C L I F F O R D

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US GOVERNMENT ISSUES XINJIANG SUPPLY CHAIN BUSINESS ADVISORY, EMPHASIZING HUMAN RIGHTS DUE DILIGENCE

On July 1, the US Departments of State, Commerce, Homeland Security, and Treasury issued an advisory, "Risks and Considerations for Businesses with Supply Chain Exposure to Entities Engaged in Forced Labor and other Human Rights Abuses in Xinjiang" ("**Advisory**"), to assist companies in complying with the ever-increasing business and trade restrictions the US government has imposed and continues to impose on public and private entities and individuals with respect to Xinjiang. The new restrictions affect businesses in a variety of sectors—including financial institutions and corporates—and apply not only to US companies, but also to any company that is subject to the US government's broad enforcement jurisdiction.

The Advisory provides the US government's background to the situation in the Xinjiang Uighur Autonomous Region of China ("**Xinjiang**"), identifies relevant US laws and enforcement authorities, encourages businesses to conduct human rights due diligence ("**HRDD**"), and provides guidance for HRDD programs. The Advisory provides important guidance for any company subject to US jurisdiction whose business has connections to Xinjiang, and more broadly for any company whose business potentially exposes it to human rights risks anywhere in the world.

THE ADVISORY

According to the Advisory, the principal risks that businesses must address with respect to Xinjiang are involvement with the development or deployment of surveillance technology for the People's Republic of China ("**PRC**") government; reliance on labor or goods sourced in Xinjiang or from factories elsewhere in China alleged to be implicated in forced labor or labor abuses of individuals from Xinjiang in their supply chains; and aiding in the construction of internment facilities or manufacturing facilities in close proximity to internment camps by businesses accepting subsidies from the PRC government.

The Advisory asserts that the surveillance infrastructure in Xinjiang relies on artificial intelligence, facial and gait recognition, infrared technology, and a mobile app used by police to enter personal data about residents. According to the Advisory, Chinese surveillance and technology companies receive support from "foreign academics, scientists, businesses, and investors." With respect to alleged forced labor and labor abuses, the Advisory identifies the following indicators / warning signs:

- Use of shell companies, contracts with opaque terms, and structuring financial transactions to obscure where the goods were produced;
- Xinjiang companies disclosing high revenue but having few employees paying into China's social security insurance program;
- Use of internment terminology, such as "Education Training Centers" or "Legal Education Centers";
- Companies receiving government subsidies for their operations in Xinjiang, in connection with "poverty alleviation efforts," "vocational training programs," or the "mutual pairing assistance program" under which companies from east China establish satellite factories in Xinjiang;
- Companies hiring workers in Xinjiang through the use of government recruiters; and
- Companies located in or near internment camps or industrial parks.

The Advisory emphasizes the need for businesses with supply chain links to Xinjiang or laborers from Xinjiang to engage in HRDD, and recommends that such companies look to the best practices described in the UN Guiding Principles on Business and Human Rights, the OECD's Guidelines on Multinational Enterprises, and the International Labor Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, to develop or improve their HRDD programs. As we have previously discussed here, HRDD programs can be integrated with and build on the foundation of a company's anti-bribery and corruption ("**ABC**") compliance program, in particular its emphasis on aligning all parts of the business and the use of certain tools that are the hallmarks of a strong compliance program. Importantly, however, HRDD differs from ABC compliance in that (1) it focuses on risks to those whose rights might be affected, rather than on risks to the business (although those may be addressed in parallel); and (2) in addition to identifying risks, HRDD incorporates expectations regarding actions to take when risks are identified, including prevention, mitigation, and, where appropriate, remediation.

Specifically, the Advisory recommends that:

- Companies examine the end users of their products, technology, research, and services.
- Companies providing construction materials to Chinese entities that may be operating in Xinjiang utilize due diligence in line with their internal risk assessment and industry practice.
- Financial institutions with ties to the US financial system "assess their potential exposure to the risk of handling the proceeds of forced labor on behalf of their clients, and . . . implement a mitigation process in line with the risk." This should include:
    - Assessing illicit financial risk;

  - Implementing sanctions compliance;
  - Implementing risk-based anti-money laundering ("**AML**"), counter terrorist financing ("**CTF**"), and counter proliferation financing ("**CPF**") programs;
  - Providing training and resources to personnel in order to effectively execute the programs; and
  - Communicating compliance expectations to counterparties, partners, subsidiaries, and affiliates.
- Before supplying goods and services to Chinese customers that may employ forced labor, "to the extent businesses have a reason to know," they should conduct "reasonable due diligence."
- Companies utilize the reports and other guidance the US government has produced, which are listed in an Annex to the Advisory, including the US Department of Labor's Comply Chain and US Department of State's Responsible Sourcing Tool.

The Advisory emphasizes that, "[w]hile due diligence practices will vary based on the size and nature of the business, well-documented and implemented due diligence policies and procedures may potentially be considered as mitigating factors by U.S. authorities, in the event businesses inadvertently engage in sanctionable activity or activity that violates domestic law."

The Advisory notes significant obstacles to conducting HRDD in Xinjiang. It states that "[t]hird-party audits alone may not be a credible source of information for indicators of labor abuses" due to (1) detention and harassment of, or threats to, auditors; (2) required use of government translators; and (3) potential unreliability of witness accounts due to pervasive surveillance and workers' documented fears of sharing accurate information. The Advisory also states that "repressive conditions" make it difficult or impossible for businesses to conduct independent onsite inspections and to work with suppliers and local law enforcement to remediate forced labor practices, which are HRDD best practices.

The Advisory encourages business to "consider collaborating with industry groups and multi-stakeholder groups to exercise leverage to address and prevent human rights abuses in their supply chains," including by sharing information, developing capacity to research potential indicators of forced labor in Chinese languages, and building relationships with Chinese suppliers and recipients of US goods and services to understand their possible relationships in Xinjiang.

The Advisory warns of reputational, economic, and legal risks to companies linked to the alleged activities in Xinjiang. It describes and provides resources related to the following legal provisions and enforcement agencies:

*US Department of Commerce Bureau of Industry and Security ("**BIS**") Entity List*

BIS's designations on the Entity List make having the designated entities anywhere in a company's downstream supply chain costly. In order to do business with parties listed on the Entity List, companies must comply with additional licensing restrictions for exports, re-exports, or in-country transfers of goods, software, or technology that are subject to the Export Administration Regulations ("**EAR**"). The EAR apply broadly, controlling US-origin commercial items and those that have both commercial and military or proliferation applications.

On October 9, 2019, BIS added 28 Chinese entities to the Entity List for their alleged involvement in human rights violations in Xinjiang. These included the Xinjiang People's Government Public Security Bureau, 19 sub-entities, and eight technology and artificial intelligence companies. On June 5, 2020, BIS added nine more Chinese entities to the Entity List, including the Ministry of Public Security's Institute of Forensic Science, a textile company, and seven technology companies, for the same stated reason. On July 22, following publication of the Advisory, BIS added 11 more Chinese entities to the Entity List, including textile and technology companies, one company that produces high-speed rail equipment, and two gene-sequencing companies. The US Department of Commerce's press release alleges that these companies are "implicated in human rights violations and abuses in the implementation of the People's Republic of China's (PRC) campaign of repression, mass arbitrary detention, forced labor, involuntary collection of biometric data, and genetic analyses targeted at Muslim minority groups from" Xinjiang.

*US Department of Homeland Security ("**DHS**") Enforcement Agencies*

The Tariff Act of 1930, 19 U.S.C. § 1307, imposes a ban on imports made using forced labor, regardless of origin. US Customs & Border Protection ("**CBP**") and US Immigration and Customs Enforcement ("**ICE**") enforce this provision. CPB has issued withhold release orders ("**WROs**") to detain imported hair products and garments believed to have been manufactured using forced labor in Xinjiang. Upon the issuance of a WRO, CBP seizes all specified imports that arrive at a US port of entry, and the importer has the option to export the goods or demonstrate that they were not produced using forced labor. Under 9 C.F.R. § 12.42, the CPB commissioner may issue a WRO "at any time" based on information that "reasonably but not conclusively" shows involvement of forced labor in production. The seizure may lead to forfeiture of the goods and potentially civil penalties against the importer. Most recently, on July 1, CBP seized approximately US$800,000 in human hair products imported from China and believed to be from Xinjiang, following the issuance of WROs on May 1 and June 17, 2020 for hair products manufactured by certain Chinese companies. CPB also issued a WRO on September 30, 2019 for garments manufactured by a certain Chinese textile company alleged to be involved with forced labor in Xinjiang.

ICE's Homeland Security Investigations ("**HSI**") initiates criminal investigations relating to importation of goods made with forced labor, which may lead to criminal prosecution.

Federal Acquisition Regulation, Combating Trafficking in Persons (FAR 52.222-50)

This regulation prohibits federal contractors, sub-contractors, and their employees and agents from engaging in forced labor or other types of trafficking. The contracting agency may impose remedies for violations, including suspension or debarment.

*Trafficking Victims Protection Act ("**TVPA**"), 18 U.S.C. § 1589*

The TVPA imposes federal criminal liability on corporations for "reckless disregard" of the fact that their businesses benefitted from trafficking, including use of forced labor in their supply chains—even where the trafficking occurred abroad. The TVPA imposes fines on companies up to US$500,000 and imprisonment of company employees for up to 20 years for violations. For violations involving additional elements such as kidnapping or aggravated sexual abuse, violators can be imprisoned for any term of years. The Advisory notes that the Human Trafficking Prosecution Unit of the US Department of Justice's Civil Rights Division prosecutes forced labor cases, working with US federal law enforcement agencies.

The Advisory notes that the TVPA includes a private right of action to pursue civil liability in US federal courts where the company participated in a venture that it knew or should have known was engaged in forced labor. Indeed, 14 guardians of children who were killed or maimed working in cobalt mines in the Democratic Republic of Congo ("**DRC**") recently filed suit against Microsoft and other technology companies in the United States District Court for the District of Columbia, alleging that the companies aided and abetted and knowingly benefited from forced labor.

Uighur Human Rights Policy Act of 2020 (Public Law 116-145)

This statute, which President Trump signed into law on June 17, 2020, requires the President to report to Congress on human rights abuses in Xinjiang and directs the President to impose sanctions on the entities and individuals responsible.

*US Department of Treasury's Office of Foreign Assets Control ("**OFAC**")*

The Global Magnitsky Human Rights Accountability Act ("**GLOMAG**") and President Trump's subsequent Executive Order 13818, discussed here and here, authorizes OFAC to list as Specially Designated Nationals ("**SDNs**") persons and entities determined by the US Departments of Treasury, State, and Justice "to be responsible for or complicit in, or to have directly or indirectly engaged in, certain human rights abuses or corrupt acts anywhere in the world." *See* OFAC FAQs issued in 2017. On July 9, following publication of the Advisory, the US Department of Treasury announced the addition of the Xinjiang Public Security Bureau and four Chinese government officials to the SDN list, making them "Blocked Persons" under US sanctions law.

The Trump Administration has frequently used the broad human rights sanctions authority under GLOMAG—nearly 100 individuals and entities were sanctioned under GLOMAG in 2019 alone, including in Mexico, Uganda, Iraq, South Sudan, Latvia, and Cambodia—but this was the first use against Xinjiang-related entities or persons. US persons must now block the property and interests in property of the newly-designated Blocked Persons, and of any entity owned 50% or more, directly or indirectly, by the Blocked Persons. US persons and the US financial system may not be involved in transactions with Blocked Persons, unless authorized by an OFAC license or exemption.

IMPLICATIONS

Businesses can anticipate continued and even increased restrictions relating to Xinjiang. Although it is the Trump Administration that has enacted these measures and issued the Advisory, businesses should expect the trend to continue even if the November 2020 US presidential election brings a change of administration. The Xinjiang-related measures have broad support from nongovernmental human rights groups and bipartisan coalitions in Congress, and Democratic presidential candidate Joe Biden has said that he would "take stronger steps."

Moreover, the imposition of trade and business restrictions by the US government's executive branch to target alleged human rights violations, including allegations of forced labor—via sanctions, export controls, and enforcement of anti-trafficking laws—is sure to outlive the Trump Administration and only grow over time. In addition to the Trump Administration's extensive use of GLOMAG, in August 2017, the US Congress passed the Countering America's Adversaries Through Sanctions Act ("**CAATSA**"), discussed here, which presumes that goods made with North Korean labor involve forced labor and restricts their entry into the United States. CBP enforces CAATSA. Separately, in February 2019 OFAC fined e.l.f Cosmetics, Inc. nearly US$1 million for alleged violations of the US government's sanctions against North Korea by importing false eyelash kits from China that contained materials made with North Korean labor, discussed here.

The approach of using trade restrictions to target alleged human rights violations is also catching on with other governments. On July 6, the UK government announced the first set of sanctions under the UK's Global Human Rights Sanctions Regulation 2020, discussed here, which is similar to GLOMAG. The Australian government is also considering the use of targeted sanctions to address human rights abuses.

In the past few decades, plaintiffs have attempted civil lawsuits seeking to hold corporations accountable in US courts for human rights abuses committed in supply chains abroad by alleging violations of customary international law pursuant to the Alien Tort Statute, 28 U.S.C. § 1350. To-date, these have not been successful—and, as we discussed here, the US Supreme Court may determine during its next term that these lawsuits may not be asserted against corporations at all. However, the Canadian Supreme Court in February held that such suits may go forward in Canada, as we discussed here. And, as noted in the Advisory, plaintiffs may attempt to use the TVPA to pursue such lawsuits in the United States, and are currently doing so.

Finally, national and international mandatory HRDD regimes are gaining momentum. France's Duty of Vigilance Law, which came into effect in 2017, requires companies to establish mechanisms to prevent human rights violations and environmental impacts in their chains of production, including for subsidiaries and companies under their control, and to report on these mechanisms in annual "vigilance plans." The Netherlands' Child Labor Due Diligence Law, which will come into effect in 2022, requires companies that sell goods and services to Dutch end users to determine whether child labor occurs in their supply chains, and if so, to develop a plan of action on how to combat it, and to issue a due diligence statement on their investigation and plan of action. The EU has stated that it will develop a legislative proposal for mandatory human rights and environmental due diligence by next year.

It is now more important than ever for companies to implement and invest in top-of-the-line HRDD programs, in order to avoid legal and reputational risks associated with allegations of human rights violations in their supply chains. This can be done by building off of existing ABC compliance programs but must take into account the unique nature of HRDD as articulated in the international "best practice" standards referenced in the Advisory and which have already been adopted by many multinational businesses across sectors.

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