoke to
 - Inhouse counsels
 - Consultants

Supplier Management

Results from Experience and Review

Key Risks Identified in Supply Chain

- Certain key risks were identified, with the focus depending on the respective industry
 - Corruption: Automotive (in particular private bribery), Tobacco (in particular bribery of (foreign) officials with respect to customs and taxes), Pharmaceuticals (private bribery and bribery of (foreign) officials)
 - Child labor / forced labor: Cocoa, Commodities, Textile, Food & Beverages
 - Health & Safety: All
 - Unfair Competition: Automotive, Pharmaceuticals

Methods of Addressing Key Risks

- Different ways of addressing key risks
 - Specific clause (warranty) in agreement
 - However, often limited to general language that all applicable laws and regulations must be observed, in some cases supplemented with examples of specific areas, typically corruption, labor, health & safety

Supplier Management

Results from Experience and Review

Methods of Addressing Key Risks

- Codes of Conduct for suppliers
 - Differ in size (frequently 2 pages to 20 pages)
 - All list unwanted conduct
 - In majority of cases Codes of Conduct mention that violation may lead to manufacturer's right to require corrective action / remediation and termination of the contract; express auditing right is exception; no financial sanctions envisaged
 - In majority of cases obligation on supplier to implement Code of Conduct also in contracts with its next tier suppliers or at least comparable standards
 - In majority of cases Codes of Conduct point to specific reporting line to report violations to manufacturer
 - In minority of cases Codes of Conduct also contain guide to implementation, several companies provide suppliers with separate implementation guidelines, including definitions and explanations to standards set for suppliers
 - In minority of cases specific corrective action / remediation measures suggested to / required from supplier
 - In minority of cases grievance mechanisms

Supplier Management

Results from Experience and Review

Application in Practice

- Standardization / Industry Standards
 - International Organizations
 - Rudimentary statements in ISO 26000 (Sec. 6.6.6)
 - Rudimentary statements in OECD Guidelines 2011
 - Specifics in OECD Due Diligence Guidance 2012 with respect to minerals from conflict areas
 - Diverse situation in most industries; Codes of Conduct in their generic structure and content similar, but therefore lack of standards for implementation in practice and high degree of discretion at regional and local level
 - Occasionally Codes of Conduct track UN Global Compact (if company is participant) or refer to ILO Conventions
 - Advanced standardization in pharmaceutical industry through "*Pharmaceutical Supply Chain Initiative*" (PSCI)
 - Principles for Responsible Supply Chain Management
 - Guidance for Implementing the Principles
 - Audit Guidance

Supplier Management

Results from Experience and Review

Application in Practice

- Reports from interviewees and review
 - Ability to incorporate Code of Conduct in contracts
 - Typically given (high bargaining / buying power)
 - In developing countries problems with literacy, local customs and usages, inheritance law (unclear who is supplier), cooperation with NGO's / cooperatives necessary
 - Enforcement of Codes of Conduct
 - Typically less sophisticated than traditional quality control processes and requirements
 - Contractual means of escalation typically designed to address traditional quality issues (especially automotive)
 - Ability to terminate agreements with suppliers
 - Unrealistic in automotive while series manufacturing is ongoing due to specifics of manufacturing process ("*Just in Time*" / "*Just in Sequence*", lack of available capacity at other suppliers, complex validation process)
 - Difficult in cocoa, as world production of beans comes from essentially three countries (Ivory Coast, Ghana, Indonesia)

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Results from Experience and Review

Application in Practice

- Difficult in textile (similar reasons as in automotive)
- Termination is standard result of supplier misconduct in tobacco, highly regulated and controversial industry, zero-tolerance necessary; in exceptional cases (convincing remediation) continued cooperation
- Corrective action / remediation is preferred method in pharmaceuticals to address supplier misconduct
- Internal Investigations at Company
 - Standard measure in case of allegations of corruption (both private bribery and bribery of (foreign) officials, violations of export controls / sanctions)

Supplier Management

Results from Experience and Review

Involvement B&K

- Our general findings in industry investigations
 - Insufficient guidelines for business conduct and / or lack of training and enforcement
 - Insufficient insight into regional and local business practices
 - Rather repentant sinner, than a hypocrite
- Main exposure (criminal law and regulatory) in our view
 - Vicarious liability for subsidiaries / business partners, in particular given broad scope of FCPA and UK Anti-Bribery Act and bribes often paid in USD (= use of US financial system)
 - In Switzerland: Inability for company to prove robust compliance structure to escape liability under article 102(2) Criminal Code, if involvement of Swiss company in supplier misconduct
 - In Switzerland: Private bribery is criminal offence
 - Increased attention from regulator

Conclusion

Developments to be Observed

- Contract Law Concepts under Pressure
 - Compliance is increasingly merged into contract law
 - Traditional separation of legal entities and associated limitation of liability in politically unfavorable environment
- Increased call for criminal law to solve social issues
- Further pressure to enhance collective redress mechanisms
- Responsibility for supply chain issues climbs up corporate ladder
- Obligations to report to public increase, reporting receives higher degree of credibility and increases legal significance
- Contractual and factual influence over suppliers increasingly becomes focal point of imputing civil and criminal liability on companies
- Heightened relevance of comprehensive risk analysis and management

Zürich

Bär & Karrer AG
Brandschenkestrasse 90
CH-8027 Zürich
Tel.: +41 58 261 50 00
Fax: +41 58 261 50 01
zurich@baerkarrer.ch

Genf

Bär & Karrer AG
12, quai de la Poste
CH-1211 Genève 11
Tel.: +41 58 261 57 00
Fax: +41 58 261 57 01
geneva@baerkarrer.ch

Internet

www.baerkarrer.ch

Zug

Bär & Karrer AG
Baarerstrasse 8
CH-6301 Zug
Tel.: +41 58 261 59 00
Fax: +41 58 261 59 01
zug@baerkarrer.ch

Lugano

Bär & Karrer AG
Via Vegezzi 6
CH-6901 Lugano
Tel.: +41 58 261 58 00
Fax: +41 58 261 58 01
lugano@baerkarrer.ch