Brands, CSR, and Compliance: Working Together to Create Value and Improve Society

By Jennie McCarthy, Marc Lieberstein, Alex Bullock, and Holly Gaudreau

I. Introduction

> "It takes 20 years to build a reputation and five minutes to ruin it. If you think about that you will do things differently."
>
> —Warren Buffet

Now more than ever, brand reputation is linked to "doing good" as corporate social responsibility (CSR) has taken on a greater importance due to increased awareness about the impact of business practices on human rights, labor, and the environment.

CSR is generally defined as "a commitment to improve community well-being through discretionary business practices and contributions of corporate resources."[1] Some observe that sustainability and business issues have now converged and that the future of CSR will be "resilient business strategies that view progress on sustainability as a means of long-term value creation and innovation."[2]

Consumer expectations and desires often drive a company's CSR efforts. A Nielsen Company 2014 study of more than 30,000 consumers in 60 countries showed the impact of CSR on consumer behavior. More than half responded they would pay more for products and services from companies committed to positive social and environmental impact.[3]

Some key benefits for brand owners participating in CSR business transactions include enhanced brand recognition and ability to manage business risk, with the potential to increase revenue, lower expenses, and engage new and more loyal customers. Indeed, companies that apply CSR actively manage risks via product safety, supply chain compliance, and ethical business practices while building goodwill through charitable contributions, promoting diversity, equality, sustainability, and the like. However, if CSR participants fail to vet their CSR affiliations or activities, including the associated supply chain compliance requirements, brand owners risk losing complete control over their brand or damage to the brand's reputation if for some reason "doing good" results in doing bad, e.g., providing free clothing to a community that results in putting the local apparel company out of business.

This article explores the relationship among CSR, brand value, and compliance and provides ideas and suggestions for brand owners and legal practitioners to consider in their CSR business transactions.

II. Laws and Regulations Relevant to CSR

There are multiple state, federal, and international laws and regulations mandating compliance with certain social and environmental principles. Companies participating in CSR activities should focus on the following:[4]

A. Human Rights and Fair Labor

- **California Transparency in Supply Chains Act of 2010**: Requires retailers and manufacturers doing business in California and having annual worldwide gross receipts that exceed $100 million to disclose "efforts to eradicate slavery and human trafficking from its direct supply chain for tangible goods offered for sale."[5]
- **U.K. Modern Slavery Act of 2015:** Requires companies doing business in the U.K. with annual gross worldwide revenues of £36 million (approximately $49 million) to publish an annual "slavery and human trafficking statement."[6]
- **Other anti-slavery laws:** Other countries such as France and Australia as well as states such as New York have enacted (or will soon enact) anti-slavery laws that can also impact CSR activity and associated transactions.[7]
- **Federal Fair Labor Standards Act:** Sets minimum wage and other fair labor standards, including the prohibition of child labor.[8]
- **Federal prohibition on imports of forced labor goods:** The U.S. Tariff Act prohibits the import of goods produced by forced, slave, or child labor and subjects the goods to seizure and forfeiture by U.S. Customs and Border Protection (CBP).[9]
- **Federal regulations and California law on "Made in the USA" standards:** Federal regulations require that product imported into the United States be marked with its country of origin.[10] Those products promoted as "Made in USA" must meet the "all or virtually all" standard (i.e., the significant parts

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or processing that go into the product must be of U.S. origin) and similar standards under California law.[11]

- **Countering America's Adversaries Though Sanctions Act of 2017:** CBP has been requesting that companies complete CF-28s to provide supply chain verification that no North Korean labor or forced labor is used.[12]
- **Federal and European Union conflict mineral regulations:** Federal regulations require companies filing reports with the U.S. Securities and Exchange Commission (SEC) to disclose use of "conflict minerals" mined from the Democratic Republic of Congo and nine adjoining countries.[13] The EU has implemented conflict mineral disclosure requirements for EU importers effective January 1, 2021.[14]

B. Consumer Safety and Environmental

- **Toxic Substances Control Act (TSCA):** Governs the production, importation, use, and disposal of specific chemicals identified by the U. S. Environmental Protection Agency (EPA). The statute requires companies to provide "pre-manufacture notice" of new chemicals; requires testing of chemicals by manufacturers, importers, and processors; requires notice when new uses are found for existing chemicals; and requires importers and exporters to comply with certain reporting and other requirements. EPA maintains the TSCA Inventory, a listing of over 83,000 substances that are regulated under the act.[15]
- **REACH:** Requires companies that manufacture and market chemicals to identify and manage the risks associated with the chemicals they manufacture or market within the European Union. Companies must demonstrate to the EU how the substance itself or as used in an article or mixture may be safely used and also communicate risk management measures to consumers.[16]
- **EU Timber Regulation:** Prohibits placing illegally harvested timber and products derived from illegal timber into the EU market. The regulation imposes requirements on timber products, including due diligence that the source is legal and record-keeping that includes the source of the timber product and the identity of the subsequent purchaser.[17]
- **California Safe Drinking Water and Toxic Enforcement Act ("Proposition 65"):** Requires businesses to provide warnings for products that expose consumers to chemicals known to the state of California to cause cancer, birth defects, or other reproductive health problems. California has identified over 800 chemicals that require such a warning. Violators face potential civil penalties (up to $2,500 per day per violation) and attorneys' fees. New warning regulations take effect in August 2018 and address the allocation of responsibility between retailers and manufacturers for providing the warnings.[18]

III. Repercussions of Non-Compliance

Failure to abide by compliance laws or consumer expectations can result in litigation, steep fines, recall of products, and ultimately damage to brand reputation. For example, the U.S. Consumer Product Safety Commission has levied multi-million dollar civil penalties against companies for failing to report defective products. These violations are often due to failures to monitor or consider risks in supply chains. In 2009, Mattel faced a massive product recall and a $2.3 million fine for lead in toys that were manufactured by a contractor in China.[19] The matter also resulted in a multi-district consumer class action lawsuit against Mattel that eventually settled for approximately $50 million.[20]

Doing business in California, in particular, requires caution to avoid running afoul of the state's broad consumer protection laws. In 2016, businesses paid over $30 million to settle Proposition 65 violations, of which over $21 million was for attorneys' fees.[21] Similarly, disclosures required under the California Transparency in Supply Chains Act have triggered a number of consumer class action suits in California federal court based on alleged inadequate or misleading corporate disclosures about the use of forced labor in global supply chains, including for seafood sourced from forced labor off the coast of Southeast Asia and child labor on cocoa plantations in the Ivory Coast.[22] Cases have been dismissed, but not before costly motion practice and negative publicity. Moreover, in February 2018, similar class action suits were filed in Massachusetts federal court against companies for alleged failure to disclose the use of child labor in the extended supply chain in the chocolate industry in violation of the Massachusetts Consumer Protection Act.[23]

IV. Key Transaction Considerations for CSR Participants: Avoiding Non-Compliance and Preserving Brand Value

A. Quality Assurance, Compliance, and Controls

Brand owners have a duty to control the quality of the goods or services offered under their marks, while consumers expect companies to manufacture products ethically and sustainably. Traditionally, trademark owners have used licensing to outsource the entire production or distribution process to third parties. To mitigate the risk posed by insufficient quality control or compliance in violation of laws or a company's voluntary CSR efforts, the documents that control the business relationship should contain, at a minimum, terms giving the brand owner the power to engage in quality control, e.g., the right to inspect and review the goods and services offered and to require compliance efforts and verification. In short, for domestic and international activities, especially when the geographic and cultural distances are such that day-to-day exchanges and monitoring are difficult, it is crucial to build into any CSR relationship an appropriate level of quality control and compliance verification with specific benchmarks that are reasonable and will likely be met.

Provisions pertaining to quality control and CSR efforts frequently include:

- retention of approval rights prior to, during, and after manufacturing, sale, and use;
- approval of all (or new) channels of distribution;
- reservation of the right to disapprove of any or all products not complying with the "standards of manufacturing" or "established as the standard in the industry or trade for the licensed products" including advertising and marketing of licensed products;
- required approval of pre-production samples and post-production samples;
- specifying dates by which the licensee should submit all samples, to whom they should be submitted, and by when approval will be given;
- compliance with specific grade and quality of materials to be used and ensure safety and restricted substances product testing is performed;
- the right to audit manufacturing facilities to ensure compliance with working hours, labor laws, environmental laws, facility compliance, quality control checks, etc.;
- reservation of the right to require the licensee to recall any/all products if they do not meet requirements in the license agreement;
- reservation of the right to monitor the licensee's sales activity and distribution, including Internet and social media activity;
- reservation of the right to review employee complaints;
- reservation of the right to inspect the factory where the products are being made at any given point in the production and distribution process;
- requiring that remedial action be taken for any breach of the foregoing provisions.

Once quality-control provisions have been established, both parties typically benefit from instituting a system to track compliance. In addition to tracking compliance with quality standards and regulatory regimes, brand owners conducting CSR activity should monitor for quantity of production and consider utilizing third-party labels or other detection devices to validate the quantities of licensed products manufactured by their licensees. These labels not only help verify the amounts produced but also help with brand enforcement. Such labels or coding can likewise be useful to monitor for control of the quality of products sold under the brand associated with the CSR activity.

B. Co-Branding Arrangements as a CSR Activity

Co-branding arrangements in CSR arise when two distinct brand owners decide that their brands can work together and/or complement each other in connection with a particular cause or other socially responsible activity. Typical co-branding agreements involve two or more companies that agree to cooperate and to brand the product with multiple brands or logos, color schemes, or other brand identifiers where one brand is a charitable, social, or environmental cause. One example of co-branding in the CSR space is Major League Baseball and Susan B. Komen (cancer awareness).[24] While co-branding efforts in the CSR context are often successful, brand owners should consider potential disadvantages as well, including the following:

- **Negative associations.** If one brand suffers damage to its reputation for quality or is associated with negative publicity, there is a risk that the other brand will be negatively affected.
- **Dilution.** This occurs when consumers no longer see independent brands and associate the two brands as one, thereby diluting the value of the brands standing alone, with each brand losing its distinctiveness in the marketplace.
- **Financial issues**. Co-branding arrangements may be associated with complex joint-venture and/or profit-sharing provisions that might take a long time to negotiate—and, if the brands ever want to separate, unravel.
- **Negative consequences**. Brand participation in CSR is not without risk that the CSR activity meant to benefit a community actually results in harmful consequences, e.g., shutting down or reducing the need for the local business providing similar goods or services or inappropriate use of the branded goods/services for unintended purposes.

A delicate balancing act is required for any co-branding CSR venture to achieve not only the short-term goals for success but also minimizing risk and exposure to the brands from any termination. Whatever legal and financial agreements at which the brand owners arrive, a sharing of risk and an equitable financial approach is imperative.

V. Practical Tips To Successfully Build a CSR Program and Maintain Brand Value

The following are some practical suggestions that should serve to protect your brand equity and build a CSR program:

- Establish a compliance program based on your company's business and operational risks associated with the CSR objectives. Obtain CEO, Board, and Senior Management buy-in for the key issues related to the business challenges. Identify the legal requirements for your CSR business program and determine the expectations of key stakeholders, investors, and your customers.

- Map your company's extended supply chain for the anticipated CSR program and understand the key material issues and risks associated with each stage of design, production, procurement, logistics, and selling to the customer.

- Determine and communicate what your business practices and expectations are with your suppliers and your internal business teams. Many companies use Codes of Conduct and Brand Guidelines to educate the suppliers and business teams on these matters, especially for implementing a CSR program.

- Implement a plan to audit suppliers, determine if suppliers have issues, and implement a remediation plan, if needed, to address the compliance gaps.

- Ensure your non-legal employees and yours and/or your partner's respective sales, production, and distribution teams understand the contracts and purchase orders associated with the CSR activity, including those provisions concerning the importance of protecting the brand's equity as well as those mandating legal compliance with applicable statutes and requirements.

- If your company plans to report its CSR efforts or use sustainable labeling or marks on products and services, ensure the data and statements are vetted, confirmed, and genuine. The statements or claims must be consistent with company filings and regulations to avoid litigation based on alleged misstatements or viewed as "greenwashing."

- Consider certifying your company as a "B-Corp." This certification is issued to companies that meet certain social and environmental standards and accountability. Currently, over 2000 companies are B corporations.[25]

VI. Conclusion

"We do this because it's the right thing to do."

—Apple[26]

Consumer, investor, and employee expectations are continuing to shape CSR practices even in the absence of legal requirements, and brand owners need to respond. Most companies recognize that CSR is good for the brand and society as a whole and that risk management is one key component of successful CSR programs, along with quality-control practices and procedures. Practitioners need to understand these new CSR opportunities and help companies align their CSR objectives and business transactions with the legal compliance requirements as well as consumer and market expectations as they continue to evolve.

Endnotes

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3. The Nielsen Company, Doing Well by Doing Good, Nielsen Global Survey of Corporate Social Responsibility (June 2014), available at www.nielsen.com/us/en/insights/reports/2014/doing-well-by-doing-good.html.
4. We do not purport to identify all laws and regulations that are relevant to CSR.
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6. *See Slavery and Human Trafficking in Supply Chains: Guidance for Businesses*, published by the U.K. government and available at https://www.gov.uk/government/publications/transparency-in-supply-chains-a-practical-guide and http://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.
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9. 19 U.S.C § 1307.
10. 19 U.S.C. § 1304.
11. *See Complying with the Made in USA Standard* published by the Federal Trade Commission, available at *https://www.ftc.gov/tips-advice/business-center/guidance/complying-made-usa-standard#standard;* Cal. Bus. & Prof. Code § 17533.7.
12. P.L. 115-44; *see also* Resource Center information published by the U.S. Department of Treasury, https://www.treasury.gov/resource-center/sanctions/Programs/Pages/caatsa.aspx.
13. P.L. 113-203; *see also* Fact Sheet published by the U.S. Securities and Exchange Commission, available at https://www.sec.gov/opa/

Article/2012-2012-163htm---related-materials.html and Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule (Apr. 7, 2017), available at https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule announcing suspension of certain requirements in light of *Nat'l Ass'n of Mfrs, et al., v. SEC*, 800 F. 3d 518, 530 (D.C. Cir. 2015), which stuck down portions of the law on free speech grounds.

14. *See* European Commission explanation of conflict mineral regulations, available at http://ec.europa.eu/trade/policy/in-focus/conflict-minerals-regulation/regulation-explained/.
15. 15 U.S.C. §§ 2601, *et seq.*
16. *See* Regulation (EC) No. 1907/2006 of December 18, 2006 available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02006R1907-20140410; Additional EU-REACH guidance available at https://echa.europa.eu/support/guidance.
17. *See* Regulation (EU) No. 995/2010 of the European Parliament and of the Council of 20 October 2010 available at http://ec.europa.eu/environment/forests/timber_regulation.htm.
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22. *See, e.g.*, *Hodsdon v. Mars, Inc.*, Case No. 3:15-cv-04450-RS (N.D. Cal.); *Wirth, et al. v. Mars, Inc., et al.*, Case No. CV 15-1470-DOC (KESx) (S.D. Cal).
23. *See, e.g.*, *Tomasella v. The Hershey Co.*, Case No. 1:18-cv-10360 (D. Mass.).
24. *See* https://ww5.komen.org/Major-League-Baseball/.
25. *See* https://www.bcorporation.net/.
26. Todd C. Frankel, *Why Apple and Intel Don't Want To See the Conflict Minerals Rule Rolled Back*, The Washington Post (Feb. 23, 2017), available at https://www.washingtonpost.com/business/economy/why-apple-and-intel-dont-want-to-see-the-conflict-minerals-rule-rolled-back/2017/02/23/b027671e-f565-11e6-8d72-263470bf0401_story.html?utm_term=.4f4c0446c56e.

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