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**THE GUIDE TO  
ENVIRONMENTAL,  
SOCIAL AND  
CORPORATE  
GOVERNANCE**

SECOND EDITION

Editors

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# Publisher's Note

Latin Lawyer and LACCA are delighted to publish *The Guide to Environmental, Social and Corporate Governance*.

Edited by Antonia Stolper and Robert O'Leary, partners at Shearman & Sterling LLP, this guide brings together the knowledge and experience of leading experts from a variety of disciplines and provides guidance that will benefit all practitioners.

Environmental, social and governance (ESG) matters are taking centre stage in Latin America. The region has some of the most biodiverse ecosystems in the world, all of which are highly vulnerable to the increasingly significant effects of climate change, not to mention that many of its economies are heavily reliant on extractive industries and other sectors that depend on those natural resources and ecosystems. In addition, there is a need to narrow sizable socioeconomic gaps and improve gender equality across Latin America, all of which have led to a boom in sustainable finance involving both sovereigns and corporates in recent years. For companies operating in the region, it has become increasingly clear that not having an ESG strategy in place can jeopardise the primary goals of maintaining profitability and staying competitive. Pressure from both investors and consumers means that businesses of all sizes have been seeking the advice of outside counsel in order to mitigate risks, but also to identify opportunities. This Guide draws on the expertise of highly sophisticated practitioners to draw out trends and outline the tools needed to navigate the fast-moving ESG landscape across the region.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide to Environmental, Social and Corporate Governance*. If you find this useful, you may also like the other titles in the Latin Lawyer series, including *The Guide to Mergers and Acquisitions*, *The Guide to International Arbitration in Latin America*, *The Guide to Restructuring*, *The Guide to Corporate Compliance* and *The Guide to Corporate Crisis Management*.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

## CHAPTER 8

# Navigating the Complex Relationship between ESG and Supply Chains

Austin Pierce and Roderick Branch<sup>1</sup>

### Introduction

The 2020s have been a decade of significant reconsideration when it comes to how global supply chains function. Geopolitical tensions, the covid-19 pandemic, and other forces have prompted a re-evaluation of the way companies do business. A significant result of this has been a push for ‘nearshoring’ or ‘friendshoring’ – the relocation of supply chains closer, either physically or ideologically, to the ultimate end market. This shift has created substantial opportunities for Latin America to leverage its ‘Goldilocks zone’ position to increase its prominence in various supply chains.

However, simultaneously, there has been an increased recognition of the role that supply chains can have on a business’s environmental, social, and governance (‘ESG’) profile. For many sectors, the supply chain can end up being the area of most substantial impact. As such, expectations from a variety of stakeholders – including regulators and business partners – are increasingly requiring companies to consider ESG issues, not only within their direct operations but also within their broader supply chains. Here, too, Latin America has opportunities. The region has a combination of ecological and natural resources, renewable energy potential, and legal institutions regarding human rights that position it to be able to significantly contribute to various global sustainability goals. But there are also challenges. Latin America’s ESG-related regulations have not generally focused on supply chains. And many entities in Latin America are still early in their ESG

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journeys, particularly in terms of navigating international expectations and frameworks that have been developed principally in downstream markets. However, given Latin America's position upstream of markets that have developed most of the supply chain ESG requirements to-date, such as the United States and European Union, Latin American entities will need to consider and respond to such ESG expectations in order to successfully position themselves to sell into these markets.

This chapter discusses some of the most prominent aspects of the current landscape for ESG expectations in companies' supply chains, as well as developing trends and outstanding questions. It also provides practical tips for entities in Latin America to consider in navigating this evolving space.

## Current landscape

The ESG landscape has evolved and continues to do so rapidly. In many instances, a dialogue exists between actions occurring in civil society and those taken by policymakers, such that regulatory and extra-regulatory frameworks build off one another. Although policymakers often adopt principles or structures initially established and promoted by civil society, at other times, civil society establishes frameworks or initiatives to help companies comply with – or go beyond – regulation. While there is some overlap, the current landscape of ESG-related expectations in the supply chain can be broken into three main categories: (1) diligence expectations; (2) substantive expectations, including those related to product provenance; and (3) disclosure expectations that implicate the supply chain.

## Supply chain diligence

The majority of ESG-related supply chain expectations that have developed to-date fall within the category of supply chain diligence. Many of the earliest such expectations have focused on human rights, due to the recognition of the potential for human – and particularly labour – rights violations in jurisdictions with low levels of legal protection or minimal ability to enforce such protections.<sup>2</sup> The concept of human rights due diligence was popularised by the United Nations Guiding Principles on Business and Human Rights (UNGPs), adopted

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2 In this chapter, 'labour rights' refers to a subset of human rights relating to working conditions, including those regarding freedom of association and collective bargaining; issues regarding forced and child labour; non-discrimination; and health and safety in the work environment. The core such standards are reflected in the fundamental conventions of the International Labour Organization, see, e.g., History of the ILO, <https://libguides.ilo.org/c.php?g=657806&p=4649148> (last accessed 26 Sep. 2023).

in 2011, which recognises differing obligations for states and businesses in regard to human rights.<sup>3</sup> The UNGPs utilise a ‘protect, respect, remedy’ framework: governments have a responsibility to protect against human rights abuses within their jurisdiction; businesses have a responsibility to respect internationally recognised human rights; and effective grievance mechanisms should be available, at a minimum through government channels but also through non-government channels.<sup>4</sup> While the UNGPs are not a treaty, and thus not necessarily binding, the framework has influenced ESG-related due diligence regulations that certain governments have adopted.

These regulations can generally be broken down into two types: (1) those primarily imposing disclosure-focused requirements and (2) those primarily imposing operational requirements. While some operational regulations may also require disclosure related to how such requirements are met, disclosure-focused regulations do not typically require companies to take affirmative steps to change their practices. Instead, they focus on corporate transparency as a means of encouraging substantive improvement to avoid having to publish undesirable information.

### **Disclosure-focused regulations**

Various governments have adopted disclosure-focused regulations that require companies that meet a specific threshold for doing business in their jurisdiction to disclose (generally on an annual basis) the steps they have taken to root out human rights violations from their supply chains – typically, measures they have taken to address issues of forced or child labour.<sup>5</sup> These regulations tend to focus on procedural elements, such as the existence of due diligence processes and trainings.<sup>6</sup> However, these laws often explicitly recognise that some companies may

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3 Although the concept of human rights due diligence was previously raised in the commentary to the draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights, U.N. Doc. E/CN.4/Sub.2/2003/38/Rev.2 (2003), these norms ultimately were not approved. As such, the concept of human rights due diligence did not receive widespread acknowledgement until the subsequent work on the UNGPs, which largely established the foundational concept of human rights due diligence as we now know it.

4 UNGPs Art. 1, 11, 25-30.

5 Governments that have adopted such requirements include those in Australia, Canada, the United Kingdom, and the State of California.

6 For example, the core disclosures required under the California Transparency in Supply Chains Act are to what extent, if any, the company: (1) undertakes verification of product supply chains to address human trafficking and slavery risks, and if yes, whether such

not have such processes and thus may simply report that they have taken no such steps. While, in practice, many companies will aim to disclose at least something to avoid reporting no action, these requirements alone have not necessarily caused companies to undertake extensive reviews of their supply chains or to address items found.

## Operational regulations

Another batch of laws has developed in more recent years looking to establish affirmative requirements for companies to conduct due diligence on their supply chains.<sup>7</sup> These laws are more varied and usually have a broader focus than the disclosure regimes, covering human rights generally – as opposed to merely having a labour focus – and they often incorporate some degree of environmental diligence as well.<sup>8</sup>

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verification was conducted by a third party; (2) audits suppliers to evaluate compliance with company standards and if yes, whether such audits were independent and unannounced; (3) requires direct suppliers to certify that materials used comply with the laws on slavery and human trafficking of the country/countries where they do business; (4) maintains internal accountability standards and procedures for parties for employees or contractors failing to meet company standards regarding slavery and trafficking; and (5) provides training on trafficking and slavery, particularly on mitigating risks within supply chains, to employees and management with direct responsibility for supply chain management. Cal. Civil Code § 1714.43(c).

Similarly, although only listed as potential items for disclosure, the United Kingdom's Modern Slavery Act identifies potential disclosures to include the organisation's: (1) structure, business, and supply chains; (2) policies in relation to slavery and human trafficking; (3) due diligence processes in relation to slavery and human trafficking in its business and supply chains; (4) risk assessment of business and supply chains for slavery and human trafficking, and steps taken to assess and manage that risk; (5) effectiveness in ensuring that slavery and human trafficking is not taking place in its business or supply chains, measured against such performance indicators as considered appropriate; and (6) training about slavery and human trafficking made available to its staff. Modern Slavery Act § 54(5).

- 7 Countries that have adopted such laws include France, Germany, and Norway. Similar laws are currently being considered by the Netherlands and the European Union. Similarly, although not legally binding, Japan has adopted Guidelines on Respecting Human Rights in Responsible Supply Chains, available at [https://www.meti.go.jp/english/policy/economy/biz\\_human\\_rights/1004\\_001.pdf](https://www.meti.go.jp/english/policy/economy/biz_human_rights/1004_001.pdf).
- 8 However, we note that there has been a broader international trend to recognise a nexus between environmental matters and human rights, including a 2022 UN General Assembly Resolution recognising a right to a 'clean, healthy and sustainable environment.' A/RES/76/300, <https://undocs.org/Home/Mobile?FinalSymbol=A%2FRES%2F76%2F300&Language=E&DeviceType=Desktop&LangRequested=False>. For more information, see Carlos de Miguel Perales and Austin Pierce, Environmental Law and Climate Change, in *A Guide*

For example, France's Duty of Vigilance Law requires in-scope companies to establish and implement a vigilance plan for diligencing and addressing human rights, environmental, and health and safety issues in their own operations, in the operations of their subsidiaries, and in their supply chains.<sup>9</sup> The vigilance plan must be developed in association with company stakeholders and, where applicable, as part of multi-stakeholder initiatives at the sector or territorial level. Required components include:

- risk mapping (including identification, analysis, and ranking of risks);
- procedures to regularly assess subsidiaries, subcontractors, and suppliers, in accordance with the risk mapping;
- appropriate actions to mitigate risks and prevent serious harm;
- a hotline (or similar reporting mechanism) established in consultation with the representative trade unions in the company; and
- a system to monitor the measures implemented and evaluate their efficacy.<sup>10</sup>

Similarly, Germany's Supply Chain Diligence Law requires in-scope companies to undertake a variety of due diligence measures, with the aim of preventing or minimising certain delineated human rights and environmental risks.<sup>11</sup> These measures consist of:

- an appropriate and effective risk-management system;
- clear determination of who has responsibility for monitoring risk management;
- risk analysis to determine the human rights and environmental risks in its own business and those of its direct suppliers (also, with its indirect suppliers, if it has substantiated knowledge of a possible breach of obligations at such level);
- appropriate preventive measures for any risks identified;

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*to Human Rights Due Diligence for Lawyers* (Corinne Lewis and Constance Z Wagner, eds., 2023).

9 Loi no. 2017-399 (Mar. 2017) Art. 1, <https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000034290626/> (last accessed 5 Sept. 2023).

10 Loi no. 2017-399 (Mar. 2017) Art. 1.

11 Lieferkettensorgfaltspflichten (Jul. 2021) Art. 2-3, [https://wirtschaft-entwicklung.de/fileadmin/user\\_upload/5\\_Wirtschaft\\_und\\_Menschenrechte/Downloads/Lieferkettensorgfaltspflichtengesetz.pdf](https://wirtschaft-entwicklung.de/fileadmin/user_upload/5_Wirtschaft_und_Menschenrechte/Downloads/Lieferkettensorgfaltspflichtengesetz.pdf) (last accessed 5 Sep. 2023). It is important to note that one of these bases is meant to cover additional matters outside of those explicitly enumerated and covers 'a breach of duty which is directly capable of impairing a protected legal position in a particularly serious manner and whose illegality is obvious when all relevant circumstances are considered judiciously.'

- a policy statement on its human rights strategy, including how it fulfils its obligations under the law, the priority issues identified by the risk analysis, and the expectations placed on its employees and suppliers;
- a complaints procedure;
- corrective measures to address actual or imminent violations of human rights or environmental obligations; and
- documenting compliance with duty of care, retained for at least seven years, and publishing an annual report on the fulfillment of its due diligence obligations.

Other laws of note in this space include the Norwegian Transparency Act, which only covers human rights but also includes a right for members of the public to request information from companies on how they address human rights impacts,<sup>12</sup> and the Dutch Child Labor Due Diligence Act.<sup>13</sup>

However, there are also several proposed laws that would greatly expand the scope of supply chain diligence laws in various markets. For example, the Netherlands is considering replacing its Child Labor Due Diligence Act with the Responsible and Sustainable International Business Conduct Act. This broader act would impose due diligence and mitigation obligations (up to and including termination of business activities or relationships in some situations) for a range of human rights and environmental impacts.<sup>14</sup>

In addition, the European Union is considering a Corporate Sustainability Due Diligence Directive (CSDDD) that would ultimately require EU and certain non-EU companies to take measures to identify and address ‘actual and potential’ adverse impacts on the environment or human rights from their own operations, as well as the operations of their subsidiaries and supply chains.<sup>15</sup> These measures include:

- integrating due diligence into company policies;

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12 Transparency Act (Dec. 2021) Art. 4–6, <https://lovdata.no/dokument/NLE/lov/2021-06-18-99>.

13 Wet zorfpllicht kinderarbeid van 24 oktober 2019, Stb. 2019, 401, <https://zoek.officielebekendmakingen.nl/stb-2019-401.pdf>.

14 Wet verantwoord en duurzaam international ondernemen van vergaderjaar 2022–23, 35 761, nr. 9, [https://www.eerstekamer.nl/behandeling/20221102/voorstel\\_van\\_wet\\_zoals\\_gewijzigd/document3/f=/vlxokdmtrnyr.pdf](https://www.eerstekamer.nl/behandeling/20221102/voorstel_van_wet_zoals_gewijzigd/document3/f=/vlxokdmtrnyr.pdf) (pending).

15 Adverse impacts include, but are not necessarily limited to, forced labor, inadequate worker health and safety, worker exploitation, greenhouse gas emissions, pollution, and ecosystem degradation. See COM/2022/71(EC), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071>.

- identifying actual or potential adverse impacts, including consultation with potentially affected groups as relevant;
- taking steps to prevent and mitigate potential adverse impacts, and to end or minimise actual adverse impacts;
- maintaining a complaints procedure;
- monitoring the effectiveness of their due diligence policy and measures; and
- annually reporting on the matters covered by the CSDDD.

As many of these laws require directly impacted companies to take steps to address adverse impacts, their reach can extend significantly beyond those companies to also impact expectations for such companies' supply chains.

### **Extra-regulatory frameworks**

In addition to laws, there are a handful of frameworks from third-party organisations that establish guidelines on ESG diligence in supply chains. Foremost among these are the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises on Responsible Business Conduct,<sup>16</sup> which have been referenced in several of the laws discussed above.<sup>17</sup> The core due diligence expectations are similar to those laid out in these laws, with particular attention to the rights of people at potentially heightened risk due to marginalisation, vulnerability or otherwise.

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16 <https://www.oecd-ilibrary.org/docserver/81f92357-en.pdf?expires=1694102434&id=id&accname=guest&checksum=E19CBA820052A65366B5196787D60AB3>.

17 See, e.g., Transparency Act, *supra* note 12 at Art. 4; COM/2022/71(EC), *supra* note 15.

The OECD has also published sector-specific guidance documents on due diligence and responsible supply chains, including for agriculture,<sup>18</sup> minerals,<sup>19</sup> and apparel and footwear.<sup>20</sup> They lay out additional guidance and recommendations informed by the particular contexts and specific risks of these sectors, and can be used to help demonstrate alignment with international best practices.

### Substantive expectations

Beyond diligence obligations, various jurisdictions have also adopted substantive requirements regarding the structure and legal compliance expectations of companies' supply chains. For example, many jurisdictions have adopted affirmative bars on the use or import of goods produced with forced labour.<sup>21</sup> In general, these laws do not require importers to prove the absence of forced labour, but instead provide for government agencies to restrict the import of goods that they have deemed to violate the prohibition. For example, under regulations adopted by Mexico in 2023, the Ministry of Labor and Social Welfare may issue resolutions designating certain goods as having been produced by forced labour; goods are considered to comply with the regulation so long as they are not subject to such a resolution.<sup>22</sup>

Increasingly, we are seeing the development of laws that establish affirmative provenance requirements for the import or sale of certain products. These laws place the burden on companies to prove the compliance of their supply chains.

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18 See, e.g., OECD-FAO Business Handbook on Deforestation and Due Diligence in Agricultural Supply Chains (2023), <https://www.oecd-ilibrary.org/docserver/c0d4bca7-en.pdf?expires=1694103783&id=id&acname=guest&checksum=5DE28CC11B3457E2D466BDEAABD72575>; OECD-FAO Guidance for Responsible Agricultural Supply Chains (2016), <https://www.oecd-ilibrary.org/docserver/9789264251052-en.pdf?expires=1694110048&id=id&acname=guest&checksum=5F945E64318D70ED424917EB8B1CA597>.

19 See, e.g., OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (2016), <https://www.oecd.org/daf/inv/mne/OECD-Due-Diligence-Guidance-Minerals-Edition3.pdf>; An introduction to the OECD Due Diligence Guidance for Responsible Mineral Supply Chains for Upstream Actors, <https://mneguidelines.oecd.org/An-introduction-to-the-OECD-Due-Diligence-Guidance-for-upstream-actors.pdf>.

20 OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector (2018), <https://www.oecd-ilibrary.org/docserver/9789264290587-en.pdf?expires=1694104853&id=id&acname=guest&checksum=21D17B6FB6A484D049E902CE9B72B725>.

21 See, e.g., Tariff Act § 307 (1930).

22 Acuerdo que establece las mercancías cuya importación está sujeta a regulación a cargo de la Secretaría del Trabajo y Previsión Social (Feb. 2023), [https://www.dof.gob.mx/nota\\_detalle.php?codigo=5679955&fecha=17/02/2023#gsc.tab=0](https://www.dof.gob.mx/nota_detalle.php?codigo=5679955&fecha=17/02/2023#gsc.tab=0).

For example, in the context of forced labour, the United States Uyghur Forced Labor Prevention Act (UFLPA) establishes a rebuttable presumption that any goods mined, produced or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region of the People’s Republic of China are ineligible for import under 19 US Code § 1307’s prohibition against import of goods produced by forced labour.<sup>23</sup> Overcoming this presumption requires the importer to demonstrate various items, including compliance with certain due diligence guidance and ‘clear and convincing’ evidence that the imported goods were not mined, produced, or manufactured wholly or in part by forced labour.<sup>24</sup>

While the UFLPA has prompted some companies to change from Xinjiang-based suppliers, products from other jurisdictions may still trigger this presumption if they incorporate materials or components that were sourced from Xinjiang deeper in the supply chain. As such, complex supply chains, integrating inputs from various sources or suppliers, can raise multiple points of concern.

Another such provenance-related law with potentially significant ramifications for Latin America is the EU’s recently adopted Deforestation Regulation (EUDR). The EUDR applies to a more limited selection of goods – cattle, cocoa, coffee, palm-oil, rubber, soya and wood, as well as relevant products that contain or have been made (or fed) with such commodities.<sup>25</sup> For such covered goods, the EUDR prohibits their marketing or sale unless they are: (1) deforestation-free; (2) produced in accordance with the relevant legislation of the country of production; and (3) covered by a due diligence statement to that effect.<sup>26</sup>

The EUDR’s first two prongs include a range of implications that may not be immediately apparent from the surface. ‘Deforestation-free’ is defined as products that avoid both the conversion of forest to agricultural use and, for products made using wood, the structural degradation of forests from natural forests to other

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23 UFLPA § 5.

24 *id.*; U.S. Customs and Border Protection Publication No. 1791-0522, [https://www.cbp.gov/sites/default/files/assets/documents/2022-Jun/UFLPA%20Fact%20Sheet\\_FINAL.pdf](https://www.cbp.gov/sites/default/files/assets/documents/2022-Jun/UFLPA%20Fact%20Sheet_FINAL.pdf). See also U.S. Customs Ruling H317249 (2021), <https://rulings.cbp.gov/ruling/H317249> (applying a ‘clear and convincing’ evidence standard under another law requiring U.S. Customs to apply a rebuttable presumption).

25 2023/1115(EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023R1115&qid=1687867231461>.

26 *id.* at Art. 3. The statement must note that the party placing relevant goods/products on the EU market or exporting them exercised due diligence and that no, or only a negligible, risk of non-compliance with the requirements of Article 3 exists. *Id.* at Art. 4.

woodland types. As such, expanding forest plantations in response to demands for specific types of wood could run afoul of the EUDR, even if total forest canopy does not change.

More importantly, ‘relevant legislation’ covers a wide range of laws: land use; environmental protection; forestry management; third-party rights; labour rights; human rights; Indigenous rights (particularly the concept of free, prior and informed consent); and various commercial laws on tax, anti-corruption, trade, and customs. Compliance with this prong will therefore require substantial consideration to determine the appropriate set of laws in scope. For example, human rights may broadly sweep in environmental quality even beyond applicable environmental legislation, given the recognition by the Inter-American Court of Human Rights and multiple Latin American governments of a right to a healthy environment.<sup>27</sup> Similarly, several countries in Latin America have adopted various recognitions of Indigenous Rights, including through relevant international frameworks.<sup>28</sup>

The degree of due diligence required under the EUDR will depend on the relative risk profile of the country of production. Such risk profiles are to be established by the European Commission within 18 months of the EUDR entering into force (therefore, by the end of 2024). Nevertheless, the degree of due diligence required in most cases is expected to be extensive. The EUDR requires this diligence to cover:

- the collection and maintenance of detailed information, such as the time and location of production, as well as ‘adequately conclusive and verifiable information’ of the relevant goods or products compliance with the requirements of the EUDR;

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27 See, e.g., Case of the *Indigenous Communities of the Lhaka Honhat (Our Land) Association v. Argentina* at ¶¶ 202–08 (2020), [https://www.corteidh.or.cr/docs/casos/articulos/seriec\\_400\\_ing.pdf](https://www.corteidh.or.cr/docs/casos/articulos/seriec_400_ing.pdf).

28 For an overview of key international frameworks and the concept of free, prior, and informed consent (FPIC), see Food and Agriculture Organization of the United Nations, *Indigenous Peoples*, <https://www.fao.org/indigenous-peoples/our-pillars/fpic/en/> (last visited 17 Sep. 2023); Austin Pierce, *Indigenous Perspectives to Sustainability*, PracticalESG (20 May 2021), <https://practicalesg.com/2021/05/indigenous-perspectives-to-sustainability-reducing-accusations-of-neocolonialism-in-companies-esg-strategies-through-incorporation-of-free-prior-and-informed-consent/>. For a review of related considerations in the Anglo-Americas, see Robyn Barabash et al., *Indigenous Involvement in the North American Energy Transition*, 37(3) *Natural Resources & Environment* 37 (2023), <https://www.dwpv.com/en/People/-/media/B241A10378A642DA9FF87FB783FF322D.ashx>.

- a risk assessment that addresses various factors, including forest coverage, the prevalence of deforestation and forest degradation, presence of Indigenous peoples and relations therewith, supply chain complexity, and ‘any information that would point to a risk that the relevant products are non-compliant’; and
- risk mitigation policies, procedures and measures to reduce the risks of non-compliance, including procedures and measures to achieve no or negligible risks of non-compliance based on the risk assessments discussed above.<sup>29</sup>

To the extent such information or responses are commodity-specific, companies involved with multiple covered goods may be required to undertake rather complex analyses to comply. Similarly, companies producing such commodities may be required to provide detailed information to their customers to aid them with compliance.

### **Extra-regulatory frameworks**

Certain industries have also developed their own substantive regimes for relevant ESG matters. Although not directly binding, these can set an industry standard that companies are ultimately expected to meet to do business with their counterparts. In some instances, these standards may ultimately be incorporated into contractual provisions, such as customers’ purchase order terms, that can have the same functional impact for companies’ supply chains.

For example, the International Council on Mining & Metals has established a series of standards to help mining companies manage the complex, sometimes competing considerations associated with ESG and mining.<sup>30</sup> Similarly, organisations such as the Better Cotton Initiative and Leather Working Group have established certifications that suppliers of such commodities meet certain standards,

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29 id. at Art. 8–11.

30 These standards come in the form of principles, position statements, and good practice guides. See, e.g., International Council on Mining & Metals (ICMM), Mining Principles, <https://www.icmm.com/en-gb/about-us/member-requirements/mining-principles>; ICMM, Tailings Management: Good Practice Guide (May 2021), [https://www.icmm.com/website/publications/pdfs/environmental-stewardship/2021/guidance\\_tailings-management.pdf](https://www.icmm.com/website/publications/pdfs/environmental-stewardship/2021/guidance_tailings-management.pdf); ICMM, Good Practice Guide: Indigenous Peoples and Mining (2d ed.), [https://www.icmm.com/website/publications/pdfs/social-performance/2015/guidance\\_indigenous-peoples-mining.pdf](https://www.icmm.com/website/publications/pdfs/social-performance/2015/guidance_indigenous-peoples-mining.pdf).

which certain customers or capital providers may use as a proxy for compliance with various ESG topics. These can, in turn, impose additional structure and requirements on supply chains to mediate the expectations of different stakeholders.

### **Disclosure requirements implicating the supply chain**

In addition to laws and extra-regulatory frameworks that directly impact how companies address sustainability matters in their supply chains, disclosure regimes may also have knock-on implications. This is typically true for disclosure regimes focused on capturing the full scope of a company's risks, impacts and dependencies on a given topic.

One of the most widespread such concepts is the use of greenhouse gas (GHG) emission scopes in climate reporting, which breaks GHG emissions into three 'scopes': (1) direct emissions, from sources the entity owns or controls; (2) indirect emissions from the generation of purchased energy; and (3) indirect emissions from all other sources, including emissions associated with purchased goods and services.

Introduced in the GHG Protocol,<sup>31</sup> the concept of emissions scopes has been adopted in a variety of disclosure frameworks, including in the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD),<sup>32</sup> the recently announced climate standard of the International Sustainability Standards Board that various countries (including across Latin America) have signalled they will adopt,<sup>33</sup> and regulatory frameworks such as the EU Corporate Sustainability Reporting Directive (CSRD) and proposed climate rules in the United States.<sup>34</sup>

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31 GHG Protocol Corporate Accounting and Reporting Standard – Revised Edition (2004), <https://ghgprotocol.org/corporate-standard>.

32 Final Report (2017) at 14, <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.

33 See Latham & Watkins, ISSB Issues Global Sustainability Disclosure Standards (2023), <https://www.lw.com/admin/upload/SiteAttachments/ISSB-Issues-Global-Sustainability-Disclosure-Standards.pdf>. The Group of Latin-American Accounting Standard Setts conducted a survey indicated that over half of surveyed jurisdictions already plan to adopt the ISSB standards in some form. For more information, see <https://glenif.org/en/2023/08/28/adoption-of-niis-in-latin-america-is-in-the-adoption-phase/>.

34 2022/2464 (EU) at Art. 29(b), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464>; Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 et seq. (2022), <https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf>.

Because Scope 3 metrics include the emissions of upstream purchased goods and services, they require companies reporting this information to determine the emissions associated with various activities in their supply chains. While there is often flexibility in estimating this information, pressures to improve data quality mean that there are increasingly efforts to capture data directly from suppliers (either directly on emissions figures or via activity proxies that allow for more refined estimates). Relatedly, as companies set targets to reduce their Scope 3 emissions, this in turn can result in outreach to the supply chain to measure and, ultimately, reduce associated GHG emissions.<sup>35</sup>

The success of the GHG Protocol and TCFD in expanding the scope of consideration of climate risks and impacts to the supply chain has resulted in uptake by various other frameworks, including the Taskforce on Nature-related Financial Disclosures, which has developed a disclosure regime parallel to that of TCFD for the broader topic of natural capital.<sup>36</sup> Similarly, the EU CSRD has incorporated supply chain considerations into its own natural capital standard, ESRS E4 – Biodiversity and Ecosystems.<sup>37</sup> The CSRD also incorporates an entire standard on labour conditions in the supply chain.<sup>38</sup>

Separately, various jurisdictions have adopted, or are considering, taxonomies to establish criteria for economic activities to be considered sustainable.<sup>39</sup> These taxonomies are designed to establish a uniform understanding of what is considered ‘sustainable’ in the relevant jurisdictions, often for relevant sustainable finance products but with potentially broader reaching market expectations.

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35 The Science Based Targets initiative (SBTi), a widely recognised framework for GHG emissions-reduction targets, even includes a dedicated approach for considering supplier engagement for Scope 3 targets. See, e.g., SBTi, *Engaging Supply Chains on the Decarbonization Journey* (2023), <https://sciencebasedtargets.org/resources/files/Supplier-Engagement-Guidance.pdf>.

36 Latham & Watkins, *TNFD Publishes Finalized Recommendations for Nature-Related Disclosures* (2023), <https://www.lw.com/admin/upload/SiteAttachments/TNFD-Publishes-Finalized-Recommendations-for-Nature-Related-Disclosures.pdf>. For more information on natural capital, see Austin Pierce, *In the Clamor About Climate Change, Don't Ignore Natural Capital*, 53 *ELR* 10095 (2023), <https://www.lw.com/admin/upload/SiteAttachments/In-the-Clamor-About-Climate-Change-Don%E2%80%99t-Ignore-Natural-Capital.pdf>.

37 Annex to the Commission Delegated Regulation at 125, [https://ec.europa.eu/finance/docs/level-2-measures/csrd-delegated-act-2023-5303-annex-1\\_en.pdf](https://ec.europa.eu/finance/docs/level-2-measures/csrd-delegated-act-2023-5303-annex-1_en.pdf).

38 *id.* at 195.

39 One of the most well-known taxonomies is the one published by the European Union. See Regulation (EU) 2020/852. However, countries have continued to push the concept and adapt it to their own regional and socio-economic circumstances. In Latin America, taxonomies have been adopted in Mexico and Colombia and are under development or

Although these are only disclosure frameworks, some of which are technically voluntary, they are expected to drive substantial action in how companies consider and address the covered topics, including in their supply chains.

### **Developing trends and outstanding questions**

Sustainability considerations in companies' supply chains are likely to continue evolving substantially in the near and medium term. While the precise contours of these expectations can be difficult to predict, several emerging trends are likely to inform developments:

- **Expansion of scope:** although ESG-related supply chain expectations have historically focused on labour rights, new regimes tend to have a much more expansive lens, covering a wider range of human rights, as well as climate and other environmentally-focused risks and impacts. As the scope of ESG matters generally continues to grow, it is likely that supply chain measures will aim to be commensurate.
- **Penetration deeper into the supply chain:** many new frameworks require an understanding not only of the impacts of direct (i.e., tier 1) suppliers, but also of indirect suppliers at tier 2 and beyond. For companies with complex supply chains, this can become a significant undertaking, particularly for any provisions that require tracing product provenance all the way to the original source.
- **More substantial consequences for non-compliance:** ESG-related regulations are increasingly backed by potentially sizeable fines for non-compliance. However, several of these laws also provide for a prohibition on import, sale or export for non-compliant offerings, which has the potential to substantially hamper a company's ability to do business in relevant markets.
- **Incorporation of ESG into business-to-business contracts:** even companies that are not directly captured by ESG regulations may still be impacted by them as other, in-scope companies cascade the requirement to their suppliers, both in terms of substance and provision of sufficient documentation or other support to demonstrate compliance.

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consideration in Argentina, Brazil, Chile, Panama, Peru and several other jurisdictions. See, e.g., Austin Pierce, Mexico's New Sustainable Taxonomy – Voluntary for Now, but Designed to Expand (5 Apr. 2023), <https://www.jdsupra.com/legalnews/mexico-s-new-sustainable-taxonomy-1007788/>.

There are also pending developments that may fundamentally impact how companies are expected to address ESG matters in their supply chains. These include several pending laws, such as the Dutch law discussed above.

However, of particular importance for Latin America is the potential development of additional laws within the region. Several countries – including Chile, Colombia, Mexico and Peru – have adopted national action plans or guidelines on business and human rights.<sup>40</sup> While these initiatives cover business and human rights generally, they represent at least some recognition of the importance of incorporating supply chains in ESG regulations. Additionally, parts of civil society are advocating for governments to advance these measures with binding legal requirements – in fact, bills to this effect were introduced in Mexico and Brazil in 2020 and 2022, respectively.<sup>41</sup> Although such laws have not yet been adopted, the potential for regulations coming into effect could have a direct impact on businesses in Latin America that are also navigating direct and indirect consequences from the passage of similar laws in other jurisdictions.

The expectations of policymakers in Latin America may also be impacted by developments in international law. UN member states have for several years been negotiating a proposed treaty on business and human rights, with negotiations on a third revised draft concluding in late 2022. If adopted, the draft treaty would impose legally binding obligations for parties to require business enterprises within their territory, jurisdiction or control to undertake mandatory human rights due diligence. At present, there is still substantial disagreement among

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40 Plan Nacional de Derechos Humanos y Empresas (2022), [https://ddhh.minjusticia.gob.cl/media/2022/03/2%C2%BAPAN\\_2022-2025-2.pdf](https://ddhh.minjusticia.gob.cl/media/2022/03/2%C2%BAPAN_2022-2025-2.pdf) (Chile); Plan Nacional de Acción sobre Empresas y Derechos Humanos (2021), <https://cdn.www.gob.pe/uploads/document/file/2399831/Plan%20Nacional%20de%20Acci%C3%B3n%20sobre%20Empresas%20y%20Derechos%20Humanos%202021-2025.pdf?v=1636730881> (Peru); Plan Nacional de Acción de Empresas y Derechos Humanos (2020), <https://derechoshumanos.gov.co/Observatorio/Publicaciones/Documents/2020/Plan-Nacional-de-Accion-de-Empresa-y-Derechos-Humanos.pdf> (Colombia); Conselho Nacional dos Direitos Humanos, Resolução No. 5/2020, <https://homacdhe.com/wp-content/uploads/2020/03/Resolu%C3%A7%C3%A3o-n%C2%BA5-2020-CNDH.pdf> (Brazil); Decreto 9.571/2018, [https://www.planalto.gov.br/ccivil\\_03/\\_ato2015-2018/2018/decreto/d9571.htm](https://www.planalto.gov.br/ccivil_03/_ato2015-2018/2018/decreto/d9571.htm) (Brazil). Mexico includes various business and human rights considerations in the country's 2020-2024 National Human Rights Program. See Programa Nacional de Derechos Humanos 2020-2024 (2020), [https://www.dof.gob.mx/nota\\_detalle.php?codigo=5607366&fecha=10%2F12%2F2020#gsc.tab=0](https://www.dof.gob.mx/nota_detalle.php?codigo=5607366&fecha=10%2F12%2F2020#gsc.tab=0) (Mex.).

41 [https://www.senado.gob.mx/65/gaceta\\_del\\_senado/documento/112449](https://www.senado.gob.mx/65/gaceta_del_senado/documento/112449); PL 572/2022, [https://www.camara.leg.br/proposicoesWeb/prop\\_mostrarintegra?codteor=2148124](https://www.camara.leg.br/proposicoesWeb/prop_mostrarintegra?codteor=2148124).

negotiating parties. As such, it is unclear if, when, or how the treaty process will ultimately conclude. However, such a treaty could substantially mediate expectations for supply chain diligence internationally, at least on human rights issues.

Even in the absence of a global agreement, supply chain obligations may proliferate through trade-related provisions. For example, Mexico's recent adoption of additional forced labour restrictions was motivated by requirements in the regional United States-Mexico-Canada Agreement.<sup>42</sup> And several jurisdictions are considering GHG-related accounting for potential emissions-related border adjustments. Such adjustments could be implemented unilaterally and impact the relative competitiveness of goods based on the perceived GHG conditions associated with their production.<sup>43</sup>

The relative importance of these actions may also turn on the degree to which regulatory and economic fragmentation continue to expand. Such fragmentation could significantly increase the number of divergent regulatory regimes that companies need to navigate – particularly for businesses operating in, or engaging with, various theatres of a fragmented global economy.

### **Practical tips**

The proliferation of expectations regarding the ESG profile of businesses' supply chains will require companies to undertake significant efforts, not only by the companies directly affected but also by those that constitute the impacted supply chains. Below are five considerations for companies developing strategies to address these expectations.

### **Regulatory mapping**

Understanding the full scope of applicable regulations is a threshold matter. Many of the supply chain expectations covered in this chapter do not turn on where a company is headquartered or domiciled, but instead on where it does business or the amount of revenue associated therewith. As such, a more granular analysis is required. This granularity is compounded under certain standards, particularly provenance requirements, which also expect assessment against an indeterminate range of additional laws or standards to determine ultimate compliance.

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42 Acuerdo, supra note 22.

43 Regulation 2023/956 (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0956>.

The variety of applicable standards creates the potential for significant divergence, or even conflict, among different regimes. Companies will also need to carefully consider strategic decisions – such as what organisational level to report on, as well as potential knock-on implications of how obligations in various jurisdictions may impact each other.

Regulatory mapping is a powerful tool for helping companies organise and understand the legal landscape. The mapping process involves businesses laying out, either on their own or with the help of a third party, requirements as they apply to their specific business structures and circumstances. Mapping can also help companies identify areas of overlap, gaps, knock-on impacts and other interactions – and understanding these interactions early is key to establishing a robust and cohesive global strategy.

### **Identifying existing systems and relevant expertise**

As with any new development in their business environment, companies should consider what resources they already have available in developing their responses to the emerging expectations on ESG in supply chains. There is no need to reinvent the wheel in dealing with each new standard or framework. Many companies have existing processes, including those for data collection and supply chain-related diligence, that they may be able to leverage to reduce the burden associated with developing and operationalising a strategy to manage ESG-related supply chain expectations.

Equally important is identifying what expertise is available, through both internal and external sources. Internal sources may include members of supply chain or procurement functions, as well as legal, compliance, and sustainability functions. However, companies should also consider the expertise within their network of business partners. Different segments of the supply chain may have better access to certain types of information or the ability to influence certain aspects of operations; likewise, capacity-building exercises can help strengthen the ability of the supply chain as a whole to understand and comply with evolving expectations.

External advisers can also play a key role in helping companies develop and operationalise coherent strategies. Particularly with increasing ESG-related obligations and growing scrutiny imposed by regulators, companies will be well-served to consult legal advisers who are experienced with not only the legal and commercial realities of the relevant jurisdictions, but also the full extent of background knowledge, frameworks and principles associated with sustainability and ESG matters. This is particularly important for multinational entities, or those working with them, due to the different approaches that may need to be covered in

developing the strategy. Companies may also need to consider engaging consultants, including supply chain auditors or subject-matter experts, to the extent that such expertise is not available in-house.

### **Extra-regulatory guidance**

Civil society-developed guidance on ESG topics can be especially useful for companies to review. These frameworks and standards play several important roles in driving expectations on ESG matters, in supply chains and otherwise. In addition to potentially being commercial requirements for certain business partners, such guidance often ends up informing regulatory regimes – either directly or in terms of the practices to gap-fill regulatory standards.

Two of the most common third-party standards when considering supply chain ESG management are the UNGPs and the OECD Guidelines for Multinational Enterprises, discussed earlier in this chapter. Other standards are applicable to particular ESG niches. One example is the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard, which serves as the predominant standard to measure and report on GHG emissions from a company's supply chain.<sup>44</sup> Companies should consider their industry, geography, and product or service offerings – as well as relevant ESG topics – when determining which standards may be most applicable to their businesses.

### **Cohesive processes and controls**

After determining the scope of applicable requirements and existing resources, companies will need to build out the processes required to act on their strategy. This will likely require several components, depending on the particular topics at hand. For example, the UNGPs – and several of the regulations that reference them – expect companies to establish a policy, due diligence process and grievance mechanism in order to address human rights matters, in addition to external reporting.<sup>45</sup> These components should work together as part of a cohesive, overarching system in order to promote a consistent and comprehensive approach.

Companies should also think through the ways in which issues arise in their operations and how they can realistically deal with them. In the supply chain, this may involve incorporating ESG considerations in the procurement process.

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<sup>44</sup> <https://ghgprotocol.org/corporate-value-chain-scope-3-standard>.

<sup>45</sup> UNGPs, *supra* note 4 at Art. 15, 21.

It may also mean including appropriate language in vendor contracts to cover expected standards of practice and means of remedying procedures if those standards are not met.

These processes will also need to be accompanied by parallel steps that promote compliance and oversight of the processes themselves. Ultimately, as with many ESG expectations, the test is not what a company intended to do or even what actually happened in a given circumstance; instead, the key element is what a company can demonstrate, including why the actions taken were sufficient and reasonable. Therefore, it is critical to maintain controls, both for record-keeping and document management, and to establish clear reporting systems so that relevant issues are raised to the appropriate level.

Such controls are equally important for any outward-facing communication about a company's efforts. As various stakeholders pay greater attention to companies' ESG-related statements, outside scrutiny is increasing. Because hindsight is often unforgiving, particularly when controversies arise, companies must be able to demonstrate clear support for statements they make, as well as why that support aligns with contemporary expectations.

### **Leaning into opportunities**

Responding to the emerging suite of expectations discussed in this chapter will be a significant undertaking. However, doing so will present companies opportunities to both expand and fortify business relationships. This applies across all levels of the supply chain. For consumer-facing businesses, the increasing consumer awareness around environmentally and socially responsible production means that supply chain controversies can make attracting and retaining customers increasingly difficult. On the other hand, a company that aligns with international best practices and pursues robust ESG practices in the supply chain can help to bolster its social licence and reputation.

Similarly, for companies further up the supply chain, helping customers meet their sustainability ambitions and needs presents a business opportunity. Especially in situations where customers face regulatory obligations, being able to provide quality data or demonstrate robust practices relevant to these laws can help to maintain, or capture further, market share by helping to reduce compliance costs or risks for customers.

Certain practices may also help to reduce companies' own risks and costs, or can produce co-benefits through synergistic practices. One example is nature-based solutions to climate risks, which can often provide a host of benefits

– including on resource provisioning and health and well-being – depending on the project.<sup>46</sup> In fact, co-benefits can arise from a range of ESG practices, and they should be factored into companies' evaluations.

As additional expectations develop, other opportunities are likely to arise as well. Companies that keep an eye out for such openings almost certainly will be better able to capitalise on trends, achieve additional benefits, or reduce costs than companies that do not.

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<sup>46</sup> See, e.g., World Bank, *Assessing the Benefits and Costs of Nature-Based Solutions for Climate Resilience: A Guideline for Project Developers* (2023), <https://openknowledge.worldbank.org/entities/publication/9ed5cb4b-78dc-42a4-b914-23d71cef24a2>.

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