

## State of Play

The Corporate Responsibility  
to Respect Human Rights in  
Business Relationships



GLOBAL BUSINESS INITIATIVE  
ON HUMAN RIGHTS



Institute for  
**Human Rights and Business**

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**The Institute for Human Rights and Business** is dedicated to being a global centre of excellence and expertise on the relationship between business and internationally proclaimed human rights standards. The Institute works to raise corporate standards and strengthen public policy to ensure that the activities of companies do not contribute to human rights abuses, and in fact lead to positive outcomes.

**The Global Business Initiative on Human Rights (GBI)** exists to advance human rights in a business context around the world. The underlying vision is a global community of corporations from all sectors *knowing* and *showing* that they respect the dignity and rights of the people they impact and interact with. GBI is led by a group of 18 major corporations headquartered in Asia, Europe, Latin America, the Middle East, North Africa and North America.

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# Contents

<b>Foreword by John G. Ruggie</b>	<b>1</b>
<b>Executive Summary</b>	<b>3</b>
<b>Compilation of Key Findings</b>	<b>9</b>
<b>Part I: Introduction</b>	<b>19</b>
Chapter One: Background and Project Overview	19
Chapter Two: The UN Guiding Principles and Business Relationships	27
<b>Part II: The Current State of Play</b>	<b>39</b>
Chapter Three: Orienting and Embedding – Internal Company Management of Business Relationships	41
Chapter Four: Respecting Human Rights Throughout the Business Relationship Cycle	49
Chapter Five: Joint Ventures	73
Chapter Six: Mergers, Acquisitions and Disposals	83
Chapter Seven: Franchising and Licensing	93
Chapter Eight: Suppliers and Service Providers	101
Chapter Nine: Direct Customers	119
Chapter Ten: Investor-State Relationships	129
<b>Part III: Conclusion and Appendices</b>	<b>141</b>
Chapter Eleven: Conclusion and Ten Themes for the Next Five Years	141
Appendix A: The Corporate Responsibility to Respect Human Rights and Business Relationships in the UN Guiding Principles	153
Appendix B: The Business Relationship Cycle and the UN Guiding Principles	171



# Foreword

In June 2011, the United Nations Human Rights Council unanimously endorsed the UN Guiding Principles on Business and Human Rights, which I developed with support from all stakeholder groups. They were the final product of my six-year mandate as the Secretary-General's Special Representative on Business and Human Rights. This was the first time that the Human Rights Council issued authoritative guidance on business conduct in relation to human rights; it also marked the first time that the Council had ever "endorsed" a normative text that governments did not negotiate themselves.

The Guiding Principles lay out in some detail the steps required for states and businesses to implement the "Protect, Respect and Remedy" framework on business and human rights I had proposed to the Council in 2008, and which it welcomed. It reaffirms that states have a duty to protect human rights and prevent and sanction abuses by third parties, including business; it establishes that companies have a responsibility to respect human rights; and it stresses the need for greater access to effective remedy, both judicial and non-judicial, for victims of business-related human rights abuses.

Evidence that the Guiding Principles are taking hold can be seen in a range of developments. For example, the updated Guidelines for Multinational Enterprises of the Organisation for Economic Cooperation and Development (OECD) now include a specific chapter on human rights that draws on the Guiding Principles. Similarly, the International Standards Organisation's (ISO) 26000 social responsibility standard and the revised Performance Standards of the International Finance Corporation (IFC) have embraced the Guiding Principles as their benchmark in the area of human rights. The European Commission has invited all EU member states to submit national plans for implementation of the Guiding Principles. These and other initiatives at national and regional level are crucial for building further momentum. But the work of implementation has only just begun.

This new report by the Institute for Human Rights and Business (IHRB) and the Global Business Initiative on Human Rights (GBI) contributes to that goal by examining how the Guiding Principles can and should inform business relationships – the daily interactions between companies of all sizes in different sectors and locations across the world. Based on discussions with representatives of 14 international companies, the report describes how these companies are beginning to incorporate human rights issues and the Guiding Principles into their relationships, including the traditional focus on supply chains as well as joint ventures, mergers and acquisitions, licensing and franchising, among others.

I am grateful to the companies who shared their experience to date of seeking to apply the Guiding Principles in their operations and business relationships. They made this report possible. Their experience provides important insights into the challenges and opportunities that lie ahead. The report makes clear that companies must still take the actions needed to reinforce human rights policy commitments, align incentives, embed human rights into management systems, and build capacity with business partners to address adverse human rights impacts. But progress is being made.

Companies increasingly make reference to human rights issues in their business operations – in due diligence investigations, in contracts with partners, operational guidelines, and reports to investors and other stakeholders. All this, supported by the work of industry associations and multistakeholder initiatives and international organisations, is helping to build what the report calls “a culture of expected adherence to the UN Guiding Principles”.

Achieving this also requires understanding and action on the part of a much broader range of professional service advisers, including legal, accounting, consulting, lobbying, and tax specialists who advise businesses on their relationships. They too have a responsibility to respect human rights.

I wish to thank IHRB and GBI for providing intellectual leadership in this area. I hope all parties involved will continue their commitment to advancing the business and human rights agenda in coming years.

*John G. Ruggie*

*Berthold Beitz Professor in Human Rights and International Affairs, Harvard University  
Chair, Institute for Human Rights and Business*

# Executive Summary

## Context and Rationale

This report (the Report) takes stock of efforts by companies to address human rights impacts associated with their business relationships. Behind the macro trends and data of globalisation lies a complex array of individual business relationships, each with specific commercial objectives. This Report explores the implications of the United Nations (UN) Guiding Principles on Business and Human Rights (Guiding Principles)<sup>1</sup> for these relationships, looking at how responsible business commitments and practices are being integrated at the micro level.

Business relationships can spur economic growth, build efficiency, create access to technologies and services, and generate opportunities for formal, safer employment. Between enterprises, commercial relationships can transmit and implement new business practices and innovations regarding responsible business conduct. At the same time, the urgency to address adverse human rights impacts of business activities has emerged, for the most part, *precisely in the context of business relationships* – in particular in relation to supply chains. This is not surprising. Business transactions are now frequent in regions where the rule of law is limited or fragile, and regulatory and policy frameworks are silent or regressive with regard to international human rights standards. Business partners may have very diverse values, levels of capacity, or commitment to legal compliance or international standards of responsible behaviour.

A growing number of corporations recognise the business case for working with partners to integrate responsible business practices. Potential benefits include: reduced operational disruption; efficiency gains; diminished reputational risks (of actual or perceived involvement in human rights abuse); improved access to capital and markets; and the avoidance of legal claims. As a result, companies have taken action to establish socially sustainable business practices and value chains with their business partners in a range of sectors, and this is increasingly reflected in policy commitments, codes of conduct, and company assessments and audits. Industry-wide and multistakeholder initiatives have also been part of the same effort to address human rights in the context of business relationships.

Companies have a responsibility to respect human rights: which means to act with due diligence to avoid infringing on the human rights of others and to address adverse human rights impacts with which they are involved. This extends to addressing adverse human rights impacts with which a company is involved through its business relationships. This is one of the key messages that the UN Human Rights Council sent to all actors when it

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1 Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, A/HRC/17/31, 21 March 2011. At: <http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf>.

unanimously adopted the UN Protect, Respect and Remedy Framework (PRR Framework)<sup>2</sup> for business and human rights in 2008, and subsequently the UN Guiding Principles in 2011.

The Guiding Principles make it clear that a company may be involved with adverse human rights impacts in different ways – through its own activities and through its business relationships. The Guiding Principles articulate that the responsibility to respect human rights extends to managing adverse human rights impacts through business relationships and provide guidance on how to prevent and address those impacts. **They put business relationships squarely on the business and human rights map.** The increasing number of references to the Guiding Principles in diverse contexts (e.g. in standards, in contracts between business partners, in industry association initiatives, guidance for companies and in multistakeholder initiatives) suggests that a culture of expected adherence to the Guiding Principles is developing. By extension, given this alignment, businesses are far more likely to face consistent expectations about their responsibility regarding human rights from business partners as well as from governments, investors, and wider society.

### Report Focus and Key Findings

At the heart of this Report is a high-level review of how a group of 14 multinational companies in diverse industry-sectors<sup>3</sup> address human rights in the context of their business relationships.

The Report:

- Sets out concepts in the Guiding Principles that are relevant to this exercise.
- Considers six types of business relationships: joint ventures; mergers, acquisitions and disposals; franchising and licensing; suppliers and service providers; direct customers; and state–investor relationships.
- Looks beyond the contractual aspects of business relationships because contracts often do not capture the whole picture of how human rights are or can be addressed in business relationships.
- Examines the entire “life cycle” of the business relationship, in line with the approach of the Guiding Principles.

The Report considers how the participating companies have begun to **embed** the responsibility to respect into their internal management structures, which in turn helps support efforts in extending their human rights expectations to their business

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2 Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, A/HRC/8/5, 7 April 2008, <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf>.

3 See Chapter 1.

partners. None of the companies interviewed claimed to have achieved full integration of human rights across all business functions, including those dealing with their business relationships. More work in this area is required. Key methods of reinforcing human rights in a company's internal culture and systems include: raising awareness through training; developing clear incentives and disincentives for staff and business partners; and providing clear guidance on how to address human rights in business relationships while balancing human rights considerations against other imperatives for the relationship.

The participating companies indicated clearly that, to assess and manage human rights impacts, they are integrating human rights in their existing management systems in preference to creating new stand-alone systems. This has the evident benefit that human rights become part of a company's daily business, including with partners; at the same time it has clear challenges in ensuring that the sum of the parts translates into a coherent and comprehensive approach. This challenge is not specific to human rights: companies that are as large and dispersed as those that participated in the research find that similar problems of coherence and coordination arise whenever they bring important new policy initiatives into established management systems and procedures.

When **starting business relationships**, companies emphasised that corporate values and business principles are the foundation, for human rights as for other matters. Companies are far more often communicating with their business partners about their own policies, principles and codes than they are about human rights directly, relying on the incorporation of human rights, implicitly or explicitly, into those documents. This has a clear value, in that company policies are part of a company's DNA and will be defended vigorously in business relationships. At the same time, it often means that businesses may apply a selected list of human rights that they find relevant, and as a result may miss key issues. Consequently, companies increasingly recognise a need to adopt a variety of tools and methods to assess human rights risk in business relationships and their human rights performance, but due diligence is rarely about human rights alone. Involving stakeholders in initial or on-going assessments in the context of business relationships remains a work in progress – whether it should be done, which business partner leads, and how this feeds into assessments about the relationship, if at all.

When **formalising their business relationships**, the companies interviewed for this Report are increasingly integrating human rights concerns into their contracts with business partners, despite identified challenges, because they understand that this creates leverage with business partners, can instil positive behaviour and enables companies to address issues if “things go wrong”. Companies also use other methods to extend and entrench respect for human rights in documents governing the relationship, including operational procedures. This said, human rights are rarely deal breakers. Problems are instead addressed in various ways, by excluding certain partners, countries or products up front, by imposing contractual requirements, building capacity or managing problems as the business relationship unfolds.

Expertise in **managing human rights in relationships** is most advanced in supply chains, where human rights problems relating to business originally became prominent. The existing supply chain model for selecting, contracting and monitoring suppliers and service providers (which the Report does not review in detail because it is well-covered in the existing literature) appears to be the learning template for some other types of relationship, especially franchising and licensing. Despite its other limitations, the model does reinforce a core expectation of the Guiding Principles, that companies should continuously assess human rights issues and their relationships (rather than make a single initial assessment at the start).

Given the large number of business partners the companies involved in the research have (often running well into the tens of thousands), all draw on the principled pragmatism of the Guiding Principles, using a risk-based approach to select partners and relationships for more in-depth review. Some companies are clearly on a path of re-adjusting their risk lens to look at risk to people and not just the company, in line with the Guiding Principles. Others, by their own admission, are just starting to think about how they might integrate this perspective in their risk management systems. Many businesses are at the start of designing and implementing grievance mechanisms at operational level, as called for by the Guiding Principles.

When **ending or renewing their business relationships**, companies recognise (as do the Guiding Principles) that human rights considerations can come into play. Terminating relationships (on human rights grounds or for other reasons) is rarely the preferred outcome for companies. Often for good reasons, they prefer to try to address concerns that arise, using incentives and training to resolve weaknesses of performance, including with regard to human rights. The reputational risks that arise at divestment and closure are increasingly recognised. Human rights are starting to be a consideration when companies divest, particularly where an asset strongly associated with a company is acquired by an organisation that does not have the same practices or values.

The six relationship types explored in the Report are quite different from each other. Each presents challenges and opportunities to companies that wish to respect human rights in their business relationships. A company can exert leverage on an acquisition in a way that is not possible over a supplier that has many other clients. A partner of a joint venture can second staff to monitor its implementation of health and safety and social standards, in a manner that is simply not feasible in most supplier relationships.

## Conclusions and the Road Ahead

The Report's first key message is that companies *are* increasingly considering human rights impacts with which they are involved through their business relationships, and taking note of the UN Guiding Principles on Business and Human Rights and the corporate responsibility to respect framework as they do so. More tangibly, there are signs that addressing such impacts can find a place in business management systems. This includes the management of business relationships. More and more companies are recognising there are solid business reasons to work with partners to ensure respect for human rights in the delivery of operations, products and services to which they are linked. None of the participating companies have fully integrated human rights concerns into their business relationships or into every stage of their life cycle. Work is developing – but more is needed – to reinforce human rights policy commitments, align incentives, embed human rights into management systems, and build capacity. Progress is being made.

The Report's second key message is that the spotlight is increasingly reaching a wider range of relationships and actors. Initially, the attention given to human rights and business relationships focused almost exclusively on supply chain relationships. It is likely that the next five years will involve a deepening of attention, knowledge and practice regarding the relationship types addressed in this Report (joint ventures, mergers and acquisitions, supply chain and service providers, licensing and franchising, direct customer and investor-state) and others. Advocacy, expertise and good practice will no doubt deepen further in the next five years. Contract farming, contract manufacturing, business process outsourcing, sponsorship and advertising (especially for major sporting events), and financial services (investment, insurance, export credit) are likely to follow soon.

Moreover, not only businesses involved in production will come under the spotlight. Professional legal, accounting, consulting, lobbying, and tax advisers also have a responsibility to respect human rights as businesses in their own right. As highlighted in this Report, the responsibility extends to their operations and business relationships – i.e. the advice they give clients about business relationships.

The Report's third key message is sobering. It is true that a handful of companies are seriously engaging with human rights and attempting to address the impacts with which they are involved. However, due to lack of awareness, lack of capacity, unclear incentives or reluctance to address human rights among many companies around the world, it is too often a one-way flow of communication emanating from large companies, well versed in international standards and committed to respect human rights. The Guiding Principles state clearly that all businesses everywhere, large and small, have a responsibility to respect human rights. Consequently, when two or more companies come together in a business relationship, they have overlapping responsibilities to respect human rights that should mutually reinforce their commitment. Urgency and innovation are required from business, government and civil society to address this challenge.

The Report concludes by looking ahead. It offers ten *Themes for the Next Five Years*.

1. Multiple actors, including businesses, governments, multistakeholder initiatives, industry initiatives and civil society organisations, will shape what are considered reasonable expectations about adequate and effective human rights due diligence.
2. Demands for transparency and traceability around human rights conditions in value chains will also drive expectations about human rights in business relationships.
3. Governments will play an increasingly important role in stimulating demand for human rights due diligence, in their role as business partners.
4. Corporate commitment to respect human rights in business relationships may be driven by clearer and more tangible business opportunities, not just risk avoidance.
5. Entering markets undergoing political and economic transition responsibly will be a major focus of government, business and civil society and will help define what is considered effective due diligence with business partners in challenging circumstances.
6. “Access to Remedy” and allocation of liability will continue to be a matter of concern with respect to business relationships.
7. Understanding of risk will continue to broaden and will increasingly include human rights risk as a routine consideration in business relationships.
8. In order to address a wider range of business relationships, companies will increasingly align their practice across corporate functions, business units and locations.
9. Companies and their stakeholders will be interested in examples of how business can create and exercise leverage with business partners.
10. Companies will continue to look for ways to access credible information and engage stakeholders as part of due diligence in business relationships.

Business relationships – and the daily interaction between companies of every size, in their many sectors and locations – are a key avenue for spreading awareness and uptake of the core concepts of the responsibility to respect human rights. Some large multinationals are taking steps to incorporate human rights issues into the enormous webs of business relationships they manage around the world, often applying a pragmatic, risk-based approach. Over time, they will reach and influence an increasing number of businesses. This is an important mechanism for implementing the Guiding Principles and contributing to a more level playing field based on respect for human rights.

The Institute for Human Rights and Business and the Global Business Initiative on Human Rights welcome feedback from businesses, governments, civil society organisations, trade unions and scholars. The task of developing guidance, methodologies, and tools, for respecting human rights in business relationships, as well as for applying them, is too important for any single player; we all have an interest in its success.

# Compilation of Key Findings

## **Chapter Three: Orienting and Embedding – Internal Company Management of Business Relationships**

- Human rights are firmly on the corporate agenda but compete for management attention in a crowded field of issues relevant to business relationships.
- The integration of human rights considerations into business relationships benefits from clear leadership and coordination of knowledge and expertise across relevant functions in the company.
- Companies prefer to bring human rights into business relationships by embedding them in existing management systems.
- There is a recognition that building capacity amongst business partners to manage human rights, rather than just to comply with codes of conduct, is a more sustainable approach.
- If companies send conflicting messages to their partners about their human rights expectations and requirements, this undermines the commitment of both parties.
- Faced by vast and complex value chains, companies constantly need to prioritise their investments of time and resources. Some are developing internal processes to ensure they give appropriate attention to human rights.
- Companies that start by addressing human rights in their own operations can address the human rights performance of their business partners with greater clarity.
- Companies are actively learning from their efforts to integrate environment, health and safety, and anti-bribery and corruption concerns in their management systems and business relationships.

## **Chapter Four: Respecting Human Rights Throughout the Business Relationship Cycle**

### *Selecting and Starting the Relationship*

- Corporate values and business principles are the foundation of efforts to integrate human rights in business relationships.
- While their codes of conduct for suppliers commonly make explicit reference to human rights, only a few of the companies surveyed have explicit statements on human rights expectations with regard to other types of business relationships.
- Companies tend to focus on particular human rights that are relevant to their industry or business relationships. They are starting to adopt a wider perspective on human rights and business risks.
- Because not all business partners understand or value the language and content of human rights, companies adopt a variety of communication strategies to discuss human rights with their business partners.

- An increasing number of actors influence company expectations, including customers, multistakeholder initiatives, investors and governments.
- Few companies have internalised or operationalised the idea that they should consider all human rights, rather than a selected number, in their human rights assessments.
- Company checks on business partners touch on human rights, but rarely do so explicitly.
- Companies generally assess the human rights impacts of operations, products or services with which they are involved through their business relationships, and the track record of business partners.
- Country assessments of human rights risk are frequent in only a few kinds of business relationships (suppliers, customers, joint ventures). Large transactions tend to receive more attention.
- Companies undertake a range of actions to prevent and mitigate human rights impacts that are associated with their business relationships.
- How often and under what circumstances companies involve outside stakeholders to assess the human rights impacts of their business relationships varies by industry and type of relationship.
- There is an emerging practice of calculating the costs and benefits of addressing human rights in business relationships.

#### *Formalising the Relationship*

- Despite the challenges, companies increasingly see advantages in including human rights concepts and language (in some form) in contracts with business partners.
- “Well-known” human rights concerns (notably forced and child labour, and security issues) are often referenced in contracts, directly or via references to company policies or codes of conduct.
- When human rights are included in contracts, companies use different reference points and different legal techniques.
- Companies are using various techniques inside and outside contracts to make human rights more specific.
- Seeking “ways to honour the principles of internationally recognised human rights” when faced with conflicting national requirements are rarely dealt with in contracting.
- Companies are creating leverage with business partners to address human rights issues but it is often not through the contract alone that they create meaningful commitment to change.
- Companies are using contractual provisions to address human rights issues in the value chain beyond their immediate business partner.

### *Managing the Relationship*

- Building the capacity of business partners to manage human rights issues can be an important mitigation strategy.
- For certain business relationships, companies have systems in place to track performance against company codes or contractual requirements.
- Companies appreciate that dynamic situations require dynamic and regular assessment and tracking, but this is not always widely embedded in actual practice.
- Companies often respond more urgently to severe human rights impacts, and expect business partners to prevent or mitigate severe impacts before addressing other issues.
- Communicating with external stakeholders about human rights in business relationships is not yet common practice.
- Establishing grievance mechanisms and providing access to remedies for negative human rights impacts in business relationships is a work in progress.

### *Ending or Renewing the Relationship*

- Companies recognise that terminating relationships on human rights grounds is an option when things go wrong, but that it is not always the best option from a business or human rights perspective.
- Companies may suspend relations with partners, or take over their operations, on human rights grounds, but usually do so in the course of dealing with broader concerns.
- Renewing business relationships can be an incentive for business partners to improve their human rights performance.
- Companies increasingly review human rights at the end of their relationships, when they consider their reputational legacy.
- Communicating about termination of business relationships on human rights grounds can be complex in reality.

## **Chapter Five: Respect for Human Rights in Joint Venture Relationships**

### *Selecting and Starting the Relationship*

- Companies can help to manage human rights-related risks by choosing their JV partners with care, but their choices may be limited in some circumstances.
- Before forming a JV, companies use various avenues to convey their human rights expectations to business partners.
- Companies do serious due diligence for certain JVs, and often consider human rights.
- Due diligence appears to vary in scope, and is more extensive when a company operates or holds a majority stake in the JV.

- To understand country situations and challenges, companies may consult external stakeholders but more frequently speak to potential business partners.

#### *Formalising the Relationship*

- JV agreements can be designed to consider human rights explicitly.
- Contractual language on human rights is considered mandatory by some companies, whereas others include it where possible.
- JV agreements may stipulate operating procedures that explicitly or implicitly address human rights.
- Companies create long-term leverage by their choice of roles and procedures in the JV.
- Internal coherence and alignment may affect the human rights content of the agreement.
- Some companies treat regulatory and reputational risks as conditions precedent.
- Referring to third party standards, including MSIs, builds further leverage to address key issues.
- Seeking finance for the JV from financial institutions that have a clear set of social and environmental standards is often a sensible way to establish leverage over JV partners.

#### *Managing the Relationship*

- When companies are not operators of a JV, they usually involve themselves less in its regular social and environmental assessments, rarely build capacity in human rights, and do not consistently report on its human rights practices.
- Some companies receive consistent reporting on their JVs' human rights performance.
- Grievance mechanisms for employees and affected communities are variable.

#### *Ending or Renewing the Relationship*

- JV agreements rarely consider human rights-related problems to be material breaches.
- Legacy issues (including human rights) can affect the reputation of former owners.

## **Chapter Six: Respect for Human Rights in Merger, Acquisition and Disposal Relationships**

#### *Orienting and Embedding*

- M&A teams may need guidance on when, how and why to consider human rights.

#### *Selecting and Starting the Relationship*

- Initial due diligence processes and interactions can uncover what is required for alignment and provide a framework for dialogue with a target company.
- The extent of human rights inquiries during initial assessments may depend on the importance of the deal.

- Existing M&A checklists are unlikely to expressly reference human rights, but checklists are evolving.
- Information gathering, including with stakeholders, may be constrained by the need to maintain commercial confidentiality.
- Country risk analysis is important to understanding broader human rights risks. Processes to take account of sanctions seem to be in place.
- When companies obtain human rights information on a target company they tend to rely on self-disclosure. They increasingly request information on financing conditions and their participation in MSIs.
- Companies are starting to scrutinise the business relationships of potential target companies.
- It can be difficult to price reputational and other liabilities related to human rights impacts. A company may find it easier to estimate the cost of bringing M&A targets into compliance with its standards.
- Human rights issues alone are unlikely to delay a merger, acquisition or disposal unless they are accompanied by other serious (reputational, legal, operational) risks. Companies may have good reasons to become more selective.
- Inquiries on human rights are more common during mergers and acquisitions than disposals.

#### *Formalising the Relationship*

- In acquisitions, leverage should not be an issue in theory but in practice may be more difficult to exercise.
- Companies tend not to include explicit references to human rights in contracts relating to mergers, acquisitions and disposals.
- Closing conditions may incorporate human rights elements even if they are not included in the contract.

#### *Managing the Relationship*

- If human rights issues are addressed, they are generally integrated in broader action plans that raise the target enterprise's practices to the company's standards. Few companies have stand-alone human rights action plans.
- Target companies may need continued guidance on raising standards.

#### *Ending or Renewing the Relationship*

- Assets can remain associated with a company after disposal.
- Disinvestment due to human rights challenges can pose difficult dilemmas.

## **Chapter Seven: Respect for Human Rights in Franchising and Licensing Relationships**

### *Selecting and Starting the Relationship*

- It is important to communicate expectations and establish standards early, especially in long-term franchise agreements.
- Consumer expectations can stimulate consideration of human rights in these business relationships.
- Company assessments are often more detailed when the company name is associated with the business relationship.
- A partner's capacity to manage human rights issues is an important dimension of assessment.

### *Formalising the Relationship*

- The duration of many franchise agreements makes it necessary to manage human rights issues throughout the relationship, rather than relying on the contract.

### *Managing the Relationship*

- Companies use many forms of leverage to focus franchisees' attention on human rights issues.
- Companies routinely track the human rights performance of franchisees.
- Grievance mechanisms are a work in progress.

### *Ending or Renewing the Relationship*

- Terminating a relationship usually requires several steps.

## **Chapter Eight: Respect for Human Rights in Supplier and Service Provider Relationships**

### *Orienting and Embedding*

- Creating coherence between human rights policy commitments and procurement is a well-recognised challenge.

### *Selecting and Starting the Relationship*

- Companies most frequently set and communicate their expectations for suppliers and service providers by developing company codes or policies.
- Understanding the supplier or service provider is a key part of understanding potential human rights risks.
- Assessing country risks often depends on where the supplier or service provider is located and the types of services provided.

- Faced by complex supply chains, companies prioritise certain risks. Some are developing approaches to risk that explicitly consider human rights.
- Stakeholder consultations in supply chains often focus only on workers once the relationship has started.
- When supply chains consolidate, it is an opportunity to align shared values.
- Companies do not yet know how to calculate the efficiency of their spending on supply chain compliance.

#### *Formalising the Relationship*

- Contractual references to human rights issues serve several purposes.
- Given the wide range of their relationships, companies use an array of tools to generate leverage.
- It is common to specify the consequences of non-compliance.
- Graduated contractual provisions can provide flexibility.
- Companies are asking partners to communicate the company's requirements to their business partners.
- Reflecting MSI and industry initiative requirements in contracts, is an approach to note.

#### *Managing the Relationship*

- Monitoring (some) suppliers has become a routine part of supply chain relationships.
- Companies are reducing the audit burden and identify key concerns.
- Non-compliance measures are often viewed by suppliers as punitive. Some companies find proactive and incentive-based systems more effective.
- Some reporting by suppliers and of audit results is occurring in select sectors.
- "Whistle-blower lines" are the most common form of grievance mechanism, but practices vary.
- MSIs can assist companies to resolve disputes and prompt development of effective dispute mitigation.

#### *Ending or Renewing the Relationship*

- Termination clauses are common in supplier contracts, but rarely applied in practice, in favour of corrective action.

### **Chapter Nine: Respect for Human Rights in Direct Customer Relationships**

#### *Orienting and Embedding*

- Consumer expectations about human rights can focus a company's attention.

- Staff need appropriate incentives and disincentives (embedded in a company culture supportive of human rights) to take on difficult discussions with customers.
- Regulatory and MSI requirements can be a source of leverage.

#### *Selecting and Starting the Relationship*

- Business customers and partners are expressing their expectations on human rights. This can lead to a “battle of standards” that companies are starting to address and avoid.
- Consumer expectations on human rights can be a source of leverage that assists companies to raise human rights issues with their business partners.
- “Know Your Customer” processes may address certain human rights issues but do not yet do so systematically.
- Including human rights considerations in standard bidding documents could improve outcomes and level the playing field.
- Knowing how customers will use products or services is a key challenge.

#### *Formalising the Relationship*

- Company contracts are excluding certain uses of products or services.
- Some companies require compliance by customers as a contractual requirement.
- A company may need to take a big picture approach regarding product misuse associated with its name or brands.
- Instalment sales contracts and after sales service agreements can provide a measure of leverage over customers’ use of products.
- Customers may use contracts to shift liability to business partners in a manner out of line with the Guiding Principles.

#### *Managing the Relationship*

- Risk management approaches can identify which customers require additional attention.

#### *Ending or Renewing the Relationship*

- Legacy issues can be a key challenge.

## **Chapter Ten: Respect for Human Rights in Investor-State Relationships**

#### *Selecting and Starting the Relationship*

- Investor-state contracts provide opportunities for private partners to proactively improve uptake of the Guiding Principles by their state business partners and level the playing field amongst public and private businesses.

- Business relationships with governments can magnify real or perceived involvement with states' human rights abuses.
- State-owned enterprises (SOEs) inexperienced in human rights management can bring risks and challenges for their private partners.
- Assessing country risk is a standard consideration.
- Developing processes to assess governments as business partners is still a work in progress.
- National authorities or international financial agencies may require stakeholders to be consulted on large projects and respondents often feel well placed to lead this process.

#### *Formalising the Relationship*

- Host states are not always equipped or willing to accommodate international and public expectations on human rights when negotiating agreements.
- Companies and external stakeholders often have different perceptions about the extent to which companies exert leverage with governments.
- Projects covered by investor-state contracts often require provision of public security. This raises challenges around state sovereignty and the duty to protect.
- Referring to multistakeholder initiatives can provide an avenue to reinforce human rights in investor-state agreements.

#### *Managing the Relationship*

- Perceptions of the benefits from (and motives for) local content requirements are mixed.
- "Additional goods and services" provisions can be seen to contribute positively to local development or inappropriately displace government's responsibility.
- Contractual transparency expectations increase when working with governments.
- Demands for public reporting of revenue are also increasing.
- Company's operational-level grievance mechanisms can provide a competitive advantage when working with government.

#### *Ending or Renewing the Relationship*

- After a change of government, companies may have to build their relationships all over again.
- Legacy, and its reputational consequences, are highly correlated to country context.



# Part I: Introduction

## Chapter One: Background and Project Overview

### Globalisation, Business Relationships and Human Rights

This Report takes stock of a range of efforts employed by companies to address the human rights impacts associated with their business relationships (the Report). Behind the big picture of globalisation lies a complex array of individual business relationships, each with specific commercial objectives. This Report begins to explore the implications of the UN Guiding Principles on Business and Human Rights<sup>4</sup> (Guiding Principles) for these relationships, looking at how responsible business commitments and practices are being integrated at the micro level.

#### *Globalisation and business relationships*

A defining characteristic of 21st century globalisation is the dramatic growth and increasing complexity of business relationships, including those that cross borders. This web of commercial transactions affects companies on every scale, and means that businesses have a direct or indirect relationships with hundreds and sometimes tens of thousands of enterprises that are not under their direct control or ownership. Nor is this the only complexity. Though business relationships are most commonly presented as bilateral, in reality a single product, service or project can involve numerous enterprises in a web of multilateral business ties.

The feature of economic globalisation that is most frequently discussed is the way in which businesses have managed risks and rewards by outsourcing activities that traditionally they undertook themselves. In 2010, cross-border non-equity business relationships (through which companies coordinate the activities of other companies without owning a stake in them) are estimated to have generated over \$2 trillion of sales.<sup>5</sup> These relationships are evident in a wide range of industries and take different forms, including contract manufacturing and farming, service outsourcing, franchising and licensing, management contracts, and supply chains. In the same year, approximately 80% of the 18-21 million workers employed through these arrangements were in developing and transition economies.<sup>6</sup> Capital flows across borders, in the form of mergers and acquisitions (M&As), joint ventures (JVs), and foreign direct investment, have also grown dramatically. Some 145 cross-border M&As were reported in South Asia alone in 2011, a 131% increase in value over the previous year, as well as 1,045 green field foreign

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4 Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework, A/HRC/17/31, 21 March 2011. At: <http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf>.

5 United Nations Conference on Trade and Development (UNCTAD), World Investment Report – Non-Equity Modes of International Production and Development (2011), p. xix. At: <http://www.unctad-docs.org/files/UNCTAD-WIR2011-Full-en.pdf>.

6 *Op.cit.*, p. xix-xx. At: <http://www.unctad-docs.org/files/UNCTAD-WIR2011-Full-en.pdf>.

direct investment projects involving transnational corporations.<sup>7</sup> All sectors are involved in these relationships. Joint ventures are common in the oil and gas and mining sectors, but they have also multiplied in the automobile, telecommunications, technology and apparel sectors.

Investment is not simply moving from OECD to non-OECD countries. Chinese investment into the European Union tripled between 2006 and 2009, and tripled again by 2011 to \$10 billion (€7.4 billion).<sup>8</sup> In the last decade, South-South trade and investment has also been on an upward trajectory. Political leaders from ASEAN regularly discuss investment and trade links with their peers in Latin America.<sup>9</sup>

“Downstream” relationships show a similar trend as companies extend their customer-base across many continents. This includes relationships with diverse types of actors, from the individual newly middle-class, or “Bottom of the Pyramid” consumer, to large public institutions.

#### *Business relationships and human rights*

Business relationships can spur economic growth, improve efficiency, provide access to technologies and services, and generate opportunities for formal, safer employment. Through their commercial relationships, enterprises can transmit and implement new business practices and innovations. This has been true across a range of core business areas, for example in quality management, lean manufacturing, just-in-time production, and more recently in the spread of ethical and responsible practices (most clearly in health and safety, environment, and anti-corruption).

At the same time, the urgency to address the human rights impacts of business has emerged, for the most part, *precisely in the context of business relationships* – in particular in relation to supply chains. This is not surprising. Business transactions are now frequent in regions where the rule of law is limited or fragile, and where regulatory and policy frameworks are silent or regressive with regard to international human rights standards. Business partners may have very diverse values, levels of capacity, or commitment to legal compliance or international standards of responsible behaviour.

Examples of adverse human rights impacts associated with business relationships include child labour rights abuses in supply chains, violent abuse by security forces, pricing

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7 United Nations Conference on Trade and Development (UNCTAD), World Investment Report – Towards a New Generation of Investment Policies (2012), p. xLvi. At: <http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf>.

8 The Rhodium Group, China Invests in Europe: Patterns, Impacts and Policy Implications (2012), p. iii. At: [http://rhgroup.net/wp-content/uploads/2012/06/RHG\\_ChinaInvestsInEurope\\_June2012.pdf](http://rhgroup.net/wp-content/uploads/2012/06/RHG_ChinaInvestsInEurope_June2012.pdf).

9 Association of South-East Asian Nations. Note the *ASEAN Latin Business Forum 2012 on July 9-10, 2012* – <http://www.asean-latin2012.com/index.html>; ASEAN Foundation/Inter-American Development Bank project *Sharing of Knowledge between Southeast Asian and Latin American Countries on Trade and Investment* – <http://www.asean-latin2012.com/sharing-of-knowledge-asean-and-latin-america.html>.

regimes that undermine minimum wage commitments, misuse of technology resulting in human rights abuses, violent appropriation of land by government partners, abuse of migrant workers by labour providers, abuses of the right to privacy of customers, and unclear remedies for victims following changes of ownership. Consequences have included civil society campaigns, media criticism, and court cases that seek accountability and assignment of liability between business partners. A significant percentage of OECD National Contact Point (NCP) cases and Alien Tort Statute<sup>10</sup> cases have involved business relationships. The investment community (from institutional investors to shareholder activists) has also taken a keen interest in business relationships.

A growing number of companies recognise the business case for working with partners to integrate responsible business practices. Potential benefits include: reduced operational disruption; efficiency gains; diminished reputational risks (of actual or perceived involvement in human rights abuse); improved access to capital and markets; and the avoidance of legal claims. As a result, some companies have taken action to establish socially sustainable business practices and value chains with their business partners in many sectors, and this is increasingly reflected in policy commitments, codes of conduct, and company assessments and audits. Collective action has been part of the same effort to address human rights in the context of business relationships. Multistakeholder initiatives (such as the Fair Labour Association, the Voluntary Principles on Security and Human Rights, the Kimberley Process, the Global Network Initiative, and the Roundtable on Sustainable Palm Oil) have set standards in certain domains, while specific industries have come together for the same purpose (the Electronics Industry Citizenship Coalition, the International Council on Mining and Metals, the International Petroleum Industry Environmental Conservation Association, and the AIM Progress Program for Responsible Sourcing).

This Report seeks to take stock of these efforts, in the new context that has been created by the United Nations “Protect, Respect, Remedy” Framework (PRR) and Guiding Principles.

## **The United Nations Protect, Respect, Remedy Framework and Guiding Principles on Business and Human Rights**

### *The UN Framework and Guiding Principles*

By adopting the UN PRR Framework and Guiding Principles, governments have reaffirmed their duty to protect against rights abuses involving third parties, including business. Equally important, the UN PRR Framework and Guiding Principles confirm that companies have an independent responsibility to respect human rights. This means that companies have a responsibility to act with due diligence, to avoid infringing the human rights of others, and to address adverse human rights impacts with which they are involved. A company’s responsibility encompasses adverse human rights impacts with which it becomes involved through its business relationships.

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10 USC › Title 28 › Part IV › Chapter 85 › § 1350.

This is a key message of the UN PRR Framework<sup>11</sup> for business and human rights. The PRR Framework was proposed by Professor John Ruggie, then UN Special Representative for Business and Human Rights (SRSG), and adopted unanimously by the UN Human Rights Council in 2008. It sets out three pillars:

- **Pillar I. The State duty to protect human rights** – against abuses by third parties, including businesses, by means of policies, regulation, and adjudication.
- **Pillar II. The corporate responsibility to respect human rights** – meaning companies should act with due diligence to avoid infringing the rights of others and address adverse human rights impacts with which they are involved.
- **Pillar III. Access to remedy** – which addresses the need for greater access by victims to effective remedies, both judicial and non-judicial.

After completing the PRR Framework in 2008, the SRSG developed the Guiding Principles to facilitate its implementation. These too were adopted unanimously by the UN Human Rights Council, in June 2011.<sup>12</sup> A new UN Working Group on Business and Human Rights was created to lead efforts to disseminate and implement the Guiding Principles and guide the work of an annual forum on business and human rights that will promote international dialogue and cooperation.<sup>13</sup> Both the PRR Framework and the Guiding Principles enjoy the support of many of the world’s leading business organisations, as well as many civil society organisations, academic experts, and trade unions.

The Framework reinforces norms based on international legal principles and social expectations, providing a foundation for national and international policy and rulemaking, and an authoritative framework for business behaviour. Critically, the PRR Framework emphasises both the obligations of governments and the responsibilities of companies, each having an independent but complementary role. This sends a clear message that a state’s failure to protect human rights does not relieve a business of its responsibility to respect.

The Guiding Principles make clear that a company may be involved with an adverse human rights impact as a consequence of its own activities or through its business relationships. They affirm that companies have a responsibility to respect human rights in both cases, and provide guidance on how to prevent and address such impacts. The Guiding Principles put business relationships squarely on the business and human rights map.

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11 Protect, Respect and Remedy: a Framework for Business and Human Rights, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, A/HRC/8/5, 7 April 2008. At: <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf>.

12 Resolution adopted by the Human Rights Council, 17/4 Human rights and transnational corporations and other business enterprises, A/HRC/RES/17/4, 6 July 2011. At: <http://www.business-humanrights.org/media/documents/un-human-rights-council-resolution-re-human-rights-transnational-corps-eng-6-jul-2011.pdf>.

13 At: <http://www.business-humanrights.org/Documents/UNWorkingGrouponbusinesshumanrights>.

### *Convergence and alignment*

The Guiding Principles have rapidly become an authoritative focal point and have been incorporated into a range of other standards. The OECD Guidelines for Multinational Enterprises were revised in 2011 and now specifically address human rights. Building on the Guiding Principles, they also include business relationships.<sup>14</sup> The OECD's NCPs hear complaints about "specific instances"<sup>15</sup> of corporate implementation of the OECD Guidelines: since business relationships were at the heart of many past complaints, they are likely to become even more prominent as a result. The convergence of standards around the Guiding Principles can be seen in other areas too: in the International Standards Organisation's ISO 26000;<sup>16</sup> in references to the PRR Framework in the updated Performance Standards of the International Finance Corporation (IFC, World Bank Group);<sup>17</sup> in the OECD's Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence, which was recently updated<sup>18</sup> and in national legislation and other national and regional initiatives.

The increasing number of references to the Guiding Principles in these and other standards, as well as in business contracts, industry association policies, corporate guidance, and multistakeholder initiatives suggest that a culture of expectation is forming. By extension, given the alignment of standards, businesses are far more likely to face consistent expectations about their responsibility regarding human rights from business partners as well as from governments, investors, and wider society.

## **Project Description**

### *Overview*

In its first *State of Play Report* (2011), which provided a general overview of human rights due diligence, the Institute for Human Rights and Business (IHRB) found that

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14 See OECD Guidelines for Multinational Enterprises, 2011 Edition, Page 33, Paragraph 43. At: <http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/48004323.pdf>. See Chapter Two of this report for an overview of how the Guiding Principles treat business relationships.

15 "Specific instances" refers to the process by which NCPs help to resolve issues that relate to implementation of the *Guidelines* and arise in specific company operations. NCPs offer a forum for discussion and are expected to assist the business community, worker organisations, other non-governmental organisations, and other interested parties to resolve such problems in an efficient and timely manner, in accordance with applicable law. OECD Guidelines on Multinational Enterprises, Procedural Guidance, Section C, p. 72.

16 At: <http://www.iso.org/iso/home/standards/iso26000.htm>.

17 See IFC, Performance Standard 1- Assessment and Management of Environmental and Social Risks and Impacts. At: [http://www1.ifc.org/wps/wcm/connect/3be1a68049a78dc8b7e4f7a8c6a8312a/PS1\\_English\\_2012.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/3be1a68049a78dc8b7e4f7a8c6a8312a/PS1_English_2012.pdf?MOD=AJPERES). See also Guidance Note, Footnote, GN6. At: [http://www1.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN\\_English\\_2012\\_FullDocument.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN_English_2012_FullDocument.pdf?MOD=AJPERES).

18 Recommendation Of The Council On Common Approaches For Officially Supported Export Credits And Environmental And Social Due Diligence (The "Common Approaches"). At: <http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=TAD/ECG%282012%2958&doclanguage=en>.

“the contractual relationships between a company and the state, or directly with other companies are increasingly a key area of focus for human rights due diligence”.<sup>19</sup> This second *State of Play* Report follows up that observation, focusing on six types of business relationship:

- Joint Ventures.
- Mergers, acquisitions and disposals.
- Suppliers and service providers.
- Licensing and franchising.
- Direct customers.
- Investor-state relationships.

Because the links between business relationships and human rights are not well understood or widely debated except in the context of supply chain relationships, IHRB and the Global Business Initiative on Human Rights (GBI) wanted to know more about what companies are doing to implement their responsibility to respect human rights in these business relationships.

Significant as the above relationships are, they comprise only one part of all the relationships of a company. A wider and deeper study would be needed to cover all the business relationships in which companies typically engage, including relationships for inputs and outputs, that manage recruitment of staff and workers, deliver professional services (legal, accounting, back office, consulting, lobbying, tax), and provide finance.

### *Aims*

This “State of Play” Report:

- **Maps current action.** It indicates what a select group of companies is doing to address human rights in their business relationships.
- **Identifies operational challenges.** It names some of the challenges that businesses face when they address human rights impacts in the context of their business relationships.
- **Gives practical examples.** It sets out the approaches that companies are using and, adopting an “open source” approach, suggests what is possible and what tools are available.
- **Opens a discussion.** It reviews how business relationships are defined and framed in the Guiding Principles, discusses how difficult concepts are being interpreted and implemented, and indicates where a systematic effort is needed across all three pillars of the UN PRR Framework.

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19 Institute for Human Rights and Business, “The ‘State of Play’ of Human Rights Due Diligence – Anticipating the Next Five Years”, Volume One: General Overview (2011), p. 31. At: [http://www.ihrb.org/pdf/The\\_State\\_of\\_Play\\_of\\_Human\\_Rights\\_Due\\_Diligence.pdf](http://www.ihrb.org/pdf/The_State_of_Play_of_Human_Rights_Due_Diligence.pdf).

### *Key choices*

IHRB, GBI and participating companies made two key choices in designing the project. They decided to:

- **Look beyond contracts.** The project extended its research beyond the content of contracts between business partners, because contracts often do not provide a full picture of the business relationship. Though contracts (or chains of contractual relationships) are the primary means through which businesses formally engage with other entities, they are not the only one. The Guiding Principles and this Report discuss a wide range of actions that companies undertake within and beyond contracts with their business partners.
- **Consider the “life cycle” of relationships.** The Report looks at the beginning, middle and end of business relationships. This is consistent with the Guiding Principles and with the way in which business relationships work in practice.

### *Methodology*

The Report is based on a dialogue with fourteen companies, and a small advisory board, which are identified in the acknowledgements. Information was gathered in confidential interviews and during two confidential roundtables of two days each. While the number of companies that participated is very small, they are large organisations, have a wide geographic spread, and are often considered global leaders in their fields.

The Report only scratches the surface of the complexities of a company’s business relationships, and only begins to suggest how human rights can be integrated in them. It does not attempt to assess the actual human rights impacts of business relationships, positively or negatively, and is not intended to be a legal or normative analysis. Since it is based on discussions with a small sample of companies over a short period, it is not exhaustive.

Observations are based on the information gathered and no attempt has been made to force consensus where it did not exist. Where differences of practice or opinion emerged, this is indicated to the extent possible. Readers should note, therefore, that specific observations do not necessarily apply to particular companies that participated in the research – still less to companies that did not.

The Report has been written by the IHRB and the GBI secretariat, without external editorial control or influence. The IHRB and GBI secretariat accept full responsibility for its content, which does not implicate in any way the companies that participated in the research, members of GBI, the advisors to the project, or the project’s funders.



## Chapter Two: The UN Guiding Principles and Business Relationships

This chapter provides an overview of how business relationships are treated in the UN Guiding Principles in the context of the **Corporate Responsibility to Respect Human Rights**. It seeks to “anchor” the discussion of issues and practices in later chapters, and is organised in two parts:

- The **Overview** summarises what the Guiding Principles say companies should do to respect human rights, including in their business relationships. The chapter mirrors the Guiding Principles by addressing “Foundational Principles” (Guiding Principles 12 to 15) and “Operational Principles” (Guiding Principles 16 to 22).
- **Key Concepts: Human Rights Risk, Degree of Involvement, and Leverage.** The chapter explains concepts in the Guiding Principles that should guide companies when they address human rights impacts in the context of their business relationships.

A table in Appendix A supports this chapter by citing aspects in each Guiding Principle and its commentary that are relevant to business relationships.

### Overview of Business Relationships in the Guiding Principles

#### *“Foundational Principles” (Guiding Principles 12 to 15) and business relationships*

The Guiding Principles make clear that a company may be involved with adverse human rights impacts in different ways: through its own activities; and through its business relationships. They provide guidance on how companies should prevent and address negative impacts.<sup>20</sup>

As defined by the Guiding Principles, “**business relationships**” include an enterprise’s relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services.<sup>21</sup> This definition covers the business relationships explored in this report.

The responsibility of business enterprises to respect human rights applies to all enterprises, regardless of their size, sector, operational context, ownership and structure.<sup>22</sup> **Where companies cause an adverse human rights impact through their own operations, they have primary responsibility for those impacts.** With respect to business relationships, the essential message of the Guiding Principles is that all businesses need to:

- **Avoid contributing to adverse human rights impacts (through or in parallel with others),** and address impacts when they occur, including by participating in remediation.<sup>23</sup>

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20 Guiding Principle 13.

21 Commentary to Guiding Principle 13.

22 Guiding Principle 14.

23 Guiding Principle 13.

- **Seek to prevent and mitigate adverse impacts directly linked** to their operations, products or services through their business relationships, even where they have not contributed to such an impact. The Guiding Principles do not require a company to provide remediation, though it may take a role in doing so.

To act effectively, businesses need to **know** if and how they may be involved in adverse human rights impacts through their business relationships, and to **show** they have taken action to prevent, mitigate and address these impacts. This requires them to have adequate policies, capabilities, and processes.<sup>24</sup>

Because many companies have a very wide range of business relationships – in number, scale and location – the Guiding Principles do not advocate a single approach. Approaches should be influenced by companies’ size, sector, ownership and structure (including whether they conduct business through a corporate group or individually). Each industry and company is therefore likely to adopt a different mix of approaches.<sup>25</sup>

The Guiding Principles make clear that businesses can have impacts on virtually all human rights.<sup>26</sup> They suggest that companies should engage with business partners on human rights issues that are particularly salient to their relationship, but review their choice and consider all internationally recognised human rights periodically, because the nature of impacts is influenced both by context and by the activities executed via the relationship, which often change over time.

### **Guiding Principle 15 – The Essence of the Corporate Responsibility to Respect**

“In order to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including:

- a) A policy commitment to meet their responsibility to respect human rights;
- b) A human rights due-diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights;
- c) Processes to enable the remediation of any adverse human rights impacts they cause or to which they contribute.”

24 Guiding Principle 15.

25 Commentary to Guiding Principle 14.

26 Guiding Principle 12.

*“Operational Principles” (Guiding Principles 16 to 21) and business relationships*

Policy commitment (Guiding Principle 16)

- *Set and communicate expectations.* A company’s human rights policy should set out its expectations of business partners and these should be communicated to partners.<sup>27</sup> The Guiding Principles do not specify how expectations should be communicated. The research for this project suggests that, among other means, companies can raise awareness, provide training, and include human rights considerations in contracts and pre-qualification procedures.
- *Embed commitments in operational policies and procedures.* Policy commitments should be set out in a statement that is then also reflected in “operational policies and procedures necessary to embed it” throughout the enterprise.<sup>28</sup> It follows that businesses should embed their commitment in policies and processes relevant to their business relationships. The aim is to integrate the commitment in day-to-day business, including relations with prospective or existing business partners.

Human rights due diligence (Guiding Principles 17 to 21)

- *Assess Impacts.* When companies undertake human rights due diligence, they should assess adverse human rights impacts that the business may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships.<sup>29</sup> The Guiding Principles state that “human rights due diligence should be initiated as early as possible in the development of a new activity or relationship, given that human rights risks can be increased or mitigated already at the stage of structuring contracts or other agreements, and may be inherited through mergers or acquisitions”. Further, because situations change, assessments should be “undertaken at regular intervals: prior to a new activity or relationship; prior to major decisions or changes in the operation (e.g. market entry, product launch, policy change, or wider changes to the business); in response to or in anticipation of changes in the operating environment (e.g. rising social tensions); and periodically throughout the life of an activity or relationship”.<sup>30</sup> This process should draw on internal and external human rights expertise and, where possible, should involve meaningful consultation with stakeholders.<sup>31</sup> Where consultation is not possible (for example, due to resource constraints or lack of direct access to stakeholders), the Guiding Principles say that “business enterprises should consider reasonable alternatives such as consulting credible, independent expert resources, including human rights defenders and others from civil society”.

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27 Guiding Principle 16 c and d.

28 Guiding Principle 16e.

29 Guiding Principle 18.

30 Commentary to Guiding Principles 17 and 18.

31 Guiding Principle 17.

- *Integrate responses.* Responses to existing or potential adverse impacts that are associated with a business relationship should be integrated effectively in the business functions linked with that relationship.<sup>32</sup> This may require companies to change budget allocations, oversight mechanisms, and incentives. Key functions linked to business relationships may include legal, M&A, sales, compliance, procurement, and government relations.
- *Track effectiveness.* A company is expected to track the effectiveness of actions it takes to address human rights issues that arise out of its business relationships, in order to be able to show, confidently and credibly, that it has addressed the concerns in question.<sup>33</sup> Where companies have systems in place to review the actions of business partners (such as compliance audits in the supply chain, or monitoring systems for joint ventures) these may be adapted to address human rights impacts.
- *Engage and communicate.* A company that conducts effective human rights due diligence with respect to its business relationships will engage, collaborate, and communicate with a range of stakeholders.<sup>34</sup> These include: relevant functions within the business; the company's business partners; and other individuals and sources who can provide relevant information about the company's business relationships and their impacts (including members of civil society, human rights experts, government officials, investors etc.). Depending on the closeness of a company's relationship (it will be more heavily implicated in a 50:50 joint venture, for example, than with a supplier down the supply chain), a company may want to engage directly with stakeholders who are affected by its business relationships.

#### Remediation (Guiding Principles 22 and 29 to 30)

- Where a business has **caused or contributed to** adverse human rights impacts, it should provide or cooperate in providing remediation, including (where appropriate) by means of effective local grievance mechanisms.
- Where a business is **directly linked** to adverse human rights impacts through its business relationships, but did not cause or contribute to the impacts, the Guiding Principles do not expect it to provide remediation, though it may take a role in doing so.<sup>35</sup>

Remediation may be achieved via official judicial (court-based) and non-judicial mechanisms.<sup>36</sup> Non-judicial mechanisms include company-level processes and multistakeholder or other collaborative mechanisms.<sup>37</sup>

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32 Guiding Principle 19a.

33 Guiding Principle 20.

34 Guiding Principles 18, 20b and 21.

35 Guiding Principle 22.

36 Guiding Principles 26 and 27.

37 Guiding Principles 28 to 30.

### Guiding Principle 31 – Effectiveness Criteria for Non-State Grievance Mechanisms

“In order to ensure their effectiveness, non-judicial grievance mechanisms, both State- based and non-State-based, should be:

- **Legitimate:** enabling trust from the stakeholder groups for whose use they are intended, and being accountable for the fair conduct of grievance processes;
- **Accessible:** being known to all stakeholder groups for whose use they are intended, and providing adequate assistance for those who may face particular barriers to access;
- **Predictable:** providing a clear and known procedure with an indicative timeframe for each stage, and clarity on the types of process and outcome available and means of monitoring implementation;
- **Equitable:** seeking to ensure that aggrieved parties have reasonable access to sources of information, advice and expertise necessary to engage in a grievance process on fair, informed and respectful terms;
- **Transparent:** keeping parties to a grievance informed about its progress, and providing sufficient information about the mechanism’s performance to build confidence in its effectiveness and meet any public interest at stake;
- **Rights-compatible:** ensuring that outcomes and remedies accord with internationally recognised human rights;
- **A source of continuous learning:** drawing on relevant measures to identify lessons for improving the mechanism and preventing future grievances and harms;

**Operational-level mechanisms should also be:**

- **Based on engagement and dialogue:** consulting the stakeholder groups for whose use they are intended on their design and performance, and focusing on dialogue as the means to address and resolve grievances.”

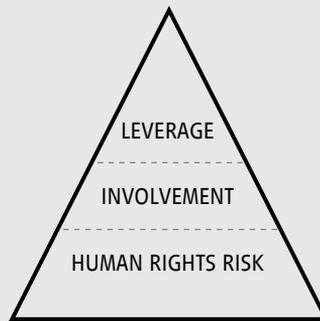
### Key Concepts: Human Rights Risk, Involvement and Leverage

It is recognised that companies, including smaller enterprises, may have extremely large and complex value chains. Bearing that in mind, what should guide companies when they seek to respect human rights in the context of their business relationships? The Guiding Principles propose a number of useful concepts, three of which are presented here:

- **Human rights risk.** First, the risk of having an adverse impact on human rights.
- **Degree of involvement.** Second, the nature of a company’s involvement in an impact informs the nature and extent of its responsibility, and its duty to take “appropriate action”.

- **Leverage.** Third, “[t]he ability to effect change in the wrongful practices of the party that is causing or contributing to the impact.”

As illustrated by the diagram, human rights due diligence should first and foremost be about impacts, or be “risk-based” where risk is understood as risk to human rights. A company should then consider the nature of its involvement. With regard to leverage, the Guiding Principles change the paradigm of most previous models and expectations regarding responsible behaviour in the context of business relationships. These generally considered leverage to be a legitimate starting point for determining responsibility. Under the Guiding Principles, responsibility is determined by a company’s impacts. Leverage can be an important consideration when discharging responsibility but does not determine it.



### Concept One: Human Rights Risk

When making decisions about where to focus attention and effort with respect to a business relationship, the Guiding Principles take a risk-based approach, where the risk of adverse impacts on people is the primary driver. The Guiding Principles address three circumstances:

- Prioritising *among* relationships in complex value chains with large numbers of entities.<sup>38</sup>
- Prioritising which impacts and issues to address first *within* a specific relationship.<sup>39</sup>
- Contexts of enhanced human rights risk including where there is a risk of complicity in gross human rights abuses.<sup>40</sup>

38 Commentary to Guiding Principle 17.

39 Guiding Principle 24.

40 Guiding Principle 23.

	Prioritising Among Relationships	Prioritising Issues Within a Relationship	In Especially High Risk Situations	
The Situation	The Guiding Principles recognise that there may be good reasons, including legitimate resource and logistical constraints, for businesses to prioritise attention to some business relationships over others, and to certain impacts within those relationships.	The Guiding Principles recognise that while business enterprises should address all their adverse human rights impacts, it may not always be possible to address them simultaneously. This could apply to situations when multiple human rights impacts need to be addressed with a business partner.	The context in which products and services are delivered and used, or in which business partners operate could provide reason for enhanced attention and action (because the risk of involvement in abuse is clearly enhanced). The Guiding Principles mention two specific situations:	
			<b>Where national laws explicitly contradict international human rights standards:</b>	<b>Where complicity in gross human rights abuses is a possibility, such as in conflict-affected areas:</b>
Considerations	<p>If companies must prioritise certain business relationships over others for human rights due diligence, or certain issues within a single relationship and no specific legal guidance exists, the key factors for decision-making should be: how <b>significant</b> the risk to human rights is, and the <b>severity</b> of potential or actual adverse human rights impacts.</p> <p>When assessing how significant a risk is, companies should be guided by:</p> <ul style="list-style-type: none"> <li>• <b>The operating context</b></li> <li>• <b>The products or services involved</b> and</li> <li>• <b>Other relevant considerations</b> (including information in the public domain or provided by stakeholders).</li> </ul> <p>Severity depends on the following:</p> <ul style="list-style-type: none"> <li>• <b>Scale</b> of impact: the gravity of impact.</li> <li>• <b>Scope</b> of impact: the number of individuals impacted at present or potentially in the future, and whether the impact is temporary or permanent.</li> <li>• <b>The irremediable nature</b> (or not) of the impact: Impacts that cannot be reversed or mitigated. This may include in particular the rights to life and health, fundamental effects on the welfare of entire groups or communities, gross human rights abuses and disproportionate, and potentially cumulative impacts on the most vulnerable groups.</li> </ul> <p>Prioritising relationships or issues within relationships based on the volume of a contract or the percentage of business a contract represents, may not be the most appropriate approach to prioritisation.</p>		<p>Companies should:</p> <ul style="list-style-type: none"> <li>• <b>Seek ways to honour the principles of internationally recognised human rights:</b> Where the domestic context renders it impossible to meet this responsibility fully, business enterprises are expected to respect the principles of internationally recognized human rights to the greatest extent possible in the circumstances, and to be able to demonstrate their efforts in this regard.</li> </ul>	<p>Companies should:</p> <ul style="list-style-type: none"> <li>• <b>Treat this risk as a legal compliance issue.</b> In the context of business relationships this may include binding contractual provisions or other mechanisms within the relationship.</li> <li>• <b>Understand the concerns and vulnerability of potentially affected stakeholders and engage relevant expertise:</b> This should ideally be done directly with stakeholders or if this is not possible through other experts including from government and civil society.</li> <li>• <b>Report formally:</b> Companies are encouraged to report formally about how they address their human rights impacts. At the same time, this should not pose risks to affected stakeholders.</li> </ul>

A risk-based approach to prioritisation requires a company to make an initial assessment to identify the areas of highest risk, taking into account such factors as the severity of the potential impact, the partner's country of operation, the sector, and the nature of the operation.<sup>41</sup> In all cases, potentially severe human rights impacts should head the list of risks to address first, and any risk of involvement in gross human rights abuses should be addressed as a legal compliance issue.<sup>42</sup> Once a company is satisfied that it has addressed an issue, it should start to address other impacts (even if these are initially judged to be less significant or severe).<sup>43</sup>

### Concept Two: Degree of Involvement

The conduct expected of companies – what the Guiding Principles term “appropriate action” – depends in part on a business's level of involvement with a potential or actual adverse human rights impact.<sup>44</sup>

- **Cause. A business enterprise causes or may cause adverse human rights impacts through its own activities.** For example, an employer adopts discriminatory practices; a factory harms the health of a local community by polluting the environment; an extractive company violates the cultural rights of a local indigenous community by mining a sacred site without obtaining consent; or company employees intimidate union representatives.<sup>45</sup>
- **Contribute. A business enterprise contributes or may contribute to adverse human rights impacts by its own activities.** For example, a company: expressly or impliedly authorises a public or private security provider to use excessive force to break up a protest; provides customer data to a government that requests it for political purposes; provides buildings or equipment to a government or other actors to use on a prison site where inhumane treatment is alleged; imposes unreasonable buying policies that affect safe working practices among its suppliers.
- **Directly Linked. Adverse impacts are directly linked to a business enterprise's operations, products or services through its business relationships.** For example, a company: provides finance to an enterprise for a project that involves illegally evicting people from land; contracts suppliers that use forced labour; sells technology that is used for purposes other than those intended to perpetuate a human rights abuse.

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41 Guiding Principle 17.

42 Guiding Principle 23.

43 Commentary to Guiding Principle 24.

44 Guiding Principle 13a.

45 The illustrations here are based on examples in Office of the UN High Commissioner for Human Rights, *The Corporate Responsibility to Respect Human Rights: An Interpretative Guide* (2012), pp. XVII. At: [http://www.ohchr.org/Documents/Publications/HR.PUB.12.2\\_En.pdf](http://www.ohchr.org/Documents/Publications/HR.PUB.12.2_En.pdf).

	CAUSE	CONTRIBUTE	DIRECTLY LINKED	
<b>APPROPRIATE ACTION</b>	<b>Prevention and Mitigation</b>	Business should <b>cease or prevent the impact</b>	Business should <b>cease or prevent contribution</b> , and <b>use leverage</b> to mitigate remaining impact	Business should <b>seek to prevent and mitigate</b> the impact. Appropriate action determined by a range of factors: leverage, how crucial the relationship is; severity; and consequences of termination
	<b>Remediation</b>	Business should <b>proteate in remediation</b> through legitimate processes	Business should <b>provide for or cooperate in remediation</b> through legitimate processes	Business <b>may take a role in remediation</b>

When a company is “directly linked” to an adverse impact, the Guiding Principles say that appropriate action depends on a range of factors, such as the **severity of abuse**, the amount of **leverage**, the human rights **consequences of termination**,<sup>46</sup> and how **crucial** the relationship is.

- If a business has leverage it should use it and, if necessary and possible, increase it (for example, by offering incentives, building capacity, or cooperating with other actors).<sup>47</sup> (See the discussion of leverage below.)
- If it has no leverage, and cannot increase leverage to help improve the situation, a business should consider ending the relationship.
- When considering whether to end a relationship, a business should consider:
  - The severity of the human rights abuse. The more severe the abuse, the more quickly it needs to see change.<sup>48</sup>

46 Guiding Principle 19 and Commentary.

47 Commentary to Guiding Principle 19.

48 Commentary to Guiding Principle 19.

- The human rights consequences of terminating the relationship. For example, will termination increase the vulnerability of workers or communities, or deprive vulnerable groups of access to basic services?
- If a business decides not to terminate a relationship because it is crucial (that is, both essential and without alternative), it should be prepared to demonstrate a continuing effort to mitigate adverse human rights impacts and should be prepared to accept the consequences of continuing the connection.<sup>49</sup>

**Guidance in the Guiding Principles with regard to levels of involvement does not provide a strict formula or legal test independent of context.** Determining whether a company is contributing to or is directly linked to human rights impact is arguably more an art than a science; there are parameters, nonetheless. In addition, one relationship may involve all three different levels of involvement in impacts (cause, contribute, directly linked), meaning that the distinctions may not always be so neat. The absence of a strict legal test or normative formula is likely to focus attention on a company's ability to show that it has taken reasonable steps to address adverse impacts that it may be involved with, and be prepared to explain any prioritisation of resources and focus. For example, if a company has taken meaningful pro-active steps to address a potential or actual impact, but abuses continue to occur, this suggests that it is "directly linked" to the abuse rather than "contributing" to it. By contrast, a company that has taken no action to prevent or mitigate the same abuse, when it could have done so, is likely to be described as "contributing" to the harm and will therefore face the higher expectations associated with that status.

Companies have overlapping responsibilities with their business partners. The Guiding Principles expect business partners to work together to prevent, mitigate and if necessary remediate harmful outcomes; and to decide who will take specific actions in support of these purposes. Ultimately, the Guiding Principles expect companies to conduct human rights due diligence so that they *know* whether their business relationships are likely to generate human rights impacts, and can respond in a manner that *shows* that they have acted to address them, directly or through their business partners. Procedures and policies, including those relevant to prioritisation, should be in place, regardless of where a relationship sits on the continuum of involvement above.

### Complicity and the UN Guiding Principles

Many companies are used to framing human rights risks associated with business relationships in terms of "complicity", because it is understood by lawyers and non-lawyers alike to convey a sense of partial responsibility for the acts of another.

The Guiding Principles explain that there may be both non-legal and legal forms

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49 Commentary to Guiding Principle 19.

of complicity.<sup>50</sup> “As a non-legal matter, business enterprises may be perceived as being ‘complicit’ in the acts of another party where, for example, they are seen to benefit from an abuse committed by that party.... As a legal matter, most national jurisdictions prohibit complicity in the commission of a crime, and a number provide for criminal liability of business enterprises in such cases. Typically, civil actions can also be based on an enterprise’s alleged contribution to a harm, although these may not be framed in human rights terms.”

With respect to business relationships, in its everyday, non-legal sense, “complicity” may fall somewhere in the “contribute” category, but extend to “directly linked”. In its legal sense, “complicity” is more likely to fit within the “contribute” category, moving towards the “cause” category. This is because international criminal law jurisprudence indicates that the relevant standard for complicity, or aiding and abetting, is ‘knowingly providing practical assistance or encouragement that has a substantial effect on the commission of a crime’.

### Concept Three: Leverage

The Guiding Principles define leverage to mean “the ability to effect change in the wrongful practices of the party that is causing or contributing to the impact”.<sup>51</sup> Leverage is an important concept in the Guiding Principles because it acknowledges that a spectrum of actions may (or may not) be available to a company that seeks to prevent or mitigate adverse human rights impacts, which it has not itself caused. Whilst a business rarely has full control over the actions of a business partner, it may have leverage to encourage the partner to respect human rights and therefore prevent or mitigate adverse impacts with which the business may be involved.

The Guiding Principles recognise that leverage can often be established at the start of a relationship, and this is therefore often an opportune moment for business partners to consider human rights issues and set and communicate expectations with regard to them. It permits all parties to structure the relationship appropriately, by contractual and other means.<sup>52</sup>

Later chapters show how some companies create and apply leverage in their relationships, and the challenges they face when they do so. An *Interpretive Guide* published by the Office of the United Nations High Commissioner for Human Rights suggests how companies and external stakeholders can establish and apply leverage to strengthen the respect of business partners for human rights.<sup>53</sup> Factors include:

50 Commentary to Guiding Principle 17.

51 Guiding Principle 19 and Commentary Guiding Principle 19.

52 Guiding Principles 16 and 17.

53 OHCHR, *The Corporate Responsibility to Respect Human Rights: An Interpretative Guide* (2012), pp. XLIX. At: [http://www.ohchr.org/Documents/Publications/HR.PUB.12.2\\_En.pdf](http://www.ohchr.org/Documents/Publications/HR.PUB.12.2_En.pdf).

#### The Nature of the relationship

- The degree to which a business has direct control over the partner.
- The proportion of work the business represents for the partner.
- The ability of the business to incentivise the partner by promising future work, increasing its capacity, etc.
- The reputational benefits for the partner of the partnership, and the reputational harm that severance would cause.

#### The Contractual relationship

- The terms of contract between the business and the partner.

#### Ability to effect change in the relationship

- The ability of a business to involve other organisations in incentivising the partner (business associations, investor groups, multistakeholder initiatives).
- The ability of the business to involve local or central government in requiring the partner to improve its human rights performance (by means of regulation, monitoring, sanctions etc.).

### Contracts and Respect for Human Rights

**An enterprise cannot contract out of its responsibility to respect human rights. In other words, it cannot use contract clauses to evade its responsibility to know and show that it respects human rights on an ongoing basis, including through its business relationships.**

Contracts enable parties to articulate the purpose, roles, responsibilities, and modalities of how they will work together in relationships. Contracts can promote respect for human rights. They do so, for example: when they clarify expectations about who will act to address potential or actual human rights impacts; or include requirements to comply with human rights policies and codes of conduct, and conduct audit, monitoring or reporting procedures to provide evidence of compliance. Contracts can also be used to allocate risks and liabilities in relationships.

While a contract may allocate responsibilities for action, and liability, the Guiding Principles are clear that each company remains responsible for respecting human rights. A company cannot contract out its responsibility to respect, because the responsibility is rooted in societal expectations, as well as legal instruments that reinforce and enforce it. Accordingly, contracts that shift responsibility and liability to one party, particularly to a business partner that is not capable of carrying out effective human rights due diligence, will not diminish a partner's responsibility under the Guiding Principles and can create a false impression of security. Business partners will still be exposed to the risks created by any adverse human rights impacts associated with their activities, including their activities in association with partners.

# Part II: The Current State of Play

## Introduction

Business relationships develop in many different ways, and certainly do not always proceed in a linear fashion. Nor are they always necessarily bilateral. The following chapters draw on research with companies who participated in this project. The findings therefore do not represent any kind of “average” of business conduct – nor do they necessarily indicate that the companies in the research are the most advanced. The Report instead represents the start of a journey to explore the implications of the Guiding Principles for business relationships.

## Cross Cutting Findings

**Chapter Three: Orienting and Embedding – Internal Company Management of Business Relationships.** This chapter discusses how companies embed human rights considerations in their management of business relationships.

**Chapter Four: Respecting Human Rights Throughout the Business Relationship Cycle.** This chapter considers the life cycle of business relationships, drawing on observations about specific relationships that are discussed in later chapters. While recognising that different forms of relationship evolve in distinct ways, and that each company will define its own path, the participating companies agreed on the following framework:

- **Selecting and Starting the Relationship.** Covers the establishment of a relationship, communicating expectations on human rights, assessment of business partners and country and local contexts, and potential outcomes of relationships.
- **Formalising the Relationship.** Covers the documentation of relationships in contracts, including any human rights provisions.
- **Managing the Relationship.** Covers steps taken during a relationship to ensure that human rights issues are managed and communicated and explores grievance mechanisms.
- **Ending or Renewing the Relationship.** Covers human rights issues that arise when relationships end, and the termination of relationships on human rights grounds as well as incentives for renewal.

## “Relationship Type” Findings

**Chapters Five to Ten** analyse themes in relation to the framework above, and give more detailed information about six specific forms of business relationships: joint ventures; mergers, acquisitions and disposals; suppliers and service providers; licensing and franchising; direct customers; and investor-state relationships.



## Chapter Three: Orienting and Embedding – Internal Company Management of Business Relationships

### **Human rights are firmly on the corporate agenda but compete for management attention in a crowded field of issues relevant to business relationships.**

Almost all the companies that were involved in the research stressed that many issues compete for the attention of senior and middle managers. This highlights the difficulty of getting management to focus on one sustainability-related issue when so many other pressing questions also require action (climate change, the economic crisis, corruption, transparency, biodiversity loss, water shortages, diversity, minorities). Several respondents acknowledged that external factors may be decisive in pushing human rights up the management agenda: shareholder resolutions, a crisis or past crisis, investor attention, unwanted media interest, innovative experiments revealing that human rights policies save costs by reducing delays, etc. As one respondent observed: “the issue is to move human rights from being seen as an obstacle to growth to being seen as an enabler”.

Companies noted how complex it is to start a significant new business relationship. It often involves a range of departments, the completion of a detailed approval process, and a variety of significant risk and issue assessments. Transactional due diligence check lists can run to hundreds or thousands of pages, covering business development, regional analysis, legal, tax and accounting matters, the environment, health and safety (EHS), human resources, security, and procurement. Many external experts may be involved in the transaction, including law firms, investment banks, security experts, political analysts, environmental and social specialists, and topic specialists. How do social issues, and specifically human rights, fit in this crowded space? As one respondent remarked, “on the 1000 page questionnaire, it is hard enough to include legal and regulatory risk, let alone things that aren’t always requirements like social considerations”.

### **The integration of human rights considerations into business relationships benefits from clear leadership and coordination of knowledge and expertise across relevant functions in the company.**

Several of those interviewed felt that it was crucial to appoint a focal point who is able to find human rights information, promote the human rights agenda, and track its relevance across many company functions. Numerous staff may be involved in the initiation of business relationships (business development, audit, legal, environment). Responding to different drivers, they may work at cross-purposes. Though many of the risks these teams are managing have underlying human rights aspects, this may not be apparent to them.

No “one size fits all” approach is appropriate for integrating human rights into company processes. Most respondents believed that achieving coherence across policies and across relationships, as the Guiding Principles recommend, remains a challenge that companies will not overcome without a wider array of tools, including: more human rights champions inside the company, a sound mix of training, tools, incentives and oversight systems, and their application to both the company’s operations and its relations with partners. Respondents noted that while business development teams need to understand the relevance of social issues, sustainability specialists also need to be sensitive to

commercial drivers. Several said that integrating human rights is not a unique case. Achieving vertical and horizontal integration and coordination is a structural challenge for complex organisations in many areas.

Procurement and sourcing teams may include team members (sometimes with their own legal and support staff), who follow supplier relationships from start to finish. However, few companies establish similar “cradle to grave” arrangements for the other relationships covered in the research. For joint ventures, or mergers and acquisitions, companies may appoint a business development team to find and develop new relationships, or a specialised counsel to initiate mergers and acquisitions or joint ventures; but they hand over the relationship once it is underway. Some human rights issues, such as discrimination, are well known to a wide range of corporate lawyers. Beyond these more familiar issues, different experiences with legal counsel were reported. Some companies take care to appoint lawyers who are familiar with human rights, while others have legal teams who feel that human rights do not present a risk, provided the company complies with national laws; they therefore leave the management of human rights issues to others. Nevertheless, companies need to be cautious in understanding the gaps between national law and international human rights standards as it is often around those gaps that key challenges concerning the corporate responsibility to respect appear.

Current contracting processes may cause discontinuities in human rights risk management and follow up. Those who negotiate with potential business partners may not be those who implement operations. The negotiating team may address human rights issues when it opens new business relationships, and include them in contracts, but its approach may not always be aligned or incentivised to be aligned with the team responsible for mitigating risk or managing the business relationship. Achieving a consistent approach, and tracking performance as relationships are handed from one team to another, requires clarity and consistency between teams.

**Companies prefer to bring human rights into business relationships by embedding them in existing management systems.**

Respondents indicated that their companies clearly prefer to integrate human rights into existing company systems, including those relevant to relations with business partners, rather than create stand-alone approaches. They perceived that by doing this it is easier to address human rights as part of routine business. Given the wide spread of human rights issues, their integration may affect a range of management systems in large and complex companies, including human resource systems, planning, environment, health and safety, risk management, compliance, sales, and procurement.

At the same time, several respondents noted that companies need to explain to their staff how human rights fit within their management systems, if staff are to know and show that the company is addressing human rights issues that arise. Innovation and sensitivity to change were also considered important. As one participant commented, a balance needs to be struck between consistent compliance with management procedures, incentivising innovation, and developing a capacity to manage emerging human rights challenges.

Many respondents recognised that the vast missing middle – staff not in departments or functions that have become familiar with and skilled in human rights – is a key target for companies that want to respect human rights, including in their business relationships. They raised questions about the extent to which such staff truly need to understand human rights and appreciate what human rights mean in practice – beyond questions in a checklist. Some noted that, if human rights are integrated in existing management systems well, companies do not need to provide specific human rights training to the majority of their staff. Skills-based functional training can equip them to implement company processes. More extensive training can then be provided to a smaller core team of staff and leaders who need to understand human rights policies and their implications in more detail. However, as several companies noted, without simple levels of specific training, staff may not be able to identify emerging human rights issues that may arise in their local context. Other companies recognise that, even when human rights are deconstructed in functional-specific instructions, it is still a challenge to understand how they interact with business and, by extension, business relationships. Some provide broader awareness-raising programmes to increase staff buy-in.

All respondents recognised that training is needed, and some companies are planning or have started to train staff. It is recognised that training needs to be adapted to specific audiences. A tailored approach focused specifically on human rights reduces the difficulty of integrating as complex a subject as human rights in the work of organisations that have tens or hundreds of thousands of staff.

### **Integration within Management Systems**

A management system assists a company to plan, do, check and act in order to ensure the effectiveness of its action, and improve or alter its performance and approach. Listed below are some of the internal systems that companies commonly use to integrate human rights, recognising that individual companies will tailor their approach to their needs:

- Overall risk management system.
- Human resources management.
- Environment, health and safety management system.
- Security management system.
- Procurement management system.
- Sales procedures.
- Community Relations / Public Relations.

Specific fields of operation may generate an additional plethora of specific planning frameworks, operating procedures, standards, performance indicators, assessment processes and feedback loops that are relevant to embedding human rights in company systems.

Embedding new concerns across management systems operating in tandem is inherently complex for many issues and not just human rights. It requires horizontal integration (ensuring coherence across policies and procedures so that staff in a diversity of departments and functions receive consistent instructions, understand their implications, and are trained and incentivised to act in ways that support the company's policy), and vertical integration (clear definition of who needs to be involved from headquarters to field level and up again to make action on human rights effective). These two objectives require alignment of strongly embedded management system structures. At the same time, the successful integration of new concepts can produce effective action and aligned decision-making across a company.<sup>54</sup>



54 See also: Arpel, «Corporate Social Responsibility Management System Framework» (2011), p. 2-6, at <http://www.arpel.org/library/publications/group/corporate-social-responsibility-management-system/>, which served as the basis of the chart.

**There is a recognition that building capacity amongst business partners to manage human rights, rather than just to comply with codes of conduct, is a more sustainable approach.**

Just as companies are working on integrating human rights into their own management systems and developing relevant capacity, there is a clear trend in supporting business partners in developing and evolving their management systems and capacity. Participants generally agreed that, in the long run, their companies will manage human rights-related impacts associated with their business relationships more durably if capacity is built in all relevant areas, both in the company and in business partners. At the same time, many business partners have low awareness of human rights issues, and companies recognise that they need to translate the Guiding Principles into specific policy documents, and establish mechanisms to measure and track the performance of partners with whom they have relationships, in order to know and show that they are respecting human rights and meeting expectations.

**If companies send conflicting messages to their partners about their human rights expectations and requirements, this undermines the commitment of both parties.**

Several respondents drew attention to conflicts that had arisen because companies had competing priorities or their corporate priorities differed from their performance incentives. For example, procurement departments are often incentivised to select business partners who offer the lowest price, and they do not necessarily take account of their company's sustainability requirements, including its human rights policies. In consequence, companies communicate conflicting expectations to their business partners and may undermine their own policy commitments. Some companies have taken steps to address such conflicts. Several apply two sets of criteria when they select business partners. To ensure that price does not automatically trump other considerations, one focuses on quantitative and the other on qualitative aspects, enabling the company to take its different requirements more fully into account. (See Chapter 8 on Suppliers and Service Providers).

Outside procurement, it is less clear what companies are doing to remove internal inconsistencies of practice regarding human rights. One company lines up personnel performance incentives with broader company policy, linking bonuses for management staff to broader EHS performance. Another is starting to consider the impact of its business practices on the human rights performance of its business partners, by examining, for example, the discriminatory effects of its bidding procedures. But, as the first *State of Play* report noted, this is recognised to be a challenge.<sup>55</sup>

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55 See footnote 19.

**Faced by vast and complex value chains, companies constantly need to prioritise their investments of time and resources. Some are developing internal processes to ensure they give appropriate attention to human rights.**

A key challenge is to reframe risk assessments, changing their focus from internal to external, in order to focus on adverse impacts on people; most company risk assessments highlight risks that a company's actions and relationships pose to the company rather than to others. A start has been made in re-focusing the risk lens in some relationship types (for example, customers, joint ventures and supply chain). A few companies reported that their supplier screening programmes have started to look more deeply at areas, sectors or suppliers that present higher human rights risks. However, they recognised that such initiatives can generate "counterintuitive" results where procurement systems have traditionally been driven by volume and price alone and that therefore may take time for staff to adjust to. In some cases, companies are changing their approach to a broader range of relationships, including customers and joint ventures.

In deciding which suppliers to focus on, one company prioritises suppliers that are located in high-risk countries *and* industries associated with human rights abuses. One company is working with the Danish Institute for Human Rights to develop an explicit human rights evaluation grid for suppliers. At the same time, it is undertaking much broader evaluations of its suppliers and service providers, with the aim of developing a methodology that will enable it to rank suppliers that potentially present the highest human rights risks.

**Companies that start by addressing human rights in their own operations can address the human rights performance of their business partners with greater clarity.**

The research suggested that companies that have thought deeply about their own human rights impacts, and developed effective internal policies to address them, are more advanced in assessing their business relationships. This is because they have identified which rights may be most salient and steps that they can take to prevent or mitigate impacts; as a result, they are better able to avoid involvement with adverse impacts associated with their business relationships. They may better understand what questions to ask in the first place of prospective partners.

**Companies are actively learning from their efforts to integrate environment, health and safety, and anti-bribery and corruption concerns in their management systems and business relationships.**

Many companies reported that anti-bribery and corruption is a governance issue that they track through business relationships. In the last 10 to 15 years, the main driver for changes in corporate behaviour with regard to corruption has been aggressive enforcement of domestic anti-corruption legislation, with extraterritorial effect, reinforced by international OECD and UN conventions that have been instrumental in prompting effective domestic legislation. The companies noted that, to meet legal requirements and build a culture of compliance, they have put systems in place that

are often extensive and include their business partners. One respondent noted, “human rights feels like where corruption was ten years ago”.

Respondents also drew comparisons with EHS policies. Companies in industrial sectors noted that they often spent extraordinary sums on worker safety, because this has become an ingrained value. “Safety gets its own dimension because it is about the impact – one life lost is not okay” as one respondent noted.

Action in both areas is no longer a novelty but an integral part of a company’s ethos and systems. Anti-bribery and corruption concerns were translated quite rapidly into hard law, at national, regional and international level. US, German and UK anti-corruption laws all emphasise (to varying degrees) corporate compliance procedures, including anti-corruption due diligence and contractual provisions. (See box below.) Environment and health and safety, while also grounded in hard law, have taken a management approach, as companies have developed often extensive management systems. Which path human rights take, including potentially their own unique path, will depend on a number of factors, including a well-reasoned business case (see Chapter Eleven: Conclusion and Ten Themes for the Next Five Years).

### **Anti-Bribery and Corruption: Parallels to Human Rights?**

A company convicted of bribery may face very serious penalties. This has a major influence on compliance. Large international companies increasingly adopt global policies and procedures based on the highest legal requirements (with small variants for specific countries, such as different monetary thresholds). As a result, companies have addressed bribery and corruption at all levels: senior management has issued clear instructions; the subject is included in personnel performance standards; specific due diligence systems have been designed; corporate approval systems require mandatory sign-offs; large investments have been made in tools and training and human resources (with one company noting it employs hundreds of compliance lawyers across the organisation).

Under UK law, companies prosecuted for corruption can argue that they had put ‘adequate procedures’ in place. In the US, this defence is a mitigating factor in sentencing. Issuing guidance on this matter, the UK government has set out six principles that should inform procedures designed to prevent the occurrence of company bribery. They contain elements that mirror the policies and procedures set out in the Guiding Principles: a policy commitment; involvement of the organisation’s top management; risk assessment procedures; due diligence; governance of business relationships; transparency and disclosure of information; communication and training; and monitoring, review and evaluation of effectiveness. Will the fact that companies are familiar with such processes, plus reputational risk and the threat of litigation, promote effective human rights due diligence?

Participants noted that the main challenge is not designing policy, but establishing an effective system that permeates throughout the business but does not cause unnecessary disruption to the business. One participant described a multi-layered approach:

- A clear **policy** on no corruption through or by business partners.
- **Screening** through IT-based tools. As a first step key data is entered on the due diligence questionnaire for a specific transaction. Based on this, there is a risk assessment performed in the tool with scoring containing topics such as previous experience, purpose of the relationship, nature and interaction with government officials, the Transparency International Corruption Index rating for the country, payment terms, etc. Scoring results in low/medium/high risk.
- **Risk categorisation** then determines the scope of the due diligence questionnaire. Without certain information or documentation the transaction cannot proceed. There are eight red flags in the system that lead to specific mitigation measures.
- **Approval** is determined by the risk category. There are different contractual requirements and monitoring rights depending on the risk category, with additional steps for higher risk. The final decision remains with the business team.
- **Periodic Review**. The due diligence is valid only for a limited period of time (2-3 years) and must be renewed thereafter.

## Chapter Four: Respecting Human Rights Throughout the Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**Corporate values and business principles are the foundation of efforts to integrate human rights in business relationships.**

One of the most consistent messages to emerge from the research is that corporate values strongly shape the selection and content of business relationships, especially ones that are strategic and commercially significant. When companies adopt human rights values, a key step is the development of a human rights policy statement, as recommended in the Guiding Principles. Unsurprisingly, company policies and codes of conduct that reference international human rights standards were the most common tool that companies used to communicate their expectations to business partners. Companies rarely ask business partners to adhere to international standards without making reference to their own policies. Respondents recognised that one of the key challenges for companies is to “translate” their corporate values into language that shows how they can be applied in business relationships.

A second clear message is that companies are increasingly working with their business partners to consolidate their value chains and build long-term value for all parties. This is especially true of their relations with large and important partners. This creates an opportunity to share values. Embedding human rights in this process is one way to communicate expectations and integrate human rights in business relationships. At the same time, nearly all businesses highlighted the difficulties of working with partners whose capacity, resources, or understanding of the operational and legal implications of those values is limited. Several noted that more “mature” values, like safety and quality, have been successfully established by a variety of means (training, broader capacity building, incentives), demonstrating that it is possible to change partners’ approaches and ultimately influence their values.

**While their codes of conduct for suppliers commonly make explicit reference to human rights, only a few of the companies surveyed have explicit statements on human rights expectations with regard to other types of business relationships.**

Some companies apply specific policies or codes in particular business relationships. In most cases, these concern supply chains, and include codes of conduct for suppliers. Others do not have separate codes of conduct but expect business partners to respect their business principles and apply the company’s policies or their equivalent, thereby applying to partners standards which the company applies to its own operations. A few companies specifically extend their corporate policies to joint ventures; in most instances, these companies distinguish between majority- and minority-owned joint ventures and apply corporate policies more strictly to the former. In the case of mergers and acquisitions, the research suggested that companies that become the majority owner normally expect acquisitions to adopt their core principles and policies, setting transition periods and deadlines to ensure alignment and compliance.

**Companies tend to focus on particular human rights that are relevant to their industry or business relationships. They are starting to adopt a wider perspective on human rights and business risks.**

Usually starting with a desk-based assessment of risk, companies tend to focus initially on selected rights that they consider to be especially relevant to their operations and relationships. Policies that explicitly target business relationships, such as supplier codes of conduct, reflect this pragmatic approach: they tend to establish standards of conduct with regard to particular rights that are deemed most relevant to the relationship. Though codes are often based on broader international human rights standards, their operational language implicitly focuses on specific rights. For instance, supplier codes of conduct commonly refer to the eight core ILO conventions (such as those relating to forced and child labour). They often adopt ILO definitions and requirements on specific rights (though not always fully) and make reference (not necessarily consistently) to underlying ILO or other human rights standards. Some companies include a wider range of human rights in their business partner codes – community issues, for example, or equal rights protection for lesbian, gay, bisexual and transgender individuals. Several companies noted that they adopt highly general language and principles to avoid having to revise company and supplier codes at very frequent intervals or whenever new issues arise, which would require repeatedly securing the support and consent of senior managers.

At the same time, the research highlighted that business relationships and associated human rights issues are highly dynamic, often requiring companies to respond with flexibility and look outside the formal terms of their codes or policies. Companies are addressing this problem operationally and procedurally rather than by reforming their codes, again because they do not wish to regularly revise their standards. Companies warned that it was important to avoid a “box ticking” approach to risk-management, because it is likely to overlook local contextual factors (some of which may be influenced by the conduct of business partners) or external factors (regional or country issues), and this may expose companies to the accusation that they pick and choose rights they find it convenient to respect.

### **All Versus Some Human Rights: Finding the Balance**

A key message of the Guiding Principles is that businesses can have an impact on a wide range of human rights.<sup>56</sup> Rather than defining that set of rights, the Guiding Principles take a practical approach: they suggest that businesses should carry out human rights due diligence, focusing on those rights that are most relevant to their particular context, operations, and partners, and prioritising action with respect to impacts that are likely to have the most severe effects.<sup>57</sup> This means that businesses can concentrate first on the rights that are most relevant (to their context, sector, operations and relationships) while working out an appropriate timeframe and

56 Guiding Principle 12.

57 Guiding Principle 17.

approach to other relevant but less severe impacts. Recognising that human rights situations are dynamic, the Guiding Principles call for a correspondingly dynamic system of regular assessment.<sup>58</sup>

Companies are balancing the need to focus on all human rights, with the need to be specific and focused in different ways:

- **Codes of conduct and policy.** Some companies make a broad commitment to the International Bill of Rights while others focus on a narrower and more specific set of rights.
- **Assessments.** The practice of some companies is to take a broad approach to assessment, shaped by circumstances on the ground. Other companies audit against a specific code of conduct as part of their due diligence.
- **Contracts.** Some companies insert specific provisions on human rights in their contracts, while others use much broader language. Some companies require compliance with a specific policy or code, while others focus on procedures (regular assessments, or management systems) to oversee human rights.

**Because not all business partners understand or value the language and content of human rights, companies adopt a variety of communication strategies to discuss human rights with their business partners.**

Respondents identified various strategies that companies employ to start conversations on the subject of human rights with business partners. Companies:

- **Use company policies to open the door.** Companies highlight human rights references in their policies. This is an effective approach if companies have incorporated human rights in their policies, but cannot be a leverage point for companies that have not.
- **Highlight the business opportunity.** Companies present human rights as a positive business opportunity that helps to retain and increase business.
- **Take a Trojan Horse approach.** Companies initially raise less controversial sustainability issues with business partners, such as environmental protection or health and safety, before introducing social sustainability and eventually human rights.
- **Identify shared interest in a well-functioning business environment.** Companies note key problems in the business environment that companies should work together to eliminate or reform, because they cause operational delays or have other financial impacts, or generate risks (of legal non-compliance or reputational harm, for example). Several respondents said this tactic has been effective on corruption issues, because business partners do not want to imply that they do not care about corruption. This might be an effective approach to human rights abuses that are widely condemned, such as child or forced labour.

- **Emphasise leadership.** Companies make the argument that, if the business partner wants to be seen as a leader in its sector or country, it should pursue a sustainable approach that includes respect for human rights.
- **Demonstrate their own commitment.** A company leads by example, showing that it asks partners to do no more than it expects of itself.
- **Reference Multistakeholder Initiatives (MSI) or third party standards like the Equator Principles.** This approach provides effective leverage over business partners that are committed to, or are required to comply with, third party standards.
- **Build creatively on culturally relevant concerns.** One respondent used concerns about and the need to prevent potential protests as a reason for providing longer-term consultation and better resettlement in line with human rights.
- **Turn human rights from a “red” to a “green” flag.** Companies explain to business partners that giving attention to human rights can tap into employees’ values about how they want the company to behave; the effect is to transform human rights into a positive opportunity rather than a signal of problems in operations.

Almost all the companies noted that, in discussions with business partners, it is important to communicate clearly and establish expectations of the relationship early on. This avoids surprises later, improves the capacity of both sides to address the issues, and gives the parties time to work on problems as their relationship is formalised and becomes operational.

**An increasing number of actors influence company expectations, including customers, business partners, multistakeholder initiatives, investors and governments.**

Many of the companies noted that they are questioned more often about their human rights approach when they meet business partners and customers. Where companies have competing policies or codes, it can lead to a “battle of standards” in which companies compete to refer to their code in contracts. Some companies regularly benchmark their standards against peers to avoid this. These trends remind management that a company is increasingly required by its own customers to show that human rights issues are important to it.

Companies involved in the project recognised that legislation may help to set standards within a country, but law is not likely to begin replacing individual codes or contracts unless it is enforced robustly by government. Local content requirements can play a significant role in determining who a business must choose as a business partner. Local content rules requiring compliance with national human rights legislation can provide incentives for compliance by local business partners they might otherwise not have had.

### **Multistakeholder Initiatives (MSIs) and Business Relationships**

The number and range of MSIs that address human rights continue to expand, signalling that collective approaches can help solve some of the broader societal challenges that companies face when they seek to address human rights in the context of their business relationships. MSIs serve a number of functions. They:

- **Set expectations.** This is increasingly true for businesses working in certain sectors (the Roundtable on Sustainable Palm Oil, the Kimberley Process) or contexts (Voluntary Principles on Security and Human Rights), or on specific issues (the Extractive Industries Transparency Initiative).
- **Build practice on due diligence.** MSIs enable companies to pool their experience of dealing with human rights challenges in specific sectors and particular relationships. This learning can help clarify the concept and practice of due diligence, create benchmarks, etc.
- **Influence the content of contracts.** Whether or not compliance with MSI requirements is mandatory for those who join them, companies are adopting MSI requirements in some of their contracts with companies involved in the same MSI and with business partners. MSIs are helping companies to resolve some of the challenges that arise when they allocate operational responsibilities across business relationships, and define the (human rights) duties of their business partners.
- **Remediation.** The next challenge is to think more deeply, in the context of the UN PRR Framework, about what MSIs can do to improve access to remedies. Can they develop models? What processes for doing so are appropriate? Some MSIs have already started down this path.

*Understanding the issues – Assessing human rights impacts in business relationships*

**Few companies have internalised or operationalised the idea that they should consider all human rights, rather than a selected number, in their human rights assessments.**

The research indicated that, when assessing prospective business relationships, companies take a range of approaches to internationally recognised human rights.

- Some systematically and methodically examine and discuss the relevance of each right to their business and their business partners.
- Some consider only those human rights that are typically relevant to their business sector.
- Some compile and consider a checklist of relevant issues.
- Some select a sub-set of rights, on the grounds that it is too hard, too confusing or simply impractical to consider all human rights.

All companies participating in the research agreed that companies are on a learning curve that may gradually lead them to address a broader range of rights, through sharing best practice, participating in multistakeholder initiatives or peer industry associations, attending learning events, and sometimes by “getting their fingers burned” as one respondent noted.

Respondents identified three areas where methods for assessing business relationships, in context, are likely to evolve.

- More detailed assessments of and for business partners who operate from or in higher risk countries or sectors.
- More detailed requirements around human rights being developed to screen business partners – such as pre-qualification criteria in procurement, and self-assessment criteria.
- Additional requirements in contracts, for example, that might require business partners to conduct periodic assessments themselves.

### Transactional Due Diligence and Human Rights Due Diligence

Human rights due diligence shares many core functions with transactional due diligence. They both:

- Enable partners to identify red flags early.
- Highlight issues that partners need to address (prevent or manage).
- Identify opportunities for partners to improve performance.
- Help to establish the cost of relevant preventive and mitigation actions.

Transactional Due Diligence	Human Rights Due Diligence
✓ <b>Timing.</b> At the start of a relationship.	✓ <b>Timing.</b> Throughout the relationship.
✓ <b>Scope.</b> Investigation of potential risks to the business from the relationship.	✓ <b>Scope.</b> Investigation of potential risks to people from the relationship.
✓ <b>Scale.</b> Depends on the potential risk to the business.	✓ <b>Scale.</b> Depends on the risk and severity of potential or actual human rights impacts on people.
✓ <b>Response.</b> Often stops at the point of identifying corrective action.	✓ <b>Response.</b> Includes management of the potential and actual impacts identified. Management in turn includes: the response; its integration in company operations; tracking and communicating results.

**Company checks on business partners touch on human rights, but rarely do so explicitly.**

Almost all the respondents make inquiries of various kinds into prospective partners' past and present performance with respect to certain social issues. These routinely cover corruption and may cover human rights, but rarely examine human rights separately. Instead, companies tend to integrate human rights inside other inquiries into EHS, criminal history and legal compliance, and searches for pending or threatened litigation on labour, health and safety or discrimination issues. The Guiding Principles make clear that a company is responsible for its involvement with adverse human rights impacts that are generated by operations, products or services associated with its business relationships; it is not responsible for its business partners or for actions they take that have no link to the company. At the same time, it is clear that a business partner's track record is an important indicator of a partner's commitment and capacity to address human rights issues.

Several respondents noted that they might use the internet to check a business partner's record on specific human rights issues. Most would use the Business and Human Rights Resource Centre's web site<sup>59</sup> to do so, but respondents generally felt that more sources should provide relevant and reliable human rights information about companies. Some commercial sources of related information were cited but these were too limited in many markets and not always accurate, requiring companies to turn to bespoke research or third party commercial providers. Even less information is publicly available on smaller companies, especially from developing countries that lack a well-functioning press. Respondents felt this problem reflected the state of social research, which is still not fully accessible or understandable to non-specialist researchers; and human rights are even less so. The nature of social issues and human rights issues make many traditional forms of quantitative risk assessment unrealistic; but engineers, scientists, finance analysts and business managers may not be comfortable if they are invited to assess social and human rights impacts on the basis of information derived using inherently qualitative methodologies.

On the other hand, firms from developed countries that operate in countries with well-developed economies and legal systems have well-established arrangements for assessing the record of business partners and significant customers on bribery, corruption and money laundering. Many companies apply detailed Know Your Customer (KYC) assessments to assess business partners, benchmarking them against international law (on corruption and sanctions) and national criminal and labour law. Some are beginning to tweak their KYC and supplier assessments to cover certain human rights issues. The benefit of using these systems is that they are likely to be well integrated and accepted within the company.

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59 <http://www.business-humanrights.org>.

**Companies generally assess the human rights impacts of operations, products or services with which they are involved through their business relationships, and the track record of business partners.**

Some companies indicated that they clearly understood it was necessary to look at the potential outcome of business relationships: at the impacts of operations, products, or services associated with a business relationship; at their actual or potential effect on human rights; and at the company's link to those impacts and effects. The clearest example came from extractive companies. They typically conduct environmental and social impact assessments, which may cover certain human rights impacts of their larger operations. Many of these are undertaken with business partners.

**Country assessments of human rights risk are frequent in only a few kinds of business relationships (suppliers, customers, joint ventures). Large transactions tend to receive more attention.**

Several respondents assess the risks of doing business with partners based or operating in certain countries; they mainly assess larger projects and more significant partners. As the Guiding Principles recognise, context is important. Some of the companies consulted operate in many countries or regions and have acquired in-house expertise on country risk. Many seem to use other sources of analysis relevant to human rights to help them build a picture of potential human rights concerns (political economy studies and indexes on security, political risk and corruption).

Companies described a wide variety of responses to countries that are considered challenging because of their governments' attitudes to human rights, or because of conflict or post-conflict concerns. Some companies require a potential target company to end their operations in countries of concern before the acquisition is completed. Others are prepared to do business in challenging environments if they feel they can make a positive impact in association with local business partners.

**Companies undertake a range of actions to prevent and mitigate human rights impacts that are associated with their business relationships.**

Companies use different techniques to prevent their business relationships from giving rise to human rights abuses. They:

- Screen out problematic partners or operations before they enter any relationship.
- Pre-qualify suppliers on company criteria, to ensure that those who obviously do not or will not meet company standards are not contracted.
- Require partners to divest from problematic operations before they are acquired or become a joint venture partner.

Certain types of relationship (for example, those with security forces) involve higher risk, and these are often processed specifically, via integrated screening programmes, contractual provisions, monitoring, and reporting. Certain human rights issues (child labour, often forced labour) are considered "no go" areas. They are screened out directly, or dealt with by imposing immediate corrective action or introducing specific material breach clauses in relevant contracts.

Many companies said that assessment processes should identify specific mitigation steps that will bring a business partner's operations up to standard, or address the concerns identified. In many cases, these mitigation steps could be incorporated in an action plan. While such an approach is consistent with a strategy that seeks to address human rights by building upon and leveraging internal systems, in many cases the responsibility for following up on human rights mitigation steps is spread across different departments and several action plans, and without a specific person being assigned responsibility for follow up. Added together, these limitations mean that companies sometimes assess and respond to some but not all of the human rights impacts that are linked to their business relationships.

**How often and under what circumstances companies involve outside stakeholders to assess the human rights impacts of their business relationships varies by industry and type of relationship.**

Companies that manage and develop projects with a large physical footprint, like those working in the extractive sector, generally apply a developed methodology on environmental and social impact assessments that are usually interactive and consultative. Apart from these processes, it is unclear when and how businesses involve external stakeholders in their assessments of business relationships (even the more significant ones). Some respondents stated clearly that consultation on human rights issues is a responsibility of the local business partner. Others may involve country experts in their reviews. But none (with the exception noted above) said that they made use of specific procedures to consult local stakeholders about their business relationships or to take stakeholders' views into account when they assessed the impact of their business relationships on human rights.

### **Involving a Range of Stakeholders and Experts**

Companies may involve a range of stakeholders in their human rights due diligence processes.

- **Commercial and contracted services.** A number of companies use commercial or contracted services in their human rights due diligence, usually to help them assess country risk.
- **Advisors: lawyers, consultancies, accountants.** A number of law firms are developing expertise in human rights law and practice in order to improve their advice to clients on these issues. With a burgeoning business and human rights services/consultancy market ranging from specialised consultancies to large accounting firms, companies have access to other experts as well to assist them in their due diligence.
- **National Human Rights Institutions (NHRIs).** Many NHRIs focus increasingly on business and human rights issues, and some are able to handle public complaints about business activities. The International Coordinating Committee

of NHRIs adopted The Edinburgh Declaration in 2011, which provides NHRIs with specific guidance on business and human rights issues.<sup>60</sup>

- **Civil society.** Businesses interact with civil society on many levels: from one-off consultations to long-term association; through bilateral relationships and multilateral collaboration (in MSIs, for example); on a spectrum from cooperation to confrontation; on projects, themes and broader societal issues (such as economic policy). Some Non-Governmental Organisations (NGOs) now have considerable experience in this field (on working conditions in supply chains, for example), while at the same time a much wider range of NGOs is now engaging on business issues and highlighting the impacts of business on human rights.<sup>61</sup>
- **Governments and embassies.** A number of governments are increasingly equipping themselves with policies and staff to deal with business and human rights issues. The European Union has invited its 27 member states to develop specific national action plans on business and human rights. Some governments provide specific training to enable their embassies to deal with company requests to intervene on their behalf with host governments.
- **UN expertise.** The UN Working Group on Business and Human Rights is composed of five independent experts appointed to promote the effective and comprehensive dissemination and implementation of the Guiding Principles.

Several UN Special Rapporteurs (SRs) on human rights are beginning to incorporate and build on the Guiding Principles, exploring their implications and providing guidance on their application to their mandates.

- The **SR on the human right to safe drinking water and sanitation** released a report on private sector participation in water and sanitation provisions, and continues to consider the role of businesses.<sup>62</sup>
- The **SR on the Right to Food** produced a set of guiding principles on human rights impact assessments of trade and investment agreements, and actively reviews the impact of agribusinesses and large-scale acquisitions of land.<sup>63</sup>
- The **SR on Indigenous Peoples** produced a report focusing on the extractive industries and is considering developing further guidance.<sup>64</sup>
- The **SR on the promotion and protection of the right to freedom of expression and opinion** released a report that examined key trends and challenges with respect to the internet, including private sector impact.<sup>65</sup>

60 At: [http://www.ohchr.org/Documents/AboutUs/NHRI/Edinburgh\\_Declaration\\_en.pdf](http://www.ohchr.org/Documents/AboutUs/NHRI/Edinburgh_Declaration_en.pdf).

61 At: <http://www.business-humanrights.org/>.

62 At: <http://www.ohchr.org/EN/Issues/WaterAndSanitation/SRWater/Pages/PrivateSector.aspx>.

63 At: <http://www.srfood.org/>.

64 At: [http://www.ohchr.org/Documents/Issues/IPeoples/EMRIP/Session5/A-HRC-EMRIP-2012-2\\_en.pdf](http://www.ohchr.org/Documents/Issues/IPeoples/EMRIP/Session5/A-HRC-EMRIP-2012-2_en.pdf).

65 At: [http://www2.ohchr.org/english/bodies/hrcouncil/docs/17session/A.HRC.17.27\\_en.pdf](http://www2.ohchr.org/english/bodies/hrcouncil/docs/17session/A.HRC.17.27_en.pdf).

### **There is an emerging practice of calculating the costs and benefits of addressing human rights in business relationships.**

Different approaches to costing human rights risks emerged in the research. Some companies:

- Identify the cost of bringing business partners up to company standards.
- Calculate the cost of delays and other negative effects of human rights problems associated with a business partner.
- Cost only those human rights issues that could lead to legal liability. Some respondents felt that costing based on reputational risk is too ambiguous.
- Doubt the ability to cost the risk of involvement in human rights problems when many business partners are still developing an understanding of human rights.
- Push back on costing human rights because they are values, and non-negotiable.

Some respondents said their companies are starting to quantify the longer-term benefit of preventing human rights abuses, and applying those benefits internally to justify cost outlays. In one case involving a large infrastructure project employing many migrant workers, the company required all contractors to provide housing to a certain standard and specified working conditions. This increased its costs, but these were recouped by measurable falls in illnesses and accidents and increased output. Other respondents noted a trend in procurement practices: companies are figuring out how they can incentivise the company's human rights requirements in their procurement processes. The result is that price is no longer the only driver (though it often remains the primary one). When it assesses suppliers, for example, one company weights the risk of child labour separately from price.

Human rights issues are rarely deal breakers in business relationships. However, several respondents noted that corruption as well as health and safety issues can be deal breakers in a variety of different relationships.

### **Formalising the Relationship**

#### **Despite the challenges, companies increasingly see advantages in including human rights concepts and language (in some form) in contracts with business partners.**

Respondents noted that the insertion of references to human rights in contracts generates several operational challenges. For example, human rights may be seen as "too imprecise to withstand the scrutiny of lawyers". Discussion revealed that more work needs to be done to connect the content of human rights to business operations, because both the business and the human rights communities hold misconceptions about how businesses can have an impact on particular rights. A number of companies have done or are now doing research in this area (in some cases with the Danish Institute for Human Rights). Others have not yet started the journey.

Respondents identified several benefits from including human rights in contracts with business partners. Doing so:

- Clarifies the expectations of business partners and the company.
- Gives policy commitments teeth, reducing the risk that policies become a communications exercise.
- Provides companies with leverage for managing human rights issues if they arise. Contract provisions are less about termination and more about being able to require action “if something goes wrong”.
- Provides a legal basis for termination on human rights grounds, recognising that it may be impossible to terminate a business association on such grounds in the absence of a contractual provision that foresees this possibility.
- Creates incentives for business partners to address human rights.
- Identifies processes for prevention, mitigation, response and remediation.
- Makes it possible to address explicit complicity concerns.
- Makes clear that the business partner is expected to share responsibility for human rights issues that arise, and any liability associated with them.

**“Well-known” human rights concerns (notably forced and child labour, and security issues) are often referenced in contracts, directly or via references to company policies or codes of conduct.**

Work on the right to life illustrates that an international human rights standard can be “translated” into contractual terms (see box below). This approach is an example of treating potential gross human rights abuses as an issue of legal compliance, including through contractual provisions.

### Translating Human Rights into Contracts

The **Voluntary Principles on Security and Human Rights (VPs)** were developed by an MSI that involved selected governments, businesses and civil society organisations. The MSI aimed to provide companies with guidance in maintaining the safety and security of their operations while ensuring respect for human rights and fundamental freedoms. Several aspects of the VPs process are of interest to other types of business relationship, even in the absence of a formal MSI.

- It brought the private sector, civil society, and governments together around the table to address a particularly challenging business relationship (working with security forces).
- It developed tools that help companies to apply relevant principles.<sup>66</sup>

66 At: [http://www.voluntaryprinciples.org/files/VPs\\_IJT\\_Final\\_13-09-11.pdf](http://www.voluntaryprinciples.org/files/VPs_IJT_Final_13-09-11.pdf).

- It highlighted the importance of clarifying what is expected of security providers, by Memorandum of Understanding (MOU) or contract.
- It demonstrated that at least some human rights (the right to life, freedom from torture, freedom from arbitrary detention) can be translated into specific documented steps, (including requirements around monitoring performance), which can be included as contractual provisions.

### **How the Right to Life is Incorporated into a Contract**

The VPs set out several performance standards for private security contractors that can be imported into contracts. They include:

- **Use of lethal weapons.** Prohibited as a rule; their use requires justification complemented by a detailed listing of the types of weapon permitted, rules on the use of force, training requirements, and notification of incidents.
- **Incident reporting.** Sets out the procedure a contractor must follow to report to the authorities and to the company.
- **References to international law enforcement principles.** These include the VPs, but also the UN Code of Conduct for Law Enforcement Officials.
- **Compliance certification.** Shows that contractor employees have been trained.
- **Specification of standards of training and supervision.**
- **Violations.** Provides the right to remove security personnel from a project if they are responsible for violating rights or procedures established for the protection of human rights.

### **When human rights are included in contracts, companies use different reference points and different legal techniques.**

Respondents reported that references to human rights in contracts include:

- General references to internationally recognised human rights standards such as the Universal Declaration of Human Rights (UDHR).
- References to specific human rights, such as labour rights.
- References to their own policies or codes of conduct, which in turn reference international human rights standards.
- References to substitute terms, such as health and safety or social performance.
- Process requirements that require integration of human rights in the business partner's management system.
- References to MSI or lenders' requirements that relate to performance, monitoring, reporting or other considerations relevant to the business relationship.

The companies consulted use various contracting techniques to address human rights issues in business relationships. They:

- Structure options to ensure that business partners give attention to key issues in the business relationship (see in particular Chapter 5: Joint Ventures). They might assign responsibility for human rights oversight to operational or management committees, establish internal reporting requirements, or give human rights management responsibility to a designated joint venture partner.
- Establish covenants requiring compliance with the outcomes of assessment processes. These might require business partners to comply with action plans on prevention, mitigation, monitoring and reporting measures that result from an environmental and social impact assessment or human rights assessment or on-going compliance audits.
- Impose reporting requirements for major security and human rights incidents.
- Provide contractual incentives for good human rights performance.
- Insert representations and warranties on human rights issues. These might require business partners to demonstrate that they comply with national labour laws, and have no past or current legal claims against them with regard to human rights issues.
- Impose closing conditions that require specific information on areas of human rights risk, or actions on unresolved human rights issues, before closing occurs.
- Impose differentiated contract clauses, according to the identified risk the business partner or business relationship poses. Where the risk is considered higher, the contract obligations are more detailed.
- Breach of contract clauses for human rights abuses. These define specific human rights abuses as material breaches; the most common are child labour and forced labour.

**Companies are using various techniques inside and outside contracts to make human rights more specific.**

Respondents had different views on the degree to which references to human rights in contracts should be specific. It was emphasised that texts need to be specific enough to provide business partners with guidance, and clear enough to be legally enforceable, but flexible enough to deal with unforeseen human rights issues. Flexibility may be especially important in longer-term contracts and relationships that may last for long periods, but there are risks in using very general language that does not provide specific guidance to the parties. One way to achieve specificity is to refer to more explicit laws or principles known to and accepted by both partners; another is to provide detail in other documents relevant to managing the relationship, such as operational procedures.

Some companies and some industries include human rights in the operating procedures relevant to the business partnership, rather than or in addition to the contract. Standards and guidance on how to meet human rights standards can be more detailed and precise

at this level. Nevertheless, if they do not use understandable and implementable language, such texts may not be “owned” by the business partner’s operating units. According to several respondents, operational targets, accompanied by measurement and reporting that are built into binding operational procedures, can provide feedback on business partners’ performance. Such an approach also gives business partners something precise to benchmark themselves against and an incentive to demonstrate they are performing well.

**Seeking “ways to honour the principles of internationally recognised human rights”<sup>67</sup> when faced with conflicting national requirements are rarely dealt with in contracting.**

While several respondents insert international corruption and environment requirements in their contracts, or apply their own global standards on environment or marketing that might go further than national law, only one company interviewed requires its business partners to comply with the eight core ILO standards when faced with inadequate national law. Though precedents are in place in other areas of law, few companies yet address human rights issues in their contracts when national law is inadequate. The Guiding Principles call on companies to seek ways to honour the principles of internationally recognised human rights when faced with conflicting national requirements. However, contracts are not the only instrument available, and companies may be working with business partners in other ways to address gaps in national law or conflicts between national law and international human rights law. What is important is that such problems are understood and proactively managed. Global Framework Agreements with trade unions are an example of how this Guiding Principle may play out in practice (see Chapter 11: Conclusion and Ten Themes for the Next Five Years).

**Companies are creating leverage with business partners to address human rights issues but it is often not through the contract alone that they create meaningful commitment to change.**

Companies need to be creative when they establish incentives for good human rights performance. Contracts provide a formal incentive to address human rights issues, but several respondents noted that contracts are not the only tool and by themselves are often insufficient. Business partners often need additional incentives to “do the right thing”, because ignoring or violating contractual provisions can be an attractive option for partners who seek a quick profit, particularly in markets with poor local enforcement of laws. Companies will therefore often need to do more than refer to human rights in contracts: it may be necessary to include specific incentives and disincentives, perhaps combined with capacity building, that make compliance possible and non-compliance costly.

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67 Guiding Principle 23.

### **Creating Leverage to Address Human Rights Issues**

The Guiding Principles can assist companies in establishing and making use of leverage in their business relationships as part of meeting their responsibility to respect human rights. Under the Guiding Principles, the responsibility to respect is determined by a company's impacts, not by its leverage. Leverage can be an important consideration when discharging responsibility but does not determine it. If a company lacks sufficient leverage to persuade its business partners to reform when they are responsible for harmful human rights impacts, the answer is that leverage must be increased or other choices made about the relationships, not that responsibility is diminished.<sup>68</sup> Examples of creating leverage include:

#### **In the market**

- Use leadership or dominant market position to impose requirements.
- Consolidate relationships to increase leverage with a reduced number of business partners.
- Exclude certain types of companies from business relationships.
- Rely on requirements that banks and investors impose on business partners as conditions of access to finance.

#### **In the contract**

- Insist that company policies are respected.
- Structure the terms of relationships to ensure that partners give specific attention to human rights issues.
- Create contractual incentives and disincentives for good human rights performance.
- Use standard form contracts that contain human rights requirements.

#### **With other partners**

- Develop Multistakeholder Initiatives to address human rights challenges.
- Participate in industry initiatives that address human rights issues.

#### **With governments**

- Work with government to create business opportunities to respect human rights (for example, the ILO Better Work Initiative).
- Support legislation that requires business partners to respect human rights.

### **Companies are using contractual provisions to address human rights issues in the value chain beyond their immediate business partner.**

In practice, some companies are applying their policies and procedures beyond their direct business partners and first tier suppliers or contractors. Several contractually require their suppliers and contractors to include the company's policies and procedures in their own sub-contracts, thereby cascading these further down the supply chain. Another company extends its contractual requirements on human rights to all companies that are in a group with its clients. Other companies impose certain requirements – on health and safety for example, or on any party that enters one of its work sites (whether or not there is a contractual relationship). Finally, several companies noted the work being done in the OECD and elsewhere to address key human rights problems associated with long supply chains.<sup>69</sup>

#### **Standard Form Contracts**

Many companies use industry-specific standard form contracts as a starting basis for contracting with business partners. These standard form agreements offer an obvious opportunity to address human rights issues across a whole sector, provided governing bodies can be persuaded that human rights are a material issue for the industry. Examples include:

- **International Federation of Consulting Engineers (FIDIC).** Its standard form for contracting with Multilateral Development Banks includes clauses on compliance with labour rights and other human rights.<sup>70</sup>
- **International Bar Association (IBA) Model Mining Development Agreement Project.**<sup>71</sup> This contract draws from 50 mine development agreements, and provides representative language for each contract provision, supplemented with example clauses from existing agreements. Its headings include human rights provisions and examples on: Social Acceptability; Social Impact Assessment and Action Plans; the Parties Commitment to Protecting Human Rights; Fair and Economical Project Operation; and security and human rights.

69 At: [http://www.oecd.org/document/36/0,3746,en\\_2649\\_33765\\_44307940\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/36/0,3746,en_2649_33765_44307940_1_1_1_1,00.html).

70 Conditions of Contract for Construction For Building And Engineering Works Designed By The Employer, Multilateral Development Bank Harmonised Edition, June 2010, General Conditions.

71 At: <http://www.mmdaproject.org/>.

## Managing the Relationship

### **Building the capacity of business partners to manage human rights issues can be an important mitigation strategy.**

A number of companies highlighted their capacity building programmes for important suppliers, service providers, franchisees and Small and Medium-sized Enterprises (SMEs). A number of factors determine which business partners may benefit from capacity building: it is a crucial relationship for the company, local content rules that require local partnerships with companies who may not yet meet the company's standards, partners that use the company's brand, and in some cases, a broader interest in building capacity in local and regional markets because of the company's long term interest in the market. Companies benefit from building the capacity of business partners to address issues relating to the environment, health and safety and human rights because it reduces risks. Business partners benefit because they get access to potential new partners with similar requirements.

### **For certain business relationships, companies have systems in place to track performance against company codes or contractual requirements.**

The most commonly used model for tracking the performance of supply chain partners against specified codes of conduct was developed 20 years ago.<sup>72</sup> Broadly speaking, it has evolved but has not changed dramatically, and companies involved in the research, like many others, use a fairly standardised approach to monitoring suppliers. For more significant suppliers, franchisees, and in some cases customers, companies often use a combination of self-assessment and reporting, company monitoring, and third party verification to monitor compliance. Almost all monitor against a company or industry code of conduct, rather than a particular human rights standard. Failures of compliance are drawn together in a corrective action plan tied to contractual provisions that require the company concerned to implement it, usually escalating to potential termination if suppliers or other business partners do not follow up on corrective actions.

### **Companies appreciate that dynamic situations require dynamic and regular assessment and tracking, but this is not always widely embedded in actual practice.**

Some business relationships described in the research are structured around management systems that require a regular review of the operating environment as well as company performance against management system requirements, such as JVs. These periodic scans provide opportunities and tools for assessing human rights issues as well. Other companies regularly update risk profiles for their business partners and projects. If a company is not in a position to prompt its business partners to update their assessments, it may be in its own interest to do so; and again, human rights risks can be included in such exercises.

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72 Ergon Associates, Background Paper for the World Development Report 2013, "Private Sector Voluntary Initiatives on Labour Standards," (2012), At: [http://siteresources.worldbank.org/EXTNWDR2013/Resources/8258024-1320950747192/8260293-1320956712276/8261091-1348683883703/WDR2013\\_bp\\_Private\\_Sector\\_Voluntary\\_Initiatives.pdf](http://siteresources.worldbank.org/EXTNWDR2013/Resources/8258024-1320950747192/8260293-1320956712276/8261091-1348683883703/WDR2013_bp_Private_Sector_Voluntary_Initiatives.pdf).

Respondents identified different ways in which their companies ensure that regular assessments and tracking or monitoring of their business relationships can evolve based on the changing context:

- **Regular overview of trends.** As part of their regular monitoring, companies periodically take a broader look at impacts inside and outside the business partner's facilities, to capture trends and changes in the environment.
- **Grievance mechanisms.** Sound operational-level grievance mechanisms can flush out key concerns from stakeholders and can provide important feedback to the business partner on the effectiveness of its human rights due diligence. In some circumstances, companies require that their business partners share updates with them on complaints submitted via the business partner's grievance mechanism.
- **Periodic review and benchmarking.** These exercises are designed to identify emerging issues, and assess new problems, benchmark the actions of peers, grievances, and customer and investor demands.
- **Reporting.** Joint venture agreements often establish a self-contained monitoring system, which reviews compliance with the JV's operating procedures. These agreements often require companies to report directly to shareholders, sometimes on specific topics such as corruption or EHS.

### Social Compliance Versus Human Rights Due Diligence

As one respondent noted:

"Social compliance is different from due diligence so in that sense the UN Guiding Principles are a game changer. All that a social compliance audit is going to do is tell you where something is at in a given moment. If I am about to enter a relationship, I do have to do a social compliance audit and they are useful as a simple checklist. This gives us data points – but it is other forms of interaction that drive change. Sometimes we are relying on audits as the change mechanism and have not analysed what generates change in behaviour. An audit itself is not the drive for improvement. Human rights due diligence is more work and a different quality of work, but it is likely to be more effective as it goes beyond simple compliance, beyond the four walls of the business and lasts through the entire business relationship."

**Companies often respond more urgently to severe human rights impacts, and expect business partners to prevent or mitigate severe impacts before addressing other issues.**

A number of companies are beginning to focus on human rights as they prioritise *among* relationships building on the key concept in the Guiding Principles of prioritising based on risks to people rather than risks to companies. Some respondents reported that they are trying to operationalise the concept. This work is most apparent in relationships where

partners have the longest experience of human rights: suppliers and service providers. Several companies are applying a combination of criteria (country risk, sectoral analysis, capacity) to rank suppliers and identify those that need special attention. (See Chapter 8 on Suppliers and Service Providers.)

As to prioritising responses to potential and actual human rights impacts *within* relationships, this also seems to have come furthest with suppliers and contractors for large projects. To help them to manage such issues, and to respond quickly and appropriately, many companies use colour-coding or similar systems to track significant human rights concerns, non-compliance of suppliers over time, and trends in compliance.

Crisis or media attention can also drive prioritisation, as several respondents noted, with problems at small, second tier or even third tiers business partners quickly becoming a top priority for the company. In such cases, the issues prioritised are not always the most significant ones from a human rights point of view. Crises and media coverage can have a number of longer-term effects. They impress on senior and line managers that human rights are under scrutiny in more and more places; increasingly making human rights material from a company risk management point of view, and causing companies to consider a wider range of human rights risks that are reasonably foreseeable – given the sector or the country context.

### **Communicating with external stakeholders about human rights in business relationships is not yet common practice.**

MSI initiatives like the Fair Labour Association (FLA) and the Ethical Trading Initiative (ETI) regularly interview workers at supplier facilities as a part of their monitoring. This practice preceded but is in synch with the Guiding Principle that calls on companies to include feedback from external stakeholders, including affected groups, when they track performance. Many of the companies involved in the research have compliance auditing in partner facilities that presumably builds on these models. It was unclear whether interaction with workers and other stakeholders was a part of monitoring in other types of relationships.

Companies applying the Guiding Principles' "knowing and showing" approach should be able to demonstrate to those who are affected by their activities that they have acted to address negative impacts. "Showing" can include a range of actions, including formal reporting where appropriate.<sup>73</sup> A number of companies report on their supply chain relationships without disclosing the identity of specific partners. (This trend is apparent in apparel industry reporting.) One company reports on core customers. The Global Reporting Initiative (GRI) includes two indicators on business relationships.<sup>74</sup> Companies in the GRI report on both in a range of ways and in varying detail. For the GRI Indicator

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73 Guiding Principle 21.

74 Version 3.1 of the GRI Sustainability Reporting Guidelines includes two indicators on business relationships.

HR 1,<sup>75</sup> some respondents report on supplier contracts that contain human rights clauses but do not report on any other types of investment agreements. With respect to GRI Indicator HR2<sup>76</sup> some companies supply detailed statistics on their assessments and audits and improvement plans, while others match their (existing and goal-setting) compliance levels against their human rights screening criteria.

**Establishing grievance mechanisms and providing access to remedies for negative human rights impacts in business relationships is a work in progress.**

Some companies have had feedback mechanisms for business partners in place for many years. They recognised, long before the Guiding Principles were drafted, that it was clearly in their interest to monitor the conduct of suppliers who are expected to comply with company codes of conduct. Most do this by establishing a specific hotline for workers at supplier facilities, or a more general hotline that is accessible in supplier facilities. Hotlines or web sites provide an accessible avenue for complaint; but whether they work in practice will often depend on conditions on the ground, in business partner facilities. As one respondent noted, if the hotline is next to the manager’s office, access can be illusory. Whistle blower protections, which many of the participating companies have in place, are a procedural guarantee that can improve the accessibility of operational grievance mechanisms.

Some hotlines deal only with breaches of company codes that business partners are contractually required to respect. Others have a wider mandate and address a broader range of concerns more in line with the Guiding Principles’ concept of operational-level grievance mechanisms. Where companies route all complaints to one number, it is crucial to ensure that staff who receive calls or e-mails are trained to identify those related to human rights and distinguish more serious concerns. Some companies have systems in place that appear to be closer to the Guiding Principles concept of an operational-level grievance mechanism, including an ombudsperson.

The Guiding Principles list several effectiveness criteria for non-judicial grievance mechanisms.<sup>77</sup> They note that a mechanism will not serve its purpose unless the people it is intended to serve know of it, trust it, and can use it. As one respondent noted, hotlines, websites and similar mechanisms will only work if grievances are consistently recorded, followed up and addressed in a predictable and credible manner, ensuring robust accountability. Where this occurs, such procedures start to meet the criteria set out in the Guiding Principles for effective operational-level grievance mechanisms.

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75 HR1: Percentage and total number of significant investment agreements and contracts that include clauses incorporating human rights concerns, or that have undergone human rights screening.

76 HR2: Percentage of significant suppliers, contractors, and other business partners that have undergone human rights screening, and actions taken”.

77 Guiding Principle 31 sets out the effectiveness criteria for non-judicial grievance mechanisms. They should be: legitimate, accessible, predictable, equitable, transparent, rights-compatible, and a source of continuous learning. Operational level grievance mechanisms should be based on engagement and dialogue.

Assessing the quality and effectiveness of a grievance mechanism presents a further challenge. As a respondent noted, having fewer grievances over time may mean that the company and its business partners are performing better, but can also mean that stakeholders have learned not to trust the grievance mechanism because it does not provide results, is not timely, etc.

Operations that leave a larger footprint often engage more directly with surrounding communities, including in their approach to grievances. This is seen to be a way of resolving issues at the local level, before they develop into serious grievances that have effects on both the community and the company. One company involved in the research required regular reports on community grievances and their resolution, even though community engagement and grievances are a contractor's responsibility. It also provides capacity building support and guidances to contractors to improve their performance in this area. Companies that track patterns of complaint from their operations across the world can see which issues appear frequently, and which are specific to regions or communities, and adjust their responses accordingly. This underlines that grievance management contributes to continuous learning.

### **Ending or Renewing the Relationships**

**Companies recognise that terminating relationships on human rights grounds is an option when things go wrong, but that it is not always the best option from a business or human rights perspective.**

In general, companies include certain human rights abuses (commonly, child and forced labour) as material breaches of contract – in order to have contractual leverage to require change. At the same time, most respondents made clear that, while companies impose contractual obligations to reinforce the seriousness of the issue, they believe that changes in practice are more often achieved by providing incentives (more business or access to new markets), appealing to corporate values (sustainability, leadership), and building capacity. Almost all the companies noted the practical and at times legal difficulties associated with termination, just as all valued the option that a contractual provision provides.

Some companies require their business partners to respond swiftly if they discover certain serious human rights abuses such as forced labour or a child in their employ or the employ of sub-contractors, or if they find that security personnel have violated human rights.

**Companies may suspend relations with partners, or take over their operations, on human rights grounds, but usually do so in the course of dealing with broader concerns.**

Partners in joint ventures and franchises, and major contractors that operate joint or shared management, usually retain step-in rights to take control, temporarily or permanently, if one of the parties repeatedly violates its contractual obligations. One

company said that it assumed temporary control in one case, where the business partner had been unable or unwilling to meet company requirements, including those regarding human rights.

**Renewing business relationships can be an incentive for business partners to improve their human rights performance.**

Several respondents noted that contract renewal (or opening new contracts with peer international companies that have similar requirements) can give partners an incentive to improve their ability to meet key sustainability requirements, including human rights requirements. Contractual penalties can work; but they often work better when a company reaps rewards from spending time, energy and money on building capacity. It appears that assessing performance on meeting human rights standards is often part of wider assessments of performance that occur when renewal negotiations take place.

**Companies increasingly review human rights at the end of their relationships, when they consider their reputational legacy.**

Some respondents indicated that they carefully considered the risk of reputational harm when they sold a business and would not sell assets to an enterprise that was disreputable or would run the project in a very different way.

Large projects and projects that have a visible legacy usually require a planned process of disposal, closing and departure. Human rights considerations increasingly appear in such processes. Respondents raised a number of legacy dilemmas – around products, service and projects – and suggested that companies should think about the long-term and unintended use of their products, services and projects, after they have surrendered control. (For further discussion, see Chapter 9 on Direct Customers.)

**Communicating about termination of business relationships on human rights grounds can be complex in reality.**

Transparency around breaches of contractual provisions on human rights that lead to termination is a trend to keep an eye on. Some companies are starting to report on breaches and terminations of business partners and to explain the reasons for them, but they do so without revealing the identity of the actual business partner. Such communications inform stakeholders that the company is tracking performance in certain business relationships, and taking action when necessary.



## Chapter Five: Respect for Human Rights in Joint Ventures Relationships

### Overview

#### *Brief overview of joint ventures relationships*

Joint ventures (JVs) are formed when companies combine their resources and expertise to pursue a common business goal that is typically limited in scope. Companies initiate JVs by entering into an agreement that sets out their goals, duties and rights. JVs can be structured in different ways. A JV typically involves the creation of a new entity, in which each JV partner takes specific roles. One partner may be responsible for funding a percentage of the venture, while another runs day-to-day operations. In some instances, partners second staff to fill JV positions.

JVs are often vehicles for major projects that companies are unable or do not desire to fund and manage on their own. JVs are increasingly used in the oil, gas, and mining industries and for major infrastructure projects (dams and electricity generation plants), because these investments typically involve significant outlays of capital, sometimes over the course of many years. Oil and gas JVs often do not create a new legal entity, and are purely contractual. JVs typically include majority and minority owners, and operating and non-operating partners, whose relations are defined by agreement. Policies and procedures are similarly defined by agreement. In part due to potential liability, companies normally carry out substantial financial and other due diligence on potential JV partners. If they are not the operator, partners in JVs typically maintain audit rights over some issues.

JVs are also employed in research and development, to launch new products, and to support manufacturing processes with local partners.

#### *Human rights and joint ventures*

Businesses may consider human rights impacts for a number of reasons when they enter JVs. For example:

- Managers and technical experts in JVs often come from diverse backgrounds and corporate cultures. This creates challenges and positive opportunities for exchange of experiences, including around adherence to international social and environmental standards, including human rights.
- The largest infrastructure projects and extractive projects (mines, dams, integrated industrial plants, transport and logistics hubs) are frequently operated as JVs. They tend to have a high profile and to affect local communities and environment significantly. They frequently generate human rights issues, *inter alia* around land use, resettlement, cultural heritage, security, and access to basic services such as water and sanitation. In addition, they tend to employ a large number of skilled and unskilled workers, who are rarely available in the immediate vicinity. The responsible recruitment of migrant and other workers is another issue with a human rights dimension. Finally, large JVs generate a complex network of subordinate business relationships, which tend themselves to generate human rights impacts.

- In recent decades, many businesses have been exposed to reputational, operational, financial and legal risks due to actions by JV partners. Both majority and minority partners can be affected, because stakeholders are less interested in whether a company is an operator or controlling partner, especially in situations where the company is the better-known company and is viewed as having the capacity to encourage its JV partner to behave more responsibly. As accountability becomes more globally networked and sophisticated, even a minority involvement in a JV can bring exposure – sometimes even after a company has exited the JV. As accountability becomes more nuanced, all partners, whether minority or majority, will be exposed to risk and criticism. Additionally, partners that leave the JV in question may be held accountable for human rights abuses that occurred during their watch.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**Companies can help to manage human rights-related risks by choosing their JV partners with care, but their choices may be limited in some circumstances.**

Companies usually make a significant effort to identify and investigate potential JV partners, since the relationship is important and often long-term. Many companies observed that the best method of reducing the danger that a JV will be embroiled in human rights problems is to select its partners with care. At the same time, in some sectors and circumstances, companies have little or no choice. For instance, many governments require oil and gas companies to ally with the state-owned national oil company as a condition for securing a concession agreement.

**Before forming a JV, companies use various avenues to convey their human rights expectations to business partners.**

As they do with other forms of business relationship, companies typically address human rights issues with JV partners by reference to their own values and policies. When a potential JV partner is like-minded and has similar policies, such discussions are relatively straightforward, and the parties may explicitly focus on human rights. When the JV partner is sceptical of human rights, companies sometimes introduce human rights concerns indirectly, by discussing ethical policies or other policy positions and referring to environmental and social practices and expectations.

*Understanding the issues – Assessing human rights impacts in joint venture relationships*

**Companies do serious due diligence for certain JVs, and often consider human rights.**

When they form larger JVs, particularly to implement large infrastructure projects, companies reported spending significant amounts of time and money on initial due diligence. They investigate potential business partners, and sometimes consider human rights when they do so, though they may not use the term explicitly. Companies often

consider the environmental, health, safety, labour, and security practices of potential JV partners, for instance. When a partner has a poor record or capacity in these areas, companies take steps to limit risk, by taking particular roles in the JV, or inserting specific policies and procedural safeguards in contracts (see below). In a few sectors (support manufacturing, research and development), companies reported that they conduct little due diligence on JVs (including human rights), because they believed that the projects they undertake have a different and lower risk profile. They admitted, however, that this practice created blind spots.

**Due diligence appears to vary in scope, and is more extensive when a company operates or holds a majority stake in the JV.**

Companies may conduct more detailed due diligence if they are operators of the JV or project, or hold a majority stake. Companies in this position usually presume that their operating procedures will apply. On these grounds, they focus on the national environment in which they will be operating and may spend less time scrutinising the operating practices of their partners. An exception is made for corruption. Companies with a majority interest are likely to consider the corruption safeguards of JV partners. Initial due diligence on the national context includes: expropriation; political instability; corruption; poor rule of law; weak enforcement of international labour standards; claims of indigenous peoples; and other human rights concerns.

By contrast, the due diligence process may look quite different when companies are minority stakeholders in a project, do not operate it, or have little leverage on a JV—though most understand that they may still be held liable, legally or reputationally, for the JV's actions. Some companies have therefore developed specific due diligence processes for JVs, and increasingly consider their partners' environmental, health, safety, labour, and human rights practices. Where pertinent, companies also sometimes consider a partner's history of working with private and public security forces. One company involved in the research has developed a list of due diligence questions on human rights that it specifically uses when it has a minority stake in a JV.

**To understand country situations and challenges, companies may consult external stakeholders but more frequently speak to potential business partners.**

Most companies seek to keep confidential the possibility that they will form a JV until they decide whether to proceed. If the JV is in a high-risk country, they sometimes reach out to civil society, think tanks, and government officials to better understand the country's risk profile – sometimes using a third party to maintain their anonymity. In one instance, a company said that it consulted an environmental NGO it knows well about the practices of potential business partners; but this practice appears to be infrequent.

Companies typically ask potential partners to provide additional information about their environmental and social practices, though they more frequently ask about their record on corruption. In the course of due diligence, for example, several companies regularly ask potential business partners to disclose corruption investigations and lawsuits, which helps them to quantify risk. In principle, companies could also ask about NGO

campaigns and human rights-related cases; but it is not common to do so. In some industries (oil, gas, and mining), large and mid-sized companies are already aware of the environmental, social, and human rights practices of their peers, both through their industry groups and because they often work together in JVs.

### Formalising the Relationship

#### **JV agreements can be designed to consider human rights explicitly.**

JV agreements create a new structure with specific operating and governance procedures. The structuring of the JV provides the main opportunity for a company to create long-term leverage within the JV – around human rights or any other issue. For example, companies may:

- Integrate language on human rights into the agreement or its annexes.
- Ensure that the project adopts specific environmental, social, or human rights policies and procedures.
- Obtain relevant management positions in the new organisation, allowing them to oversee operations that are relevant to human rights. (One company places “governors” in its JV’s management structure, with authority over particular topics that are of interest to the company.)
- Require audit rights in relation to social policies and procedures, enabling the company to determine whether the JV is implementing its commitments.
- Require the JV to report to the management, a designated official, or JV partners on specific topics of interest to the company.

When two companies with similar human rights practices form a JV together, an agreement may declare their human rights expectations explicitly. Texts typically focus on specific rights (labour or health and safety), although they may include a more general reference to human rights. Some companies bring human rights into agreements by making reference to external standards (such as the Equator Principles<sup>78</sup> or IFC Performance Standards<sup>79</sup>), which refer to specific human rights. One agreement referred to the Equator Principles and required the JV to develop an additional environmental and social policy for implementing them. Where one partner is recognised as a global leader, other JV partners may accept its policies in order to learn from its environmental, social, and human rights practices.

#### **Contractual language on human rights is considered mandatory by some companies, whereas others include it where possible.**

Some companies would not sign a JV agreement unless it contained certain human rights commitments. Other companies would not sign a JV agreement that did not require the operator to respect social and environmental standards (including explicitly or by implication human rights standards) that were at least as high as those of the company.

78 At: <http://www.equator-principles.com/>.

79 At: <http://www.ifc.org/performancestandards>.

One company noted that, when it has a minority stake in a JV, it expects potential partners to make representations and warranties regarding their human rights records and compliance efforts; it also seeks to include an exit clause if serious human rights abuses arise. Other companies consider that human rights language is not mandatory. Although some have developed model language for JV agreements that explicitly refers to human rights, they admit that they will agree to changing or dropping that language if the partner is not willing to accept it.

Some companies hold the view that it is not possible to address all the human rights issues that might confront a JV during its lifetime. These companies suggested that in practice other mechanisms can more effectively ensure that JVs address human rights issues. Obtaining key positions in the venture that provide leverage over social issues is an example (see below).

### Rethinking Investment Contracts, Including JV Contracts, to Promote Sustainable Development

The International Institute for Environment and Development (IIED), an international development and environment policy research organisation, has undertaken detailed research into contracts that cover natural resources. Several of its reports examine JV agreements.

- **How to scrutinise a Production Sharing Agreement (PSA): A guide for the oil and gas sector based on experience from the Caspian Region.**<sup>80</sup> This report provides a guide for civil society to oil and gas contracts. It outlines key characteristics of PSAs, focusing on JVs, concessions, and PSAs. Action points for civil society organisations involved in monitoring contracts made by extractive industries include: public participation in the contracting process; economic fairness; integration of social and environmental concerns; and consideration of economic, social and environmental issues over the project's lifetime.
- **Investment contracts and sustainable development: How to make contracts for fairer and more sustainable natural resource investments.**<sup>81</sup> This report identifies the main contractual issues and processes associated with exploitation of energy, minerals and agricultural commodities, and suggests how investment contracts, including JV agreements, could be drafted to maximise the contribution of such investments to host countries' sustainable development.
- **Land deals in Africa: What is in the contracts?**<sup>82</sup> This report analyses twelve land deals in Africa, and their wider legal frameworks, from a sustainable development perspective. It suggests ways to improve large land-acquisition contracts.

80 At: <http://pubs.iied.org/pdfs/16031IIED.pdf>.

81 At: <http://pubs.iied.org/pdfs/17507IIED.pdf>.

82 At: <http://pubs.iied.org/pdfs/12568IIED.pdf>.

**JV agreements may stipulate operating procedures that explicitly or implicitly address human rights.**

Some companies noted that embedding good human rights practices implicitly or explicitly in the JV's policies or operating procedures is the most effective way to ensure that human rights are addressed on an on-going basis. If the companies forming the JV are committed to human rights, the venture will typically adopt the human rights policies and procedures of the operating or majority partner.

If the JV partners have different approaches to human rights, the situation becomes more complicated. At least one company involved in the research requires partners in a JV to adopt the company's social practices or their equivalent, even if it is a minority or non-operating partner. Other respondents said that, if the operating partner was hostile to human rights or unwilling to discuss them, their companies might seek to have the JV agreement state that the operator would use their social and ethics policies. Since the social and ethics policies of these companies refer to and therefore incorporate their human rights commitments, the companies in question believe they can thereby create space for a discussion of human rights in the future.

**Companies create long-term leverage by their choice of roles and procedures in the JV.**

Companies may seek to fill specific positions in a JV to promote strong social, environmental, and anti-corruption practices, extending in some instances to human rights. When it is not the operator, one company places its staff in legal, financial, and compliance positions from which they can manage key risks, such as corruption and human rights. Another appoints a "governor", with authority to take decisions and report to partners, to manage topics in which the company has a particular interest. The company trusts its employees to robustly implement the JV's policies, and spot problems, including human rights challenges that its policies might not address.

Opportunities to advance human rights also occur when JV committees are formed, and powers are assigned to them. One company seeks to control the JV's compliance committee, to give that committee oversight of environment, health, and safety issues, and to have the JV agree to a compliance plan which the committee then monitors. Another company seeks, through the JV agreement, to set up a social responsibility committee.

The design of voting rules can create further opportunities. One company seeks to ensure that a supermajority is required for decisions related to compliance and human rights-related procedures, so that it can block problematic proposals.

**Internal coherence and alignment may affect the human rights content of the agreement.**

Whether the JV agreement includes human rights or other social concerns depends in part on who negotiates the agreement and the extent to which negotiators consider such concerns important, or are incentivised to do so. As noted in Chapter 3, performance incentives can help to determine whether issues like human rights are addressed in negotiations and included in agreements.

In some companies, lawyers are closely involved in drafting agreements. A number of companies rely on standard contractual language that they modify for specific deals. Unless company lawyers are instructed to include human rights issues in the template, or to address human rights in the agreement, these issues may not be raised. Lawyers also sometimes find it challenging to draft language on human rights that is specific and enforceable, and may therefore choose to avoid the subject.

In other companies, business units negotiate JV agreements; company lawyers merely review them technically. Unless business units are convinced that social and human rights issues present material risks to the venture, they are unlikely to highlight such topics if they are not required to include it as mandatory language in the agreement. One company involved in the research found that employees of local business units who were charged with forming JVs did not consider the company's commitment to the Equator Principles to be important and therefore made limited efforts to reference them in agreements. The employees believed that local law provided sufficient protection, and just wanted to "get the deal done". To ensure the Equator Principles are adequately addressed, the company's investment committee at headquarters now reviews JV agreements before they are concluded.

**Some companies treat regulatory and reputational risks as conditions precedent.**

At least one company involved in the research uses conditions precedent to protect itself against unwittingly assuming human rights-related risks that would otherwise only become apparent by carrying out in-depth due diligence. It also requires JV partners to provide warranties regarding compliance and their human rights history.

**Referring to third party standards, including MSIs, builds further leverage to address key issues.**

Some JV agreements refer to industry or multistakeholder principles or codes of conduct, or include language that draws from them. Oil, gas, and mining companies sometimes refer to the Voluntary Principles on Security and Human Rights, or include language from the Voluntary Principles to require the JV to implement security practices that safeguard human rights. Such language has been included in some agreements with state-owned enterprises (SOEs) from emerging economies such as China. The Voluntary Principles do not presume that companies should adopt their language in JV agreements; the practice appears to have developed because companies are concerned about legal, reputational, and operational risks related to poor security practices. Another company participating in the research seeks to include the Equator Principles in JV agreements for similar reasons. The company is not an Equator Principles bank, and appears to be motivated by its own commitment and concerns about environmental and social risk.

**Seeking finance for the JV from financial institutions that have a clear set of social and environmental standards is often a sensible way to establish leverage over JV partners.**

In some sectors, JVs seek loans from international financial institutions such as the International Finance Corporation (IFC) or an Equator Principles bank. The IFC

requires organisations that it funds to adopt its Environmental and Social Performance Standards, and to report on their compliance with them as a condition of continued funding. Conditionality of this kind can be helpful when projects operate in locations in which the authorities are hostile to human rights concerns, because the JV can argue that its human rights standards are externally imposed rather than self-initiated. The same argument may be used when dealing with SOEs that are disinclined to address human rights concerns.

### **Managing the Relationship**

**When companies are not operators of a JV, they usually involve themselves less in its regular social and environmental assessments, rarely build capacity in human rights, and do not consistently report on its human rights practices.**

When companies operate a JV, they typically audit its performance against relevant environmental and social policies and procedures, as they would for any of their operations. When companies are not operators, they rarely do so. Audits focus primarily on financial practices and, in some instances, corruption.

That said, some companies do audit the environmental and social practices (including human rights) of JVs in which they hold a minority stake. Such audits, often jointly conducted by the operator and non-operator, are more likely to occur when the JV is working in a high-risk environment. One company in the research seeks to ensure that the JV has the right to have its first tier suppliers audited, to verify that they comply with certain human rights standards; this is a relatively new practice.

If they are the operator, companies seem to invest in the capacity of JV staff, because they apply their own social, environmental, and human rights policies and procedures, and train staff in them. A company that is not the operator is far less likely to provide human rights training, and more likely to do so on an ad-hoc basis because it has identified a risk to the company. By contrast, a number of companies systematically provide anti-corruption training even when they are non-operators.

**Some companies receive consistent reporting on their JVs' human rights performance.**

JVs report formally and informally to their owners, providing opportunities to discuss human rights challenges. JV board and committee meetings provide a venue for discussion of human rights concerns. Some minority partners require incidents to be reported. However, if non-operators do not raise questions on human rights at the board or in committees, and do not audit compliance with the JV's social policies, it is difficult to see how they can make themselves aware of human rights challenges until the issues catch the attention of the media, NGOs, or social investors.

**Grievance mechanisms for employees and affected communities are variable.**

Typically, a JV's operating procedures determine whether employees or affected communities have access to grievance mechanisms for alleged human rights abuses, in addition to remedies available through the judicial system. JV grievance mechanisms vary according to the industry, and can be robust or non-existent. What is offered depends on the operator and the operating procedures defined in the JV agreement.

**Ending or Renewing the Relationship****JV agreements rarely consider human rights-related problems to be material breaches.**

Few JV agreements define environmental, social, or human rights problems as material breaches or grounds for terminating a relationship. Were agreements to do so, companies would still have to balance this against the time and money they have invested. Companies indicated that generally they preferred to influence a JV's actions, through the JV's board or committees. Under oil and gas agreements, a material breach of environmental, health or safety obligations by the operator may trigger its removal as operator.

**Legacy issues (including human rights), can affect the reputation of former owners.**

In a few instances, companies that wish to sell their shares in a JV have considered the effect on communities or employees of selling their assets to purchasers that do not respect human rights. Some of these companies have sold their stakes to purchasers that offered slightly less money, but were more likely to operate the asset responsibly.

After a JV closes, or a company sells its stake, human rights problems can continue to affect a company. For example, plaintiffs may sue a company for human rights abuses that occurred on its watch. (The extent of a company's liability will be influenced by the structure of the sale and whether it transferred relevant liabilities to the buyer.) A purchaser of a company's stake in a JV might also, as part of its initial due diligence, request information about human rights incidents that occurred, which might reduce the price the purchaser is willing to pay.



## Chapter Six: Respect for Human Rights in Merger, Acquisition and Disposal Relationships

### Overview

#### *Brief overview of merger, acquisition and disposal relationships*

An acquisition and disposal contract is a single agreement, or series of agreements, that governs the acquisition by one party, and the disposal by another, of part or all of a business or entity. Though contracts can vary in scope and form, acquisition contracts generally take the form of an entity purchase contract or an asset purchase contract. Under an entity purchase contract, the buyer purchases a majority (or greater part) of the target entity's stock. The new owner then steps into the shoes of the previous owners, often buying the other entity's liabilities. Under an asset purchase contract, the buyer purchases all the target entity's tangible and intangible assets, but can limit its liability for past actions of the entity. Companies typically conduct substantial due diligence before acquiring a target company and, particularly under entity purchase contracts, seek to value and track liabilities alongside assets. The contract allocates risk between the parties and indicates the buyer's remedies. A buyer will often apply its policies and procedures to the purchased entity or assets and may absorb the entity entirely into its corporate identity. In such circumstances, it will frequently establish a rigorous process of monitoring to chart progress in bringing the acquired entity up to its standards.

A disposal contract is an agreement governing the sale of a business's assets or the entirety of a business. In some cases, a buyer may be interested in only part of a business, leaving the seller with some obligations and liabilities. In other cases, the entire business is sold, including its liabilities. It is usual for a buyer to do due diligence on the seller, in order to understand what liabilities it will inherit. In some instances, a seller conducts due diligence on the acquiring company, for legacy reasons.

#### *Human rights and mergers, acquisitions and disposals*

Businesses may consider human rights impacts for a number of reasons when they undertake mergers, acquisitions and disposals. For example:

- A company may expose itself to involvement in adverse human rights impacts and their consequences if it does not understand the human rights-related risks it may assume through a merger or acquisition, or the entity with which it is effecting a disposal. The target company's products, services or operations may result in adverse human rights impacts or the target company may be contributing or directly linked to adverse impacts through its own business relationships. Moreover, commercially insignificant elements of a target company, or elements that are irrelevant to the motive for a merger or acquisition, may generate significant risks. The target company would typically provide information on these potential risks. If a target company is not aware of its human rights responsibilities, or its impacts this may be a red flag for the acquiring company, signalling that more detailed due diligence is necessary to identify potential human rights problems, both in the target company and in its business relationships.

- Failure by a target company to identify and manage human rights risks in its operations and business relationships may have consequences for the long-term sustainability of an acquisition or merger or at least the difficulty of successfully absorbing the target company (because the target company's values and standards do not align with the acquiring company's values, for example, or because the target company is not capable of meeting the company's standards).
- An acquiring company also assumes the stakeholder relationships of the company it purchases. Those individuals and communities may have long standing grievances. Identifying and addressing any legacy of human rights grievances may be an important part of a company's initial due diligence. This issue is relevant to disposals as well as mergers and acquisitions.
- Disposals relieve a company of businesses that no longer fit its commercial objectives and strategy. However, companies may find that disposal does not always end their association with an asset they have sold. If an acquiring company causes or fails to address human rights abuses, or acts disreputably, this may have reputational consequences for the former owner.

### **Orienting and Embedding – Internal Company Management of Merger, Acquisition and Disposal Relationships**

**M&A teams may need guidance on when, how and why to consider human rights.** Respondents affirmed that mergers, acquisitions and disposals are typically led by the business development department (or its equivalent), supported by other relevant departments (finance, legal, human resources, and operations). Human rights experts in sustainability (or related) teams may be involved, but are often not systematically involved. By the nature of their work, business development teams will generally focus on commercial growth, and especially on valuing assets and liabilities. They may not immediately see the relevance of social issues including human rights as part of that valuation exercise. Several respondents emphasised that it is important to work within this reality, and to help business development teams to see human rights and related experts as enablers, not obstacles.

To do this, and to achieve outcomes that match the company's human rights policy objectives, all departments need to be more aware of each other's interests and drivers. Some companies indicated they are addressing this issue by including human rights and related experts in the cross-functional teams that support mergers and acquisitions, and business development teams in cross-functional human rights working groups or steering committees. The aim is to encourage all sides to be better aligned. In some cases, external advisers, including law firms, were asked to help identify links between human rights and other risks that need to be addressed in the course of mergers, acquisitions and disposals.

Several respondents cautioned against business development teams liaising solely with the legal team in relation to human rights risk where the legal team is focused only on legal compliance. To explain why, suppose that a company wishes to acquire a business

that has a contract with a government allowing it to use local water suppliers. The arrangements are legal under national law, and raise no red flags with the legal team, which is assessing legal liabilities against national law requirements. However, if the target company's operations reduce the access to water of local small-holder farmers and as a result it does not respect the right to water and sanitation, and may have impacted negatively on other rights, it creates potential reputational and financial liabilities for the acquiring company. Recognising that this is an issue, some of the companies are working with their legal teams to make them more aware of the Guiding Principles and corporate responsibility to respect human rights, and so to think beyond legal compliance with national law, to international human rights standards.

## **The Business Relationship Cycle**

### **Selecting and Starting the Relationship**

*Setting expectations and communicating them to business partners*

**Initial due diligence processes and interactions can uncover what is required for alignment and provide a framework for dialogue with a target company.**

The Guiding Principles explicitly recognise that human rights risks may be inherited through mergers or acquisitions, and that due diligence procedures should include human rights from an early stage. Respondents commented that due diligence processes (carried out before a potential merger or acquisition to review potential assets and liabilities) can assist an acquiring company to understand what needs to be done to bring a target company into alignment with its own values, standards and practices. Such initial assessments are considered vital to understanding who the acquiring company is dealing with and whether other stakeholders (including government and relevant communities) will support the deal in the long run. Respondents also recognised that initial due diligence enables a company to discuss responsible business conduct, including its policies and practices on human rights, with enterprises it wants to acquire.

*Understanding the issues – Assessing human rights impacts in merger, acquisition and disposal relationships*

**The extent of human rights inquiries during initial assessments may depend on the importance of the deal.**

Since mergers, acquisitions and disposals come in all shapes and sizes, respondents emphasised that companies need to decide how to meet their responsibility to respect based on the deal at hand. They said they tended to prioritise a potential target company's human rights performance in more detail when a deal was of strategic importance or involved higher risks. Examples of high risk might include the acquisition of an enterprise that was based in a country in which human rights abuses were common, that was a party to a human rights-related legal proceeding, or that had been accused of association with gross or serious human rights abuses. Companies seemed to take the same approach to disposals.

**Existing M&A checklists are unlikely to expressly reference human rights, but checklists are evolving.**

Most respondents reported that their existing checklists for M&A due diligence do not explicitly mention human rights or use human rights language, though they commonly cover certain human rights issues, especially occupational health and safety and other labour conditions. Some companies are amending their lists to include human rights references more directly. For example, some companies ask potential target companies to describe the extent to which they have implemented the Guiding Principles or respect human rights. Other companies have not changed their checklists but advise relevant teams on how they can use them to make human rights inquiries. As noted earlier in Chapter 4, while there are evident benefits in clearly defined guidance, there is a risk that overly prescriptive checklists for practitioners not well versed in human rights issues (particularly where these are not accompanied by training on human rights issues) may mean they miss human rights issues that are not immediately recognisable or take a new form.

**Information gathering, including with stakeholders, may be constrained by the need to maintain commercial confidentiality.**

Respondents noted that M&As and disposals are often confidential, and that it is not always easy to follow up desktop questionnaires or reviews with site visits or other more robust assessments of human rights performance, particularly with external stakeholders. Respondents recognised the value of understanding community, government and other stakeholder concerns about a potential target company or buyer; but they agreed that the range and content of site visits, including discussions with employees and other stakeholders, were inevitably conditioned by the need to protect the confidentiality of deals and respect insider trading regulations.

Several respondents noted that information on social issues is more likely to be in the public realm, and in theory is easier to obtain than proprietary information (like geological data). However, many said the lack of *reliable* information on social issues, including human rights, hampers them from conducting the kinds of comparative analysis they regularly do on financial viability.

**Country risk analysis is important to understanding broader human rights risks. Processes to take account of sanctions seem to be in place.**

Several respondents are starting to incorporate country-related human rights risk inquiries into their initial assessments. For example, a desired acquisition may be based in a country that lacks a land registration system; its government may have breached regulations when it provided the acquisition with permits; or the government may have engaged in forced resettlement, contrary to international standards, to facilitate the acquisition's operations. If, as a result, the target company has been involved with adverse human rights impacts, the acquiring company will need to explore the potential costs of resolving these impacts.

All the companies involved in the research have rules in place to avoid mergers, acquisitions or disposals in countries subject to sanctions. Some avoid deals in countries with high levels of political risk; human rights are considered to be a factor in such decisions, but are not the only determinant.

**When companies obtain human rights information on a target company, they tend to rely on self-disclosure. They increasingly request information on financing conditions and their participation in MSIs.**

The respondents reported that they do internal and external desk-based research on the human rights records of potential target companies, but also rely heavily on self-disclosure via questionnaires. If they are concerned by a response, or lack of response, some companies invite external experts to conduct further inquiries. However, questionnaires tend to focus on occupational health and safety, anti-corruption, and discrimination in the context of labour rights, rather than on human rights more broadly. Companies whose projects have a large physical footprint are the exception to this: they tend to research the target company's record on land and resettlement issues, and notably their relations with indigenous peoples.

Several respondents indicated that they are starting to ask target companies whether they belong to or support relevant voluntary initiatives or have signed on to certain international standards. Examples include the UN Global Compact, the OECD Guidelines on Multinational Enterprises, and the Voluntary Principles on Security and Human Rights. One company asks target companies about their public commitment to human rights and other social performance standards, and the management systems they have put in place to implement, monitor and audit these commitments.

Some acquiring companies inquire about the conditions related to environmental and social issues, including human rights, which have been imposed on target companies by financial institutions such as the those adhering to the IFC Performance Standards or Equator Principles. One company has widened the range of documents that need to be requested and screened during its M&A process to include information on environmental, social and human rights conditions in financing agreements, loans and related documents.

**Companies are starting to scrutinise the business relationships of potential target companies.**

Respondents indicated that, when they scrutinise the human rights performance of a potential M&A target, companies are beginning to consider its business relationships. Several companies ask potential target companies to provide information on their suppliers and contractors, and say what they do to encourage their partners to behave responsibly. One asks potential target companies which codes of conduct they have applied to suppliers, and the extent to which adherence with codes has been incorporated in contracts. Such inquiries rarely mention "human rights" specifically; they do tend to ask about occupational health and safety, and other labour issues including child and forced labour.

**It can be difficult to price reputational and other liabilities related to human rights impacts. A company may find it easier to estimate the cost of bringing M&A targets into compliance with its standards.**

As they do for other areas of commercial risk, business development teams may want a clear financial estimate of what human rights risks may cost the company before or after a target company is acquired, as part of valuing and tracking assets and liabilities associated with the deal. Respondents noted that it is often very difficult to monetise reputational or operational risk linked to human rights impacts. It may be easier to cost legal risks, based on previous claims. Some of the companies surveyed reported that, instead, they estimate how much it will cost their company to align a target company with the company's human rights policies and practices.

Several respondents said that, if searches revealed that a potential acquisition would cause human rights risks and costs, they would generally always prefer to proceed and to mitigate risks and cost by capacity building and other measures, rather than cancel. This was especially true if the target company's human rights shortcomings could be rectified. They would be more reserved if specific allegations had been made against the M&A target (claims of forced or improperly conducted resettlement, for example) which might require immediate and expensive mitigation and remediation, or if the target company continued to breach legal norms. Respondents felt that weaknesses of company culture could usually be fixed; known problems have known solutions, especially when the target company and the acquiring company operate in the same industry. Some noted, nevertheless, that it may be hard to change the culture of a direct competitor, because of staff resentment, or because staff cuts may leave fewer people to implement the change process.

**Human rights issues alone are unlikely to delay a merger, acquisition or disposal unless they are accompanied by other serious (reputational, legal, operational) risks. Companies may have good reasons to become more selective.**

Several respondents acknowledged that it is difficult to persuade relevant staff to review the merits of a merger, acquisition or disposal on human rights grounds alone. The risks most likely to command attention are liabilities from (actual or potential) legal claims, reputational damage, or (some forms of) operational delays. The fact that certain forms of liability may not even be taken into account (see above: *M&A teams may need guidance on when, how and why to consider human rights*) makes it harder still to argue that human rights-related risks should be addressed.

Nevertheless, several respondents suggested that it would be in the interest of companies to be more selective in their acquisitions, mergers and disposals. This is not simply because companies will thereby avoid reputational, legal, operational and other risks. A more selective approach may also be positively received by investors, governments, civil society (including communities), customers and potential business partners. In the long term, companies will benefit if they are perceived to be discerning business partners that consistently act responsibly.

**Inquiries on human rights are more common during mergers and acquisitions than disposals.**

Nearly all companies involved in the research said they look at human rights performance more actively when considering mergers and acquisitions than when they consider disposals. Some respondents felt this is because the risks that a company triggers when it sells assets to another company (that might harm or might have harmed human rights) are less clear than those that arise when it acquires human rights-related liabilities. It may also have less leverage in the case of disposals.

**Formalising the Relationship**

**In acquisitions, leverage should not be an issue in theory but in practice may be more difficult to exercise.**

In theory, it should not be difficult for a company that acquires control to apply leverage. This is less evident in practice, however. Firstly, a company may need to develop targeted internal action programmes to bring acquired assets up to company standards. Secondly, in many cases, such action programmes may not have been effectively costed into the deal, leaving the company with insufficient resources (people and money) to raise standards to the desired level. Thirdly, if the company has less than 50% ownership, it can usually do no more than encourage the acquired company to comply with company policies, and cannot require it to do so.

**Companies tend not to include explicit references to human rights in contracts relating to mergers, acquisitions and disposals.**

According to respondents, companies are unlikely to make explicit references to human rights in contracts (except for some labour rights), and generally refer to a target company's obligation to comply with company codes of business conduct, which may include some commitments to human rights. In some cases, companies require an acquisition to make warranties and representations with respect to liabilities, potentially including human rights-related legal risks; but respondents recognised that this was unlikely to protect an acquiring company against exposure to reputational and operational risks that emerge at a later date.

**Closing conditions may incorporate human rights elements even if they are not included in the contract.**

Several respondents noted that human rights-related closing conditions may be applied in the deal, even if they are not in the contract. For instance, a company may make it clear to a potential acquisition that it needs to divest parts of the business that operate in countries subject to sanction, or may ask the target company to show that it has sufficient funds to deal with any outstanding human rights-related legal claims. As noted below, a company may also require a target company to complete an action plan before the deal is closed, that will raise its standards to those of the acquiring company. According to respondents, such plans are not likely to focus explicitly on human rights, but they are increasingly likely to contain human rights elements.

On disposals, the situation is complex. Several respondents underlined that it is extremely difficult to enforce social or environmental performance clauses in a disposal contract, including those related to human rights. If such clauses appear meaningless, they are unlikely to be retained in contracts.

### **Managing the Relationship**

**If human rights issues are addressed, they are generally integrated in broader action plans that raise the target enterprise's practices to the company's standards. Few companies have stand-alone human rights action plans.**

Several respondents noted that human rights are increasingly integrated in broad action plans designed to bring target companies up to the company's social performance standards. One respondent commented that a stand-alone human rights action plan is not just unusual; it may be counter-productive if it is not supported by staff, who may be unused to human rights concepts and language.

Several respondents said that their companies prefer to entrust the task of monitoring compliance with action plans on social performance, including human rights, to a representative of the acquiring company (rather than the target company). Doing so helps to make sure that the acquisition aligns fully with the company's standards. It may also help to strengthen relationships.

**Target companies may need continued guidance on raising standards.**

While respondents emphasised that expectations with respect to social policies, including performance on human rights, are generally made clear to a target company before a deal is completed, raising standards is often a slow process, particularly with less sophisticated target companies. The pace of integration may be slowed further if the acquisition is asked to adopt and comply with a large number of policies and processes.

Cultural change may also take time. According to one respondent, target companies may have policies or codes that resemble those of the acquiring company, but their implementation and practice may be worlds apart. For instance, employees in an acquired company that have never had access to a complaints procedure (but reported complaints to other forums including senior management) may need in-depth training on how to use a grievance procedure efficiently, to avoid flooding the system.

## **Ending or Renewing the Relationship**

### **Assets can remain associated with a company after disposal.**

Some companies undertake a specific review when they dispose of assets, and will not sell assets to a company that plans to run its project in a very different manner, or to a company with a disreputable history, because of concern for the company's reputation. One respondent noted that it is difficult to monitor compliance with company standards when disposals occur. In one case, the company set up a community foundation to ensure that, under the new buyer, the disposed company would continue the same standard of community relations. However, being difficult to monitor over time, such an arrangement was likely to require the assistance of other stakeholders such as the government, local civil society and community leaders.

### **Disinvestment due to human rights challenges can pose difficult dilemmas.**

Some respondents pointed out the dilemmas that can arise when companies disinvest from countries where the human rights situation had worsened, noting at the same time that human rights campaigns often call for disinvestment from such countries. They observed that disinvestment decisions require companies to balance carefully their commitments to local staff, the impact of disposal on local communities, and broader economic considerations. A company needs to know who will replace its services or activities, and how these will be managed and delivered after the company departs.



## Chapter Seven: Respect for Human Rights in Franchising and Licensing Relationships

### Overview

#### *Brief overview of franchising and licensing relationships*

Licensing and franchising contracts have similarities, but also some significant differences. These relationships can range from a long-term relationship for a branded franchise to a brief, standard contractual relationship to license a patent for a minor piece of technology or intellectual property. By comparison with a license contract, a franchise is usually broader in scope, longer in duration, and more specific. It generally requires more capital up front, but there is more predictability in the nature and duration of the relationship between the franchisor and franchisee. A licensing contract is subject more often to revision and renewal, and usually does not entitle the licensee to the same level of support from the parent company.

A licensing agreement is a contract by which a licensor grants permission to a licensee to use its intellectual property, such as its patent, trademark or copyright. In return, the licensee will generally pay a flat rate or royalties, or some combination of both. This type of contract does not convey ownership of the intellectual property to the licensee. It is more limited in scope than a franchise agreement.

Franchise contracts are based on the idea that, by reproducing a proven business model, both parties to an agreement gain something of value. The franchisor grants a franchisee permission to use its intellectual property and its various systems and marketing campaigns. The franchisee, in return, agrees to conduct the business in accordance with the practices and policies of the franchisor. A franchise contract will often include the franchisor's instructions on how the business should be operated, a license permitting the franchisee to use the franchisor's system, mentoring and technical advice for the franchisee, and a shared obligation to develop and improve the business. Arguably, franchisors have more control over their franchisees than a licensor has over a licensee, because they can determine the structure of the management systems, require specific policies, and provide training.

#### *Human rights and franchising and licensing*

Businesses may consider human rights impacts for a number of reasons when they undertake franchising and licensing. For example:

- When a company name or brand is involved, (whether through licensing or franchising), stakeholders will often make no distinction between the licensee or franchisee and the company. They will have the same expectations of the brand, regardless of who delivers the product or service, or the type and tenure of the relationship. These expectations are increasingly relevant to the company's human rights reputation.
- Human rights impacts do not necessarily correlate with the duration or extent of a relationship. Companies may be exposed to human rights risks if they focus their

due diligence exclusively on longer-term or higher value relationships, because small contracts can also expose them to risk.

- Even in the case of an unbranded licensing agreement, use by the licensee of a company's intellectual property in a manner that has negative human rights impacts can link the licensor to the human rights impacts, as recent examples in the information and communications technology (ICT) and pharmaceutical sectors have shown. The unintended use of licensed materials by customers (including licensees and franchisees) that have negative human rights impacts is an area of growing concern that companies are beginning to address.
- Franchise agreements usually require a franchisee to start new operations, involving the acquisition of property and land, construction of facilities, employment of workers, contracting with local suppliers, and management of the environment. All these stages of business start-up have the potential to link the franchisor with any adverse human rights impacts.
- Intellectual property rights, and their application and enforcement, have implications for human rights that are relevant to business relationships in this area.<sup>83</sup> While protecting intellectual property rights is a valid objective that is often covered by national law, it may have a 'chilling effect' on freedom of expression when there are overly broad attempts to remove content or products from the public domain on claims of intellectual property violations. This human rights issue is becoming a key point of debate, notably in the ICT industry, that may have long-term implications for business relationships.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**It is important to communicate expectations and establish standards early, especially in long-term franchise agreements.**

Since franchises are often long-term relationships that bear the franchisor's trademark, communicating clear expectations about company values and requirements is important. One company noted that it is vital from the start to establish ethical values alongside

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83 There are certain overlaps between the content of human rights and intellectual property rights. "The human right to benefit from the protection of the moral and material interests resulting from one's scientific, literary and artistic productions safeguards the personal link between authors and their creations and between peoples, communities, or other groups and their collective cultural heritage, as well as their basic material interests which are necessary to enable authors to enjoy an adequate standard of living; intellectual property regimes primarily protect business and corporate interests and investments. Moreover, the scope of protection of the moral and material interests of the author does not necessarily coincide with what is referred to as intellectual property rights under national legislation or international agreements." General Comment No. 17 (2005), The right of everyone to benefit from the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he or she is the author (article 15, paragraph 1 (c), of the Covenant), UN Committee on Economic, Social and Cultural Rights.

management, technical and financial standards of performance. The longer-term nature of a franchise relationship can also provide an opportunity to build relationships with franchisees around shared policy goals. By contrast, several of the companies involved in the research treated licensees like suppliers or service providers. Expectations of performance centred on meeting the company code of conduct for suppliers, and the code then became a point of reference for discussion of human rights issues. (See Chapter 4, discussion of codes of conduct.)

**Consumer expectations can stimulate consideration of human rights in these business relationships.**

Franchising and licensing for consumer brands adds an important driver to the business relationship because of rising consumer interest in the human rights impacts associated with the consumer brands they purchase. Consumers are interested in the quality of products and how the goods they consume are produced, and by extension in labour conditions and other human rights issues related to production. They want products to be made safely and humanely. (See the discussion of transparency and traceability in Chapter 11.) Consumer concerns create leverage that companies can use to start a conversation on human rights with their franchisees and licensees, or to justify the inclusion of human rights requirements via contract or management mechanisms.

*Understanding the issues – Assessing human rights impacts in franchising and licensing relationships*

**Company assessments are often more detailed when the company name is associated with the business relationship.**

Licensing and franchising generate additional revenue from intellectual property, licensed processes or the brand, but where they involve the company name, they also generate reputational risk. That can cause the franchisor or licensor to sharpen its risk assessment processes, including those that relate to human rights. One company reported that it had imposed specific requirements on the contractors and subcontractors of a large branded facility, to ensure that their treatment of migrant workers complied with company labour requirements. Another indicated that it became particularly vigilant when licensees marketed certain products or employed the company trademark. Whenever they license a trademark, companies require more detailed adherence to the company's code of conduct. This concern seems to be driven by reputational risk. It is less clear from the research what level of assessments companies require when their name or trademark is not used.

Where franchisees manage a wide range of corporate activities (sourcing, production, marketing), companies noted that assessments need to consider the full scope of issues, benchmarked against national law as well as company policy. One company is developing a suite of human rights due diligence tools, focused on human rights impacts it has identified among franchise operators.

With respect to licensees, several companies noted that their assessments resemble those applied to suppliers, and they often use a pre-certification process. If a potential business partner does not qualify in the certification process, they are not awarded a licensing

contract. One company reported that it paid more attention to the assessment of licenses that had the potential to affect consumer health and safety, compared to “trinkets and trash” licensing of branded apparel or non-consumables. Some companies reported that, when they lacked resources to assess licensing and supply chain partners, they might give a pass to business partners working with other big companies, on the assumption that those companies had already reviewed their performance.

### Licensing and Indigenous Peoples’ Rights

One area where licensing relationships intersect with human rights is when licensing may have impacts on indigenous peoples’ traditional knowledge and traditional medicines. This draws attention to the fact that research and development (R&D) departments may need to address issues, including human rights issues, that they had considered distant from their concerns.

There are deep divisions in the international community over what standards and regulations should govern the protection of traditional knowledge, and how the benefits and income generated by traditional medicines and products patented and licensed for large-scale production by private companies should be shared. One side considers that the intellectual property protection of traditional knowledge and medicines facilitates and advances their transmission, and that their commercial development benefits the indigenous peoples who identified and possess them. The other considers that the intellectual property rights regime, as applied, undermines and exploits indigenous cultures and ecosystems, to the almost exclusive benefit of private companies. The global discussion is a complex one, involving the World Trade Organisation (WTO), the World Intellectual Property Organisation (WIPO), the Food and Agricultural Organisation (FAO), and the Union for the International Protection of New Varieties of Plants (UPOV).

The Convention on Biological Diversity recognises the sovereign rights of states over their natural resources and seeks to promote the fair and equitable sharing of benefits from the use of genetic resources and associated traditional knowledge. The Convention’s access and benefit sharing agreement shifted protection of traditional knowledge and medicine to the national jurisdictions of states. As a result, companies need to exercise due diligence to ensure they do not infringe national law. The multilateral Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement (under the WTO) established for the first time a minimum standard for global free trade, including free trade in intellectual property.

Several cases of alleged misappropriation of traditional knowledge have attracted attention in the past twenty years. These have often involved the exploitation of genetic resources for medicinal use. Companies have been accused of infringing access and benefit sharing requirements in South Africa, Peru, Bolivia and a number of Asian countries.

**A partner's capacity to manage human rights issues is an important dimension of assessment.**

Because franchisees may be required to manage a wide range of requirements, assessments often focus on the quality of the business partner's management system. Some require partners to support their systems with training and audits. The objective is to continuously improve their capacity, not least to enable franchisees to cope with the appearance of new and emerging human rights issues, particularly ones that were not covered by the original franchise agreement.

**Formalising the Relationship**

**The duration of many franchise agreements makes it necessary to manage human rights issues throughout the relationship, rather than relying on the contract.**

As franchisees are often producing or selling products or services using company trademarks, central requirements of their contracts often require them to comply with local law, uphold quality, and refrain from injuring the trademark. One company noted that, since the relationships – and contracts – are often long-term and complex, companies are reluctant to load more into the contract. Instead, franchisees are provided with training and other resources that enable them to adapt their operations when new issues arise, including those of relevance to human rights. This is an example of creating leverage based on managing the relationship rather than relying solely on the contract. The contracts for longer-term or more significant licensing agreements often require licensees to comply with the company's supplier code of conduct.

**Managing the Relationship**

**Companies use many forms of leverage to focus franchisees' attention on human rights issues.**

As many franchise relationships are longer-term, the relationship dynamics can be very different from short-term relationships based principally on contracts. As one respondent put it, "if you rely on the contract to alter behaviour, you've already lost". Given the potential reputational risks associated with franchising, a franchisor is motivated to help franchisees work through problems and increase their capacity; termination is not the preferred option, except when faced with egregious abuse.

Extended franchise relationships also need to be flexible, able to adapt to change and raise standards over time.

Franchisees may need franchisors to support them in building their capacity to respond to their human rights expectations. One way to incentivise appropriate behaviour among franchisees is to provide governance, processes and tools that motivate them to continuously improve their standards and performance. "Translation" of human rights into operational targets and management systems is critical, as one respondent

noted, because it creates a clear list of requirements that both parties can track and report. Companies can also develop a shared approach to human rights issues by joining industry or multistakeholder initiatives in which both franchisors and franchisees have an interest.

### **Companies routinely track the human rights performance of franchisees.**

Given the importance of franchise relationships, companies often have monitoring systems in place, similar to the social compliance systems they use for suppliers. These typically include audits to identify non-compliance with agreed standards, corrective action, and follow up. Results and follow up actions are typically tracked. “Audit fatigue” and cost concerns can cause resistance to corrective action. As noted in Chapter 8 (on Suppliers and Service Providers), the “social compliance model” provides an approach to identifying and addressing human rights impacts, which may require some adjustment in light of the Guiding Principles. For long-term relationships, capacity building may ultimately be a more sustainable approach.

Licensees who have a contractual obligation to comply with company codes of conduct may also be subject to monitoring. As with assessments, companies are often prioritising their monitoring among licensees in light of resource constraints. In many cases, the primary driver is reputational risk.

### **Grievance mechanisms are a work in progress.**

Companies may install a telephone hotline, website access (or both) and may also request a franchisee to run its own hotline. Respondents said that the main point is to ensure that franchisees have systems that can receive and address employee and community grievances. As noted in Chapter 4, hotline mechanisms are only one element of operational grievance mechanisms defined in the Guiding Principles.

## **Ending or Renewing the Relationship**

### **Terminating a relationship usually requires several steps.**

Franchise agreements are usually long term. Termination is rare, but not unheard of. When it happens, it is often tied to markets and performance, but one company noted that it had terminated franchisees on human rights grounds. (The franchisee had been discriminatory and had failed to respect freedom of association.) Faced by less serious breaches, sale to another franchisee, taking control, or buyout are options. When licensing agreements require compliance with a company code of conduct, breach of the code may be a justification for termination but, as in other types of relationships, it is usually not the preferred option.

### **Complying with a Licensor's Social and Environmental Requirements**

Business for Social Responsibility (BSR), a global network of over 250 companies that are developing sustainable business strategies and solutions, recently produced a guide for licensees in consultation with the Licensing Industry Merchandisers' Association. *Good Practices for Complying with Licensor's Social and Environmental Requirements*<sup>84</sup> provides information on how to meet the expectations of licensors and brands with respect to social and environmental standards in supply chains. The guide covers: licensors' expectations; social and environmental compliance in licensees' business relationships with suppliers; assessing risk; communicating with licensors; remediation steps to help improve working conditions; and collaboration with others around social and environmental challenges related to licensing.

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84 At: <http://www.bsr.org/our-insights/report-view/good-practices-for-complying-with-licensors-social-and-environmental-requir>.



## Chapter Eight: Respect for Human Rights in Supplier and Service Provider Relationships

### Overview

#### *Brief overview of supplier and service provider relationships*

A supply contract is an agreement between a vendor and a customer for the procurement of goods. A service contract is an agreement for the provision of services. A “hybrid” contract includes elements of both. Contracts set out the specific goods and services to be provided, the costs and means of doing so, and allocate risks between the parties.

Supply and service relationships are often critical to the efficiency and effectiveness of a company’s operations. Many types of supply and service arrangement exist ranging from: purchasing a product or service directly from another business, to standard purchase contracts (sometimes conducted electronically) for commodities where there is never a direct relationship between the buyer and the seller, trader or producer, to outsourcing critical functions involving outside service providers who are privy to the intimate details of a company’s operations on a long-term basis. The terms of contracts also range widely, from standard form agreements, to complex documents with payments tied to performance criteria. Supply and service provider relationships can involve long chains of entities that may or may not be contractually linked.

Supply and service contracts are often agreed by two or more parties following the issue of a request for proposals. The request and subsequent contract frequently use similar language. Contracts are often tailored to meet the specific needs of the parties, clearly articulating their rights and obligations. Typically (though not always), the buyer can assert a degree of control over the supplier or service provider. In certain contracts (such as consigned manufacturing contracts), the buyer determines all terms and conditions, and selection criteria, and retains control for second and third tier suppliers.

The extent to which a company conducts up front due diligence on its suppliers and service providers typically depends on how many it has, the volume and value of contracts, and its perception of risk. Contracts tend to specify in detail the goods or services to be delivered and may contain incentives and provisions for monitoring the delivery and quality of particular goods or services, as well as penalties (including the possibility of termination) for non-performance. While monitoring production quality has a long history, it is only comparatively recently that monitoring of environmental, health, safety and labour has been regularly included in an increasing range of industries’ supplier and service provider contracts. When companies have long-term relationships with service providers or suppliers, they tend to work with them to improve practices rather than end relationships.

### *Human rights and suppliers and service providers*

Businesses may consider human rights impacts for a number of reasons when they work with suppliers and service providers. For example:

- Several of the early defining moments of the human rights and business movement were around supply chains – children making clothes, stitching footballs, weaving rugs. Media and NGO campaigns put human rights issues front and centre in some sectors. It is the business relationship category that has attracted the most consistent attention from the human rights community. There has been a particular focus on labour rights, starting in the apparel and sporting goods industries, working its way into the electronics and consumer goods industries, and increasingly into other sectors.
- Although labour rights are often the focus of human rights attention, supplier and service provider relationships can impact on a range of human rights. Problems have been associated *inter alia* with security provision, resettlement (e.g. due to factory expansion), air and soil pollution, and access to water resources. Though public attention has concentrated on working conditions in developing countries, recent cases in the agricultural, hospitality, and cleaning sectors have shown that human rights are equally relevant to supply chain relationships in developed countries.
- Advocacy on human rights abuses in supply chains focused initially on branded products in a few specific sectors. However, interest in improving social and economic development through improved conditions in global production networks has now spread to a wide range of products and services, from commodities to tourism. The number of initiatives addressing production conditions has exploded in recent years.<sup>85</sup>
- Companies are increasingly expected or required to be transparent about the origins and conditions of production of their products. This has implications for all their production relationships. Slowly, information about the origins of goods, and their conditions of production, are being standardised and becoming more widely available to consumers.
- Some governments use procurement incentives and disincentives to encourage companies to promote human rights and sustainability in their value chains. Though it is unclear how governments weight these factors alongside price in final award decisions, companies that have human rights due diligence systems in place will be in a better position to respond than companies that do not.

Many valuable initiatives promote and support business attention to human rights in supply chains. Frequent news reports and an extensive literature have examined human rights abuses in supply chains and service relationships. This chapter does not review that work but focuses on the relevance of the Guiding Principles to business relationships with suppliers and service providers based on information from respondents.

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85 See for example, <http://www.standardsmap.org/>.

### What the Guiding Principles Bring to Supply Chain Relationships

Branded companies are increasingly requiring first tier (and sometimes second or third tier) suppliers to provide specified labour and working conditions that are in line with, or approximate to, internationally agreed standards. Approaches have often been 'audit led': brands at the top of the supply chain commission internal or external expert teams to verify that suppliers comply with codes of conduct set out in supplier agreements.

The Guiding Principles call into question some aspects of this traditional way of managing supplier relationships.

**First**, the Guiding Principles apply to all businesses, regardless of geography, size or sector. Therefore suppliers too have a responsibility to respect human rights, and take action to prevent their activities from causing or contributing to adverse human rights impacts. On these grounds, the Guiding Principles encourage companies to strengthen the management and leadership of their suppliers, so that they can conduct their own human rights due diligence. In effect, the capacity to manage takes precedence over successful audit results.

**Second**, the Guiding Principles require companies to prevent and mitigate negative human rights impacts (rather than merely complying with company standards). For example, the Guiding Principles encourage companies to proactively consider the adverse impacts of their purchasing behaviour, or the harm they might cause if they place supply chains in areas that have known human rights risks.

**Third**, the Guiding Principles require all businesses that are parties to a relationship to exercise due diligence with regard to *all* relevant human rights impacts, not just those relating to core labour standards. This might require companies to look at human rights issues within the workplace, which do not traditionally fall within labour relations (such as 'privacy'), and at impacts on workers and communities outside the workplace. (Relevant issues might include worker dormitories and accommodation, or mental health or family abuse issues associated with overwork or degrading conditions.)

As highlighted in this Report, the Guiding Principles are a new framework that is prompting companies to think carefully about its implications for their operations and their business relationships. Traditional approaches to supply chains may not be fully fit for purpose, suggesting that even familiar areas of corporate responsibility need to be reappraised.

## **Orienting and Embedding – Internal Company Management of Supplier and Service Provider Relationships**

### **Creating coherence between human rights policy commitments and procurement is a well-recognised challenge.**

Many of the companies in the research have specific and dedicated procurement departments to oversee supply chain relationships. These are backed up by procurement management systems that cover all phases of the business relationship, from identifying and evaluating suppliers, to selecting and negotiating contracts, monitoring and termination. Procurement departments and auditing functions are often managed by technical experts. Internal guidance developed by dedicated human rights staff or cross-departmental teams may be necessary to help these experts assess potential human rights issues. A number of companies have formed cross-departmental teams to make sure their environmental and human rights standards are fed into the procurement process.

The Guiding Principles note that procurement systems in particular need to be monitored for coherence. One well-known example involves a company's purchasing department issuing orders that undermined overtime pay, which conflicted with the company's supplier code of conduct requiring adherence to ILO standards for working hours and overtime pay

Respondents that are themselves suppliers highlighted the pressures suppliers face, especially in seasonal supply chains and when sudden demand peaks oblige their workforces to do extensive overtime. These pressures may force suppliers to balance their ability to fulfil signed contracts against their contractual obligations to maintain agreed working conditions, and price. Companies raised questions about the impact of end consumers' behaviour and expectations regarding price and lead-time demands and their own resultant human rights impacts.

Respondents identified a number of approaches they have taken to achieve coherence on human rights across company functions. Companies:

- Evaluate certain human rights requirements, and consider them, separately and alongside price, when they take decisions.
- Use pre-qualification systems to evaluate a supplier's ability to manage human rights issues.
- Train procurement staff to understand company codes of conduct and standards on appropriate workplace conditions and apply them in their procurement procedures.
- Explicitly monitor procurement orders against the company's human rights requirements, giving special consideration to the impact on suppliers and their staff of seasonal demand and demand peaks. Conduct periodic follow up and re-evaluation on an ongoing basis.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**Companies most frequently set and communicate their expectations for suppliers and service providers by developing company codes or policies.**

Respondents emphasised the importance of making clear to business partners what human rights standards they are expected to uphold, as purchasers of supplies and services and as suppliers and service providers themselves. Among the six business relationships covered in this Report, companies often have the most explicit human rights expectations of their suppliers. Respondents identified several approaches, usually articulated in a code of conduct. Companies:

- Apply the same expectations to suppliers that they apply to themselves in order to demonstrate that they can meet their own requirements.
- Develop codes of conduct specifically for their suppliers.
- Apply a graduated system, setting the strictest requirements for contractors who work on-site (akin to those applied to employees); less strict though still extensive expectations for strategic suppliers or service providers; and with fewer requirements for suppliers deemed less strategic.

Dedicated supplier codes of conduct usually focus on a defined set of labour rights, often the eight ILO core labour conventions. They often follow ILO definitions and standards (though not always fully), and refer to underlying ILO or other human rights standards (though not consistently). Respondents regularly mentioned child labour and forced labour when they discussed supply chain codes, with some treating breaches in these two areas as cause for termination in their standard contracts with suppliers. The codes of a few companies cover other labour rights, such as wages and benefits, and a few make reference to freedom of thought, conscience, religion, speech, or to community issues that implicitly or more explicitly integrate a wider range of human rights principles. Most codes expect companies to comply with national law. Industry-wide codes, like the Electronic Industry Code of Conduct, help to clarify expectations across a sector.

Supplier codes of conduct and detailed procurement requirements are evidently points of leverage. Suppliers or service providers meet or agree to meet them, and are not considered for partnership if they do not. Recognising that smaller suppliers or service providers may initially be unable to meet requirements, several respondents have capacity building programmes that assist such suppliers meet the requirements over time.

Companies that seek to ensure human rights are respected throughout their supply chain often find it difficult to communicate clear expectations and standards to business partners, as called for in the Guiding Principles, and at the same time act with the flexibility they require to deal with potential human rights issues in widely different and unpredictable circumstances. Particular human rights risks arise in certain countries

and sectors of a supply chain, new human rights issues appear that may not be covered in existing codes, and stakeholder expectations ceaselessly evolve and change. The Guiding Principles expect companies to assess their arrangements at regular intervals; periodically, they are also expected to undertake a more general review of their actual and potential impacts inside and outside supplier or service provider facilities, to capture broader trends and issues. Well-functioning operational-level grievance mechanisms offer a further way of identifying new human rights impacts requiring attention in the relationship. In response to these expectations, respondents said their companies had implicitly or explicitly adopted several approaches. Some:

- Undertake more detailed human rights due diligence on higher risk countries, sectors or partners.
- Add more detailed requirements to the procurement system (such as pre-qualification criteria that may not be public but are used to vet suppliers).
- Insert more detailed requirements in their contracts.

*Understanding the issues – Assessing human rights impacts in supplier and service provider relationships*

**Understanding the supplier or service provider is a key part of understanding potential human rights risks.**

Respondents highlighted the often-huge range of suppliers and service providers they deal with. They include other multinationals, small and medium sized enterprises, and companies in every form of jurisdiction. Some are based in the OECD, others in countries that have weak or contradictory laws and poor or non-existent law enforcement. Some partners set extremely high standards of conduct, while others have little or no awareness of their human rights obligations and have little internal capacity to assess or manage them. In some instances, suppliers and service providers may actively conceal their adverse impacts on human rights. The respondents noted that it is often impossible to undertake human rights due diligence on all partners. In such cases, they instead use a prioritisation system (see below).

Most of the companies involved in the research consider the assessment of potential business partners, particularly more strategic suppliers and service providers, to be of fundamental importance to the due diligence process. Many have extensive “know your customer” procedures they use with business partners, grounded in their experience of anti-corruption and anti-money laundering standards. They sometimes undertake a very extensive review of a business partner’s record and reputation. Several companies explicitly review any court cases involving human rights, as well as public sources that link the business partner to human rights issues. In this respect, respondents regretted that very little reliable information is publicly available.

Some companies in the extractive sector look explicitly at a supplier’s community commitments (for example, social investment plans, local hiring, training programmes for local communities, provision of services and local purchasing targets). In some

countries, government local content rules impose local hiring and purchase quotas. For specific types of service providers (notably private security forces) companies carry out specific background checks, often using specialised consultancy services. External benchmarks, such as membership in the Dow Jones Sustainability Index, also figure in some companies' initial assessment of partners.

A number of companies have pre-qualification systems, some of which address specific human rights (notably child labour, forced labour, health and safety and discrimination), as well as broader environmental and social issues. Inquiries may be supplemented by on-site inspection. Several companies explicitly review a supplier's management system and its ability to manage key procurement requirements, including human rights issues that are referenced in company codes of conduct and procurement rules. These checks provide some additional assurance that business partners have the capacity to address key performance challenges, rather than relying on contractual requirements alone. One company has developed a corporate responsibility self-assessment module specifically for suppliers, undertaken after pre-qualification, and when the supplier has agreed to abide by the company's code of conduct. In some companies, more detailed "key performance indicators" (KPIs) are further applied to track performance. These pre-qualification systems provide an interesting opportunity to put the analysis of the technical and management capabilities of supplier systems into the hands of human rights experts in companies (if such expertise exists). When suppliers are considered high risk, some companies also do post-award audits involving desktop due diligence followed by on-site inspection, leading to a detailed action plan.

**Assessing country risks often depends on where the supplier or service provider is located and the types of services provided.**

Many respondents undertake country assessments on a wide range of issues. Their first basic question is whether to do business in a country. Some then look more explicitly at human rights issues, using publicly available sources such as the Business and Human Rights Resource Centre or commercially available sources. The analysis that emerges is then applied to identify key risk areas, for example the heightened vulnerability of migrant workers in some countries, the prevalence of child labour, or the presence of indigenous peoples. On the basis of this work, companies prepare a broader risk analysis. Some companies do not conduct country risk analysis in OECD countries, judging that their domestic systems are sufficiently robust to protect human rights.

**Faced by complex supply chains, companies prioritise certain risks. Some are developing approaches to risk that explicitly consider human rights.**

Context matters when identifying human rights risks, which tend to be locality and sector specific. Given this, and the length and diversity of supply chains, human rights due diligence processes need also to be locality and sector specific in order to identify and prioritise these risks (see Chapter 2 for further discussion on prioritisation). The supplier screening systems of a few respondents explicitly prioritise in-depth reviews of regions, sectors or suppliers that present high human rights risk. This mirrors the Guiding Principles' pragmatic view that companies with large supply chains may find

it unworkable to assess human rights risks in each of their relationships. The Guiding Principles expect a company to adopt an approach that prioritises the most serious risks, focusing on risks to people (not just risks to the company). Respondents recognised that this new approach may generate “counterintuitive” results for procurement systems that have traditionally been driven by volume and price.

In deciding which suppliers to focus on, one company evaluates human rights risk by country and by industry and focuses on suppliers that score high in both categories. Other companies identify products and services that generically raise human rights concerns (for example, small and home-based producers who may employ child labour). Prioritised suppliers are then often targeted for site visits. One company is actively searching out suppliers and contractors who employ disabled workers. This illustrates how a business can promote suppliers who provide a non-discriminatory workplace. Other companies have not yet started to prioritise. As a first step, they are focusing on incorporating human rights issues in their procurement systems, in a manner they find manageable.

**As one respondent noted:**

“We are trying to get a more comprehensive picture of the impacts of our products and services and we are doing that in two principal ways. We are working with the Danish Institute for Human Rights to develop a grid that evaluates our suppliers on human rights issues, and we are mapping our own products and services in all regions around the world to look at the human rights and environmental risks and opportunities associated with those products and services.”

**Stakeholder consultations in supply chains often focus only on workers once the relationship has started.**

While companies consult stakeholders about the overall direction of their human rights policies, some take the view that it is the responsibility of their business partners in the supply chain to consult local stakeholders.

Once a business relationship has been established, companies do interact to an extent with workers when they audit through their supplier monitoring programmes. The Guiding Principles expect companies to integrate stakeholder input in their human rights due diligence, but give little guidance on how this is to be achieved in large supply chains.

Respondents whose projects have a large physical footprint, involving many suppliers and service providers, generally utilise a well-developed methodology around interactive, consultative environmental and social impact assessments. It is unclear however, how much and when businesses involve external stakeholders in their assessments of human rights impacts in other suppliers and service provider relationships, even the more significant ones.

**When supply chains consolidate, it is an opportunity to align shared values.**

Several companies participating in the research detected a growing trend to consolidate supply chains. Companies are creating deeper relationships with fewer suppliers, particularly strategic ones. In the process, purchasers focus on long-term value, grounded in expertise more than price. This implies closer and longer-term relationships, and sharing of standards and systems. It may be that this process will make it easier to integrate human rights, ethical values and good practices in supply chains.

**Companies do not yet know how to calculate the efficiency of their spending on supply chain compliance.**

None of the companies consulted could readily calculate how much their supplier monitoring system costs or whether the benefits justify its cost. One estimate carried out in Denmark calculated that Danish companies spend annually on their monitoring systems an amount equivalent to 40% of the Danish foreign aid budget.<sup>86</sup>

**Formalising the Relationship**

**Contractual references to human rights issues serve several purposes.**

Noting that it would be prohibitively expensive and burdensome for companies to conduct human rights due diligence across whole value chains, many respondents observed that standard contractual provisions that reference human rights serve several purposes:

- They codify expectations upfront and provide a means to raise questions and require corrective action when things go wrong, especially when coupled with contractual provisions on monitoring and auditing.
- They provide a contractual justification for termination if corrective action is not taken.
- They prompt suppliers and service providers to reflect on their responsibilities.

Respondents undertake a range of different approaches to contracting. Many companies require suppliers to adhere to their codes of conduct or other supplier standards, which contain (explicit or implicit) human rights requirements, rather than directly reference human rights issues in contracts. One company participant does not include requirements on supplier auditing and corrective action unless there is a realistic expectation that they will be implemented. It considers that contractual provisions alone, without the capacity to deliver or follow them up, risk presenting a façade of attention that may mask significant or underlying human rights risks.

Most companies have some kind of standard form agreement that can be adapted to local law and conditions, with varying levels of control by legal counsel in company headquarters. In many companies, the business team that holds overall responsibility for the supplier relationship is responsible for the contracts that relate to it.

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<sup>86</sup> *Changing Course – A study into Responsible Supply Chain Management*, Global CSR and Copenhagen Business School for the Danish Ministry of Foreign Affairs (2011), 13. At: [http://www.global-csr.com/fileadmin/Our\\_Approach/RSCM\\_MainReport\\_110111.pdf](http://www.global-csr.com/fileadmin/Our_Approach/RSCM_MainReport_110111.pdf).

**Given the wide range of their relationships, companies use an array of tools to generate leverage.**

It is often assumed that a large multinational will always be a large purchaser with leverage to impose conditions on its supply chain or service providers. In reality, the size of the contract varies widely and relationships are so diverse that companies need to actively adopt many techniques to create leverage over suppliers directly linked to their operations, products and services to respect human rights. This is especially true when supply chains are long and increasingly anonymous.

When discussing what causes suppliers to adopt shared values, respondents repeatedly emphasised the effectiveness of incentives and capacity. To secure change, several companies said they provide suppliers and service providers with incentives (repeat business, capacity building, opportunities to build their systems, offers of preferential treatment) rather than impose punitive approaches (contractual requirements, auditing systems). One company uses “supplier scorecards” (that include EHS issues), which it uses to assign new business and reward suppliers who perform well.

**Creating Leverage Beyond the First Tier**

When seeking to create leverage beyond first tier suppliers, different approaches were identified. Companies:

- Require suppliers to apply the company’s code of conduct or an industry-wide code of conduct in their contracts with their suppliers (sub-suppliers).
- Involve sub-suppliers in training and capacity building.
- Encourage first tier suppliers to promote key values among second tier suppliers, thereby engendering wider local buy in.
- Apply the same requirements to all contractors and sub-contractors who work on a site or in connection with a project.
- Make use of local content requirements to involve government departments and local NGOs in longer-term capacity building programmes.
- Simplify contract award procedures if standards are met and maintained.

**It is common to specify the consequences of non-compliance.**

Most companies stated that their contracts specify the consequences of non-compliance with contractual conditions or company codes of conduct. Where suppliers do not comply with legal and regulatory conditions, companies usually define the corrective action they must take, monitor their performance, and eventually terminate the relationship if non-compliance persists. Many companies emphasised that their objective is not termination but compliance, because termination can harm the interests of the company, the supplier and potentially the suppliers’ employees.

### **Graduated contractual provisions can provide flexibility.**

Though not a common practice, some companies use or are considering using graduated contractual requirements to address different levels of risk in their supplier relationships. These could potentially be adapted to address human rights risks. When a company identifies that a supplier relationship is high risk, it monitors the supplier more frequently and requires it to meet more stringent or more detailed conditions. A different approach may be taken for less sophisticated suppliers: the company includes more capacity building and training in the contract, and inserts higher penalty levels if “things really go wrong”.

### **Understanding and Managing Contracting Chains in the Oil and Gas Sector**

A recent report by the International Institute for Environment and Development (IIED), **Shared value, shared responsibility: A new approach to managing contracting chains in the oil and gas sector**,<sup>87</sup> highlights critical challenges for major companies. These include how to:

- Cultivate a sense of shared responsibility throughout the contracting chain and across stakeholder groups.
- Adequately implement systems and procedures to enforce standards and incentivise good performance.
- Operate across differing cultural and contextual landscapes.

The report identifies short and longer-term recommendations. These include:

- Collaborate on early-stage planning and assessments.
- Invest in capacity building in underdeveloped local markets.
- Encourage uptake of standards through procurement processes.
- Ensure that contracts incentivise good practice.
- Build capacities and trust on the job.
- Ensure excellent communication and oversight throughout the contracting chain.
- Build trust and accountability with external stakeholders.

### **Companies are asking partners to communicate the company’s requirements to their business partners.**

Several companies require or expect their suppliers or service providers to apply the company’s code of conduct to their own direct sub-contractors and potentially to further layers of the supply chain. Some also require suppliers or contractors to audit sub-contractors. These provisions serve to cascade human rights requirements down the supply chain and extend the company’s human rights influence. Some companies explicitly review a contractor’s application of provisions to sub-contractors, while

87 <http://pubs.iied.org/pdfs/16026IIED.pdf>.

others noted they see explicit legal problems with going more than one step down the supply chain. All the companies recognised that practical difficulties arise when they seek to exercise influence beyond the first layer of the supply chain. Several noted, nevertheless, that they are analysing their full supply chain, often in response to new US requirements on conflict minerals (see box above). On-site operations provide the exception. Several companies impose explicit requirements (typically health and safety rules) on all contractors, sub-contractors, and sub-sub contractors who enter their sites. These requirements are enforced by a strict system of visual, on-site inspection.

**Reflecting MSI and industry initiative requirements in contracts is an approach to note.**

Earlier chapters have already observed that several MSIs explicitly or implicitly address human rights issues in the supply chain or with service providers. They include the Voluntary Principles on Security and Human Rights, the Roundtable on Sustainable Palm Oil, the Kimberley Process Certification Scheme, the Electronic Industry Code of Conduct, and the Fair Labour Association. Some of these initiatives have developed specific guidance on management of supply chains and service providers. Some MSIs explicitly require their provisions to be included in supply chain or service provider contracts (where they are usually referenced). Referencing all or part of their codes or guides within contracts with suppliers or service providers has several advantages. They:

- Provide a shorthand way to authoritatively define detailed expectations, because most have been carefully negotiated and discussed, often in a multistakeholder setting.
- Clarify the meaning and intention of certain contractual conditions.
- Provide for referral of disputes (where an MSI has created this function).

As with other clauses on human rights issues, more meaningful attention and leverage are possible if contractual requirements include compliance with these initiatives (or relevant parts of the initiatives), and are backed up by additional provisions providing for on-going tracking and communication, as called for in the Guiding Principles.

### **Due Diligence in Supply Chains around Conflict Minerals and Metals**

“Conflict” in company supply chains has been making headlines since the 1990s. Since the original controversy over ‘blood’ diamonds, the mining and supply of a range of minerals (tin, tungsten, tantalum, gold) has come under scrutiny, notably in the Democratic Republic of Congo (DRC). Numerous multistakeholder approaches to regulation of the production and use of minerals and metals have been created by states, civil society, trade unions and business.

- **The Kimberley Process and Certification Scheme (KPCS)** was the first of these joint initiatives. A tripartite government, industry and civil society initiative, formed to stem the flow of conflict diamonds, the KPCS is an import-export certification scheme that requires governments to certify that the origins of rough diamonds are conflict-free.

- The OECD organised a multistakeholder process with the eleven African countries of the International Conference of the Great Lakes Region, and with industry, civil society and the UN Group of Experts on the DRC. The group produced the **OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas**.<sup>88</sup> This document focuses on the supply of tin, tantalum and tungsten, while a **Supplement on Gold**<sup>89</sup> was published subsequently. These reports provide guidance to companies on their due diligence responsibilities at different phases of mineral and gold production and supply.
- The recently launched **Public-Private Alliance for Responsible Mineral Trade**<sup>90</sup> brings together the US government, twenty high-tech and automotive companies, four industry associations, six NGOs and the International Conference of the Great Lakes Region. It aims to establish fully traceable and validated supply chains that are credible to companies, civil society and governments, and to act as an information hub for those interested in taking action on responsible minerals trading.

Two additional industrial initiatives are looking at improving the traceability of products.

- **The Electronic Industry Citizenship Coalition (EICC) and the Global e-Sustainability Initiative (GeSI)**, two socially and environmentally focused electronics industry associations, have joined forces to address conflict minerals in the electronics supply chain.<sup>91</sup> Their joint working group will enable companies to source conflict-free minerals by: implementing their Conflict-Free Smelter and Due Diligence programmes; supporting in-region sourcing schemes to enable future legitimate trade from the DRC and surrounding countries; supporting the OECD's due diligence guidance; and engaging with stakeholders.
- **The Responsible Jewellery Council (RJC)**, a membership organisation of over 360 businesses and associations in the diamond, gold and platinum metals supply chain, has undertaken several multistakeholder initiatives. The most recent is the Chain-of-Custody Certification Standard,<sup>92</sup> which guarantees that materials are conflict-free and responsibly produced according to the human rights, labour, environmental and ethical standards outlined in the RJC Code of Practice.

88 At: <http://www.oecd.org/dataoecd/62/30/46740847.pdf>.

89 At: <http://www.oecd.org/dataoecd/54/39/49187571.pdf>.

90 At: <http://www.resolv.org/site-ppa/>.

91 At: [http://www.eicc.info/documents/EICC-GeSI\\_ConflictMineral\\_Overview\\_30May2011FINAL.pdf](http://www.eicc.info/documents/EICC-GeSI_ConflictMineral_Overview_30May2011FINAL.pdf).

92 At: <http://www.rjc-dev.logicspot.com/chain-of-custody-certification/>.

## Managing the Relationship

### **Monitoring (some) suppliers has become a routine part of supply chain relationships.**

Given the long history of attention to this issue, it is noteworthy that the basic approach to addressing human rights with suppliers has not evolved significantly since the early days of monitoring supply chains, nor as the system has migrated from industry to industry.<sup>93</sup> All the companies that participated in the discussion of supply chains employ a similar system for setting standards, monitoring, and correcting shortcomings of performance. Respondents implicitly or explicitly recognised the need to review their business relationships periodically because all have a form of risk-based monitoring for their suppliers. This often combines supplier self-assessment with company or independent third party assessment. Assessments determine which suppliers are audited, based on a range of factors (country risk, number of employees, type of labour, quality of relationship). Monitoring usually focuses on supplier compliance with the company's code of conduct for suppliers, or other contractual requirements.

Respondents raised questions about the extent to which companies' continuous monitoring of suppliers should employ KPIs that examine human rights performance vis-à-vis their code of conduct or other business principles (as well as more traditional indicators that focus on operational and financial performance and customer satisfaction). It was noted that a company's decision to use standardised performance indicators will be influenced by its position on human rights, and its size, sector, and operating context.

### **Companies are reducing the audit burden and identifying key concerns.**

If non-compliance is discovered, a company will usually prepare a corrective action plan that is monitored until the supplier or service provider completes the corrective action. Some companies have banded together with others in their sector to reduce the auditing burden on suppliers and shifted attention to corrective action, for example using the Supplier Ethical Data Exchange (SEDEX). Others, while recognising the trends noted above, have moved towards an incentive-based approach, away from one based solely on monitoring.

In addition to structured monitoring systems, several companies review human rights issues by "piggybacking" on other forms of audit or monitoring. One company participant used safety inspections to monitor child labour. Several companies referred to "eyes wide open" visits. Here, staff familiar with the company's standards and code of conduct are trained to keep their eyes open for breaches of human rights when they visit suppliers or service providers for an unrelated purpose.

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93 See footnote 70, which assesses the current array of initiatives and considers the extent of their demonstrated impacts on working conditions.

**Non-compliance measures are often viewed by suppliers as punitive. Some companies find proactive and incentive-based systems more effective.**

When supply chains are very long, many respondents observed that it is not feasible to provide capacity-building support to all supply chain or service partners. Such programmes often focus on specific business needs (such as meeting local content regulations), particular risks to the company (such as security issues), or a more general approach to driving productivity. Their content ranges from sharing good practice, to detailed technical training, or induction into web-based tools. In some cases, companies have engaged local NGOs as trainers, or asked local suppliers to sub-contract this service. Capacity building is an important complement to contractual conditions to avoid situations where companies use contractual conditions to shift liability for human rights failures to partners who lack knowledge or capacity to seriously address the issues in question (as discussed in Chapter 2).

Some companies run capacity building programmes, often designed specifically for local SMEs, to meet their procurement standards (including those related to human rights). Other companies said they lacked the capacity to provide such outreach. In some cases, capacity building had purely business motives (to respond to increasing local content requirements, particularly in the infrastructure and extractives sectors). A number of companies wished to build or deepen local acceptance. Still others undertake capacity building because they understand it to be core to their social responsibility.

**Some reporting by suppliers and of audit results is occurring in select sectors.**

As noted above, considerable attention has been devoted to human rights problems in supply chains, particularly in certain industries. Several companies in sectors subject to stakeholder scrutiny report on their supply chain auditing programmes and results, and some report in detail (though they rarely disclose the identity of suppliers). Several companies in the retail sector transparently report on business relationships in their supply chain, but this is not yet a widespread trend.

**‘Whistle-blower lines’ are the most common form of grievance mechanism, but practices vary.**

Businesses in the sector have adopted different models of operational-level grievance mechanisms. One of the most common is a “whistle-blower line” or website on which individuals can report concerns confidentially. These procedures tend to focus on company policy or compliance with codes of conduct, supported by a process to assess and address issues that are reported. A few of the companies in the research allow complaints about business partners to be reported via their own whistle-blower line. Others require business partners to operate their own whistle-blower system. Some others have either not yet addressed the issue or consider it entirely the business partner’s responsibility.

Some companies whose projects have large physical footprints require their principal contractor to establish an operational level grievance mechanism for community relations issues. The contractor is required to report on grievances and their resolution.

### MSIs can assist companies to resolve disputes and prompt development of effective dispute mitigation.

MSIs can provide an obvious place to resolve disputes but experience here is a work in progress. Respondents noted a number of features of an effective MSI grievance process. It should encourage cooperation among the different tiers in the sector's supply chains and open dialogue between stakeholders. It should also encourage active mitigation of issues before escalation to the MSI. To provide accountability, the grievance process could include a membership termination option, if members do not adequately resolve 'serious grounds' of complaint against them.

### Innovations on Labour Standards Compliance

Much innovative research has recently been done on supply chain management.

- **The Capturing the Gains Programme.**<sup>94</sup> Based at the Brooks World Poverty Institute at the University of Manchester, this programme considers that "economic and social upgrading" contributes to more sustainable growth and development in global production networks. Economic upgrading stimulates innovation and competitiveness among firms, while social upgrading promotes employment based on decent work and respect for labour standards. The programme is investigating how private sector global production networks are changing the dynamics of trade, production and employment in developing countries.
- **The Commitment Approach.** An alternative to lean production and traditional labour standards compliance models has recently been developed by Richard Locke and others at the Massachusetts Institute of Technology (MIT).<sup>95</sup> While the concept of lean production is well established, the research applies it to supply chains to improve certain labour standards (wages, overtime and accident rates, though not freedom of association). Complementing traditional compliance-driven approaches to production, the 'commitment' model focuses on learning, capacity building, incentives, mutual respect and mutual gains for compliance officers and the suppliers they inspect. Finding that compliance programs have produced only modest and uneven improvements in working conditions and labour rights in most global supply chains, it seeks to address the 'root cause' of low standards through joint problem solving, information sharing and generation of trust – as laid out in Locke et al's comparative table below.

94 At: <http://www.capturingthegains.org/>.

95 See for example, Locke et al , *Virtue out of Necessity?: Compliance, Commitment and the Improvement of Labor Conditions in Global Supply Chains* (2009), 46. At: <http://www.princeton.edu/~smeunier/Locke>. See more generally: <http://web.mit.edu/polisci/people/faculty/richard-locke.html>.

Comparison of the Compliance vs. Commitment Approach		
	Compliance	Commitment
Approach:	Rules/Standards Focus "Meeting" Standards	Uncovering, Analyzing and Correcting "Root Causes" of Current Issues
Mechanisms:	Policing, Detailed Audit Protocols (checklists), Inspections, Documentation	Joint Problem Solving, Information-Sharing, Trust, Reciprocity
Dynamics:	"Us vs. Them" Functional Division of Labor Mixed Signals	Mentoring, Coaching, Diffusion of Best Practices, Integration of Standards with Operational Excellence
Drivers of Change:	Repeated Audits, Pressures from Above, (Negative) Incentives	Learning, Capacity-Building, (Positive) Incentives, Mutual Respect

### Ending or Renewing the Relationship

**Termination clauses are common in supplier contracts, but rarely applied in practice, in favour of corrective action.**

All contracts typically have some form of termination clause. Given the scrutiny of human rights conditions in supply chains, specialised contract clauses have been developed to permit termination on specific human rights grounds, typically for child labour and forced labour. Some companies have a no-tolerance policy on these issues, and require an immediate response from their business partners if these abuses are reported. A number of companies reported that their contracts include more general clauses for non-compliance with their code of conduct for suppliers (or similar company policies), requiring suppliers to carry out corrective action when failures of compliance are identified. Corrective action is subject to monitoring and reporting. Several companies reported that very rarely they terminated relationships on grounds of non-compliance, but their clear preference is to promote corrective action, maintain the relationship, and resolve the problems that have been identified.



## Chapter Nine: Respect for Human Rights in Direct Customer Relationships

### Overview

#### *Overview of direct customer relationships*

This chapter focuses on instances where a company has a direct relationship with the customer, end-user or consumer – referred to in this chapter as “direct customers”. Direct customers can be different types of actors including other businesses, governments and the individual consumer. Agreements with customers can be expressed in a variety of types of contractual relationships. A direct customer agreement is the means by which two or more parties enter into a legal relationship with regards to the possession or use of goods, property, and, in some cases, use of services. The most common type of contractual relationship with customers is a sales or service agreement (or a combined sales and service) agreement. These contracts can cover a wide range of exchanges, including the selling and purchasing of goods, real estate, personal property, securities and services. The laws governing the agreement will depend on the terms of the contract and national law. Contracts are generally voidable if they are entered into under duress, undue influence, fraud, or misrepresentation or if the contract violates public policy.

At times, a company will not have a direct interaction or contract with the consumer or end-user of a product or service that it sells. While the customer buying a product may conduct due diligence on the product and producer, it is less common, except in the case of large business-to-business purchases, for the seller to do due diligence on the customer. In the case of large purchases, where reputational issues associated with the product or potential legacy issues may exist, sellers may carry out due diligence on their customers. Where the end customer is a consumer, the seller’s options for undertaking due diligence may range from limited to impossible.

The conditions set out in sales contracts vary widely depending on what is for sale. They may be simple standard form contracts to very detailed sales contracts accompanied by extensive conditions of sale for larger products or services. Companies may specify and take action regarding how, by whom, in what circumstances and on what terms its products and services are consumed or used. Sellers may provide instructions or training to accompany their product to instruct customers on the appropriate use of products to limit misuse. In certain industries, there may be regulatory requirements or industry practice around including conditions on the final use and disposal of products. Servicing arrangements after sale provide an opportunity to assess the condition and use of goods sold or to provide on-going services.

#### *Human rights and direct customers*

There are a number of reasons why businesses may consider human rights impacts when engaging with direct customers, for example:

- As recent cases have shown, companies are being held responsible for acts of their customers, sometimes through legal proceedings. The increasingly wide range of

examples of product and service misuse may prompt further equally creative human rights due diligence around customer identity and use.

- Consumer-facing companies in particular sectors have been and continue to be under pressure from their consumers around their human rights performance – particularly in their value chain but also related to how consumers themselves might be impacted by products or services. As consumer focus on respecting human rights shifts to new industries, so too will those sectors have to increase their attention to human rights.
- Some products termed “dual use” are intended for benign purposes, but can be used for actions that violate human rights – this can cover a wide range of products and services from an equally wide range of sectors, from information and telecommunications to chemicals to pharmaceuticals and medical equipment, to financial services. As evidence of misuse comes into the public domain, companies will be under more pressure to understand and prevent potential misuse of their products or services.
- The human rights implications for customers of online purchasing, internet services and social networking has been a major topic in recent years. The concern relates to customer privacy and freedom of expression. The ways in which companies conduct due diligence, construct agreements and monitor their implementation for consumers and customers is attracting interest and scrutiny.

### **Orienting and Embedding – Internal Company Management of Direct Customer Relationships**

#### **Consumer expectations about human rights can focus a company’s attention.**

Several respondents remarked that consumer attention to an incident or project, or a company’s business model, can concentrate the minds of senior management – and thereby not only raise awareness of human rights but perhaps prompt the company to reorganise its processes and procedures to be able to respond more systematically to the issue. When new issues emerge, they often catch companies by surprise. Such incidents can teach important lessons for the company concerned and other companies in the same sector, as well as civil society, helping all actors to understand how such human rights issues can be addressed in a systematic manner.

#### **Staff need appropriate incentives and disincentives (embedded in a company culture supportive of human rights) to take on difficult discussions with customers.**

The Guiding Principles emphasise that a company’s policies and practice need to be internally consistent. Companies participating in the research identified several dilemmas in this area. For example, tensions can arise between sales teams (who want to maintain good relations with customers) and sustainability or compliance teams (who may wish to terminate relations with customers who fail to abide by contractual requirements on ethical, EHS or human rights issues). Human rights are a new issue and may not be seen by all as “hard” enough to terminate relations with customers. One respondent noted the relevance of appropriate incentives and disincentives because, in their absence, “you are asking the sales people to bite the hand that feeds them”. Another reported

the company practice of linking incident reporting to bonuses, e.g. if sales staff observe adverse human rights impacts at a customer site, they are instructed to address the issue and if necessary to stop selling. If they fail to respond, their bonus will be reduced. Another respondent noted that an existing training programme for sales staff on how to deal with integrity issues was being extended to include human rights, but questioned whether relevant staff would feel adequately empowered, supported and incentivised to walk away from business opportunities if a human rights issue comes to their attention.

In addition to incentives, respondents highlighted the importance of a company's culture, noting that as cutting off a customer may "hurt business, it has to be linked to company values or it would never fly".

### **Regulatory and MSI requirements can be a source of leverage.**

Respondents noted that a growing range of regulatory provisions (on export controls, trade rules and environmental regulation) require companies to undertake due diligence or investigation of some kind into customers, with corresponding contractual provisions to address potential liability. Several said that are working to integrate human rights considerations into these systems. As one respondent noted: "we are using hard law examples to signal that soft law issues can become hard law and therefore prevention pays when it comes to customers".

MSI requirements can serve the same purpose by providing a mandatory framework that member companies must apply to their relations with customers. Where the MSI involves both suppliers and customers, such frameworks also create a space within which companies can discuss common conditions of sale with their suppliers and customers. Such initiatives bring together the whole value chain to address issues facing the sector, helping to develop a common approach that can improve company practice across the sector.

## **The Business Relationship Cycle**

### **Selecting and Starting the Relationship**

*Setting expectations and communicating them to business partners*

**Business customers and partners are expressing their expectations on human rights. This can lead to a "battle of standards" that companies are starting to address and avoid.**

Consumers as well as business customers are more frequently demanding companies to demonstrate that they have appropriate human rights policies and procedures in place. They noted increasing questions about their human rights approaches when dealing with business customers. This came in the form of general enquiries, requests for specific contractual provisions or requests for compliance with a customer's code of conduct. These demands bring home to managers that they need increasingly to consider human rights as a cost of doing business with their own customers.

Competing policies or codes among business parties to a contract can lead to a “battle of standards” (as to whose code is referred to in contracts) or to a lengthy process to show an equivalence of business codes of conduct. Since most companies prefer to apply their own standards, many regularly benchmark their standards against peers and industry associations to achieve and demonstrate a basic equivalence. One company, for example, does not allow audits by customers, but undertakes to identify gaps and close them, and will discuss the alignment of its own and a customer’s standards.

**Consumer expectations on human rights can be a source of leverage that assists companies to raise human rights issues with their business partners.**

Consumer interest in human rights issues in product or service value chains, can provide powerful motivation to open a conversation with business partners that use the company’s brand (such as franchisees) about human rights.

*Understanding the issues – Assessing human rights impacts in direct customer relationships*

**“Know Your Customer” processes may address certain human rights issues but do not yet do so systematically.**

A range of companies use “Know Your Customer” systems to help them meet regulatory requirements and protect company reputation. To comply with anti-money laundering and corruption laws, for example, companies often need to investigate their customers. Several companies noted that such investigations may include issues relevant to human rights (legal compliance, reputation issues, UN sanctions, criminal or civil litigation, business references, policies and procedures), but human rights are not often considered systematically. Respondents also noted a lack of commercially available information. One company noted that it plans to do a specific gap analysis against the Guiding Principles to ensure that its initial “know your customer” due diligence checklist on customers is up to date.

For companies entering into a large project, knowing the customer and the project is an important part of the company’s assessment of potential reputational risk and is specifically addressed before putting in a bid. Due diligence on customers is often context specific. Companies concerned about dual use of products covered by export controls must take export regulation restrictions on end-users into account. It is important who the customer is: major multinationals with well-developed policies and systems will often receive less scrutiny than small customers whose understanding of company products or services, and capacity to use them appropriately, is unknown. Understanding a customer’s commitment to sustainability may be an important consideration to the seller. Some respondents observed that much depends on the nature of the relationship with a customer: their leverage and ability to impose conditions is less for a one-off sale than for long-term clients.

Businesses that sell directly to consumers can rarely assess individual consumers, because the purchase relationship is not set up for individual interaction. Instead, companies may focus on gaining a more general understanding of their consumers, including their

attitudes to human rights, for the purpose of selling more, and better, products and services. This puts the discussion into the purview of the marketing or product design or product stewardship departments.

**Including human rights considerations in standard bidding documents could improve outcomes and level the playing field.**

For companies entering into a large project, knowing the customer and the project is an important part of the company's assessment of potential reputational risk and is specifically addressed before putting in a bid. In many cases, bidding documents or purchase agreements are standardised, and allow little scope for adding conditions. This is often true of government contracts (such as public-private partnerships, host government agreements or concession agreements) where they have not begun to reflect their duty to protect in government contracts. Including human rights requirements in large infrastructure contracts would level the playing field for bidders.

**Knowing how customers will use products or services is a key challenge.**

Customers sometimes misuse a product or service to carry out human rights abuses. Many news stories have examined this issue, notably in the information and communications technology (ICT) and security sectors. In some instances, companies have sold products or services whose misuse was clearly foreseeable (as when a specially designed surveillance software was sold to authoritarian regimes and used to track human rights activists). In others, the end-use was so novel that it could not reasonably have been foreseen. Between the extremes, customer use and misuse take a bewildering variety of forms.

Companies are clearly prohibited from dealing with customers on sanctions lists and export control lists. Beyond this, however, several respondents noted that it was often hard to develop sound human rights due diligence procedures for specific customers. It is particularly difficult, for example, to obtain information on the military and police. One company uses a three-step country-customer-product review against eight prioritised human rights risks.

Companies identified several scenarios that caused particular concern:

- Participating in a large project with little leverage to prevent the products or services that it provides from being misused at a later date.
- A company sells major items of equipment that have a long life span, and has no control over their use after sale (or its exit from the project).
- A company's products are used knowingly and purposefully by a client to do harm.
- Products that resemble a company's own products are knowingly used to do harm.

These are challenging dilemmas for companies that wish to implement the Guiding Principles and assess appropriate responses to their level of involvement in abuses associated with customers' use of their products and services. One respondent noted that it is particularly concerned to understand the circumstances in which, as a consequence of the end-use of its products, it can be said to have enabled human rights

abuses. Companies dealing with products or services that enjoy high brand value and visibility have a particular incentive to ensure that customers use them appropriately. One company does extensive investigations of its customers and imposes detailed requirements on end-use. For another, end-use is a key design consideration: it tries to design its products so that purchasers cannot use them for certain inappropriate or dangerous purposes.

### **Formalising the Relationship**

#### **Company contracts are excluding certain uses of products or services.**

Recognising their leverage is often greatest at the beginning of the relationship when deciding whether to do business with a particular customer, participants noted a number of different contractual arrangements aimed at excluding certain uses or users of their products or services that might entail potential adverse human rights impacts:

- Sales agreements prohibit the customer from taking, or providing services for, any actions covered by international sanctions.
- Sales agreements restrict sales to certain types of buyers (such as professional users).
- Contracts reference a list of exclusions, specifying products that are prohibited (that the company will not use or purchase).

#### **Some companies require compliance by customers as a contractual requirement.**

In some markets and for some products, sellers are able to set the terms on which customers can use their products. One respondent has standard three-year contracts with customers requiring compliance with their code of conduct that includes a list of relevant human rights conventions. These contractual arrangements are backed up by a system of regular monitoring and management of customers. The contract also includes a 'best endeavours' clause by which customers are expected to apply the respondent's code of conduct to their own customers and significant contractors. In this manner, the respondent significantly extends the potential application of its human rights requirements.

Other models (such as click-through terms of service to which customers must consent when they make an electronic purchase) may contain certain compliance requirements, but provide no opportunity or possibility of being monitored. Several respondents noted that some governments are unwilling to amend standard contracts, or impose conditions on their use of goods and services, despite their duty to protect human rights as set out in Pillar I of the Guiding Principles.

**A company may need to take a big picture approach regarding product misuse associated with its name or brands.**

Several companies noted that, in certain cases, customer misuse (or longer-term customer use) of a product had a significant impact on human rights, including on the rights to health and to life. Some companies were applying lessons learned and changing their business relationship contracts and conditions to address the human rights risks identified. Other companies were finding they have little leverage and are exploring other ways to influence outcomes. Because companies are often “involved in” the products and services in the meaning of the Guiding Principles, respondents recognised that, to make progress, companies will need to take a big picture approach, involving more players to address customer misuse of a product or service to which the company is directly linked. Different strategies were suggested. Companies might:

- Lobby governments to regulate wider misuse.
- Work with industry associations to address misuse perpetuated or ignored by competitors.
- Work with customers or intermediaries to train end-users on appropriate use of products.
- Work with other players to offer alternative, potentially less dangerous products to certain end-users, like consumers.

**Instalment sales contracts and after sales service agreements can provide a measure of leverage over customers’ use of products.**

Where customers pay for products in instalments, the company retains some leverage over customer end-use until the last payment is made. Several respondents noted that service or maintenance contracts (for products already delivered) provide similar leverage. If customers are found to be misusing products, some companies have threatened to end further servicing.

**Customers may use contracts to shift liability to business partners in a manner inconsistent with the Guiding Principles.**

Some respondents noted a concern that standardised sales contracts imposed by customers might shift full responsibility and liability for human rights issues to the seller without a corresponding alignment of costs or other adjustments to risk allocation. They observed that such a practice was out of line with the Guiding Principles as where a direct linkage exists, both parties (to a sales contract) retain a measure of responsibility to prevent and mitigate negative human rights impacts.

### Harvard Business Review: 'GE Healthcare in India: An Ultra (Sound) Strategy?'<sup>96</sup>

From the 1970s to the 1990s, Indian doctors used GE's ultrasound technology for a range of diagnostic purposes, including childbirth complications, disease, obstructions, blood flow, heart abnormalities, cancers and, increasingly, emergency diagnostics. The company became aware that the technology was being used to determine the sex of fetuses, and that numerous female fetuses were subsequently being aborted. The case study analysed what GE Healthcare (GEHC) India did to prevent the misuse of its ultrasound machines for prenatal sex determination, which included:

- Increasing the stringency of the sales review process through a combination of training programs, amendments to legal contracts, regular auditing, and rigorous sales screening and tracking.
- Working with Indian government officials to identify proactive ways to educate doctors against misuse, such as with the stickers, labels, PNDT audits and reporting concerns about non-compliance.
- Sharing information with government officials about its internal controls and sales practices that go beyond the current legal requirements and called upon the government to increase enforcement activities and education programs.
- Pushing for industry-wide action.
- Engaging with many of the critical activist group leaders about its efforts to increase safeguards in the sales process to lower the risk of misuse of its ultrasound equipment.
- Running a poster campaign to work creatively on changing attitudes about female feticide and the status of girls and women's rights.
- Designing new CSR programs including social investment in initiatives that promote education and equality among girls in India.

The case study shows both the complexity of customer misuse, how challenging it is for companies to anticipate the full scope of relevant issues in their risk assessments, but also how a company can enhance and apply its leverage through numerous avenues to prevent and mitigate adverse human rights impacts.

96 Jared Harris, Mayank Jain, Jenny Mead, University of Virginia (Oct. 2008). At: <http://hbr.org/product/ge-healthcare-in-india-an-ultra-sound-strategy/an/UV1038-PDF-ENG>; and Business Leaders Initiative on Human Rights (2010), *The Millennium Development Goals and Human Rights: Companies Taking a Rights-Aware Approach to Development*, p. 47.

## **Managing the Relationship**

### **Risk management approaches can identify which customers require additional attention.**

When relationships with the customer are ongoing and longer-term, some respondents adopt tiered risk-management approaches to identify red flags and select high-risk customers for additional investigation and attention. A few respondents noted related multi-step screening processes as a first step to customer use of their products or services. For example, they:

- Screen all customer requests against “usual” requests to identify exceptions that should be flagged for additional investigation.
- Screen customers from high-risk countries more carefully.
- Screen for any breach of sanctions and other potential legal liability issues.

Through applying such series of screens, several companies noted they are able to narrow their focus on customer relationships requiring more serious attention. Some companies add self-declarations to the process to shift the onus back onto customers to state clearly how they will use the company’s products or services.

## **Ending or Renewing the Relationship**

### **Legacy issues can be a key challenge.**

Respondents noted that legacy issues are another key challenge, particularly for a company that sells large pieces of equipment that may outlast its involvement with the customer or its operations. For many participants, “sell and go” is no longer a risk-free option. Several noted that companies need to manage their reputational risk in such cases, and reflect more deeply on their responsibility and liability, because their products and projects can directly and significantly affect a community. Another raised the issue of company responsibility when large equipment or large projects sold later have an adverse impact as a result of the effects of a natural disaster. The assumption that the companies or persons using this equipment will do so responsibly may be changing in light of recent disasters.

One respondent highlighted a dilemma management process to provide more structure to such deliberations. It considers a range of product use issues, from product design considerations, amending due diligence procedures (including human rights due diligence procedures), to contractual requirements, and exit strategies.

Other participants noted that consumers associate sites and products with brand companies long after they exit. This highlights the importance of vetting buyers of assets associated by consumers with the company, even if it remains very difficult to impose post-sale conditions in contracts, or enforce them. Once an asset is sold, a seller would have little leverage to control how the asset is used and whether it continues to be operated to the company's standards.

As noted in Chapter 4 (the Business Relationship Cycle), companies whose projects have a large footprint increasingly consider arrangements for exit, and operations after exit, from the start of operations. Recognising that closure is likely to cause significant decline in both community income and the tax revenue of local government, these arrangements may include establishing sustainable livelihood programmes for the local community that provide for post-closure alternative income generation and sustain the delivery of social services. These programmes can help to ensure that economic, social and cultural rights, in particular, are respected.

## Chapter Ten: Respect for Human Rights in Investor-State Relationships

### Overview

#### *Brief overview of investor-state relationships*

States enter into a variety of contracts with companies, for example through procuring goods and services or entering into public-private partnerships or for natural resources concessions. This chapter focuses on investment relationships between a company and a state, including contracts signed between national governments and investors (sometimes referred to as investment contracts, government agreements or host government agreements (HGAs)). An investor-state contract is a legal agreement between an investor (often a foreign investor) and a governmental entity that defines the responsibilities of each party, typically with respect to the development, construction and operation of a project by the investor. They are particularly common for large agricultural projects, large infrastructure projects (to construct roads, railways, ports, official buildings, dams, etc.), and exploration and exploitation of natural resources (oil, gas, minerals, water, forestry resources). The contracts for extractive projects often take the form of a license, concession, or production-sharing agreement granting exploration and/or production rights.

Contract terms typically address issues that are uniquely in a government's power to grant or regulate. These may include indemnifications, authorisations, taxation, protections from expropriation, local content requirements, and granting access to land. Such contracts may also contain clauses that provide companies with subsidies, exemptions, or remedies (such as compensation if the value of their investment is adversely affected by changes in the national or sub-national regulatory regime). Such clauses are often called "stabilisation clauses". Investment contracts set out arrangements and venues for dispute resolution, which can include referral to international arbitration. More recent investment agreements may also address investor compliance with national laws and regulations on environmental and social issues.

#### *Human rights and investor-state relationships*

Businesses may consider human rights impacts for a number of reasons when entering into contracts with states. For example:

- Projects covered by investor-state contracts often have a large physical footprint. Because of their scale, they may be associated with significant human rights risks. Governments are expected to incorporate requirements related to their duty to protect human rights into the contracts they conclude.<sup>97</sup> As a result, investor-state contracts should include content that would not otherwise be included in purely private contracts. Examples include stabilisation clauses (discussed further below), human rights requirements regarding the provision of public services, and requirements to protect cultural sites. Provisions addressing human rights issues in these contracts are

likely to continue to evolve. Equally, citizens and civil society have higher expectations for transparency around such contracts because their government is directly involved in what are often large projects that are significant to the national economy. For companies, this may have important implications not only regarding transparency but also communication, grievance management and remedy, and consultation and participation.

- Contracting with a government (even when the contract limits the relationship to a single project) associates the company with the government for that project, and in the public mind, often beyond the project. Even when a company is the operator and able to control the project's performance standards, by association it may be linked to a government's poor human rights record or corruption elsewhere. In some circumstances, for example because sanctions are in place, it may be clear that it is not appropriate to work with a government. In many others, a difficult balancing of considerations is required.
- Companies may be obliged to contract with the government on a range of services that pose human rights risks and over which they may have limited control. These include land acquisition, resettlement, public consultation, and provision of security. A company must often be creative, display persistence and employ many forms of leverage to respect human rights and overcome official resistance to doing so. The Guiding Principles make clear that companies are required to act responsibly, and to respect human rights, even if the governments with which they cooperate do not.

### The UN SRSG's Work on Investor-State Contract Negotiations

The UN SRSG's *Principles for Responsible Contracts: Integrating The Management of Human Rights Risks Into State-Investor Contract Negotiations: Guidance for Negotiators*<sup>98</sup> sets out the steps and considerations that parties to investor-state contracts can consider and how such issues can be reflected in contracts.

Contract negotiations provide an important opportunity to identify, avoid and mitigate human rights risks at the earliest stages of an investor-state venture. The Principles note that states fulfil their human rights obligations in part by taking legislative measures to address a broad range of human rights issues, including health, safety, labour, environment, security and non-discrimination. Where stabilisation clauses are adopted, states must retain the latitude to adopt and fully implement such measures.

The document sets out ten principles. A commentary explains each principle's content, context and implications, and a recommended checklist for negotiations.

98 At: <http://www.business-humanrights.org/media/documents/ruggie/report-principles-for-responsible-contracts-25-may-2011.pdf>. The Principles built on the SRSG's earlier work on stabilisation clauses and their potential adverse impacts on human rights.

The principles cover:

1. Early preparations for negotiating the project.
2. Identification of responsibilities for preventing and mitigating the project's potentially adverse human rights impacts.
3. The project's operating standards.
4. Use of contract stabilisation clauses.
5. Use of 'additional goods and services provisions'.
6. Physical security for the project.
7. Community engagement.
8. Project monitoring and compliance.
9. Grievance mechanisms for non-contractual harms to third parties
10. Transparency of contract terms and conditions.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**Investor-state contracts provide opportunities for private partners to proactively improve uptake of the Guiding Principles by their state business partners and level the playing field amongst public and private businesses.**

Through investor-state contracts, companies can raise their state business partner's awareness of the Guiding Principles and promote their implementation. Respondents acknowledged this requires concerted effort and frank dialogue about operating standards, because few governments have yet to reflect their duty to protect into their negotiations or contracts. Where the agreements involve state-owned enterprises (SOEs), respondents noted in particular that levelling the playing field with public sector competitors and partners is especially important in moving forward with global implementation of the Guiding Principles. As one respondent remarked, both private companies and SOEs have a responsibility to respect human rights and both should therefore compete on the same terms, including adherence to international standards and expectations.

*Understanding the issues – Assessing human rights impacts in investor-state relationships*

**Business relationships with governments can magnify real or perceived involvement with states' human rights abuses.**

Respondents noted that entering into a business relationship with a government involved in human rights abuses unrelated to the business relationship nonetheless risks criticism for doing business with the government. As one participant noted, it is an issue of proximity

– there is a real likelihood that if issues with the government arise the company would likely be criticised. The test should be whether the actions of the government are “directly linked” in any way to the business relationship. In sectors where relations with government are integral to doing business (such as the extractives, infrastructure, and to a lesser extent, telecommunications sectors), the perception of “directly linked to” may be far wider than is actually the case. It requires careful planning and management to enter and structure a relationship with a government to minimise linkage and even more importantly, impacts.

**State-Owned Enterprises (SOEs) inexperienced in human rights management can bring risks and challenges for their private partners.**

Recognising the wide variations in size and scale of SOEs, respondents noted that it is difficult to generalise about the attitudes of these companies to human rights or their capacity to respect them. However, smaller SOEs (which governments often impose on private companies as business partners) are generally regarded as higher risk and lack awareness of their human rights responsibilities and associated due diligence measures. At the same time, participants regarded some larger SOEs as increasingly open to learning, gaining experience and obtaining insights from international companies, for example, through the use of their private partner’s or industry association’s resources on issues such as health and safety, impact assessments and local community relations.

**Assessing country risk is a standard consideration.**

All participants carry out some form of country risk assessment within their due diligence processes, especially when dealing with a government as a business partner. Assessments of this kind generally draw on publicly available third party research such as country reports by the US State Department, Amnesty International, Human Rights Watch, the Business and Human Rights Resource Centre’s country portal, and Transparency International’s Corruption Perceptions Index, amongst others. Some of the participant companies also commission risk assessments and bespoke research from private consultancies. Most also require their own local staff to prepare regular or periodic briefings to headquarters of the situation ‘on the ground’. A company’s country risk assessment tends to become more detailed over time as it accumulates project and design information, experience in working with the government, and this information becomes incorporated into its impact assessment.

Participants noted that they often take account of particular country contexts, including:

- **Weak, absent, or unenforced law.** Some companies apply formal criteria to decide when and whether to enter or exit a country, while others identified this as a gap which they planned to address as they moved forward on implementation of their responsibility to respect.
- **Conflicts between domestic law and international human rights standards.** All respondents were versed in the objective of seeking to honour the principles of internationally recognised human rights standards in the face of silent or conflicting domestic law. Some more systematically addressed the conflict of laws dilemma than

others, such as by providing formal guidance to staff potentially faced with such situations, agreeing methods at the point of contracting for ensuring compliance with relevant international and third party standards, and ensuring flexibility in the project's governance framework for evolving standards.

- **Conflict or potential conflict.** In general, the risk that companies may become linked with state abuses of human rights – and potentially the most serious forms of abuse – rises sharply wherever conflict occurs. Internal or international armed conflicts often bring principles of international humanitarian law into play, and require heightened human rights due diligence processes and procedures.

**Developing processes to assess governments as business partners is still a work in progress.**

The Guiding Principles note that a potential business partner's track record on human rights is a relevant consideration that should be factored in when setting up a relationship. Most companies can readily establish whether a government business partner is subject to international or national sanctions; and most can evaluate broader country risks. Expertise in assessing states or state agencies as business partners is less well developed, however, than for private sector partners.

In certain sectors, notably the extractive industries, companies may be given little choice about who they can partner with. Respondents noted a number of problems where governments or SOEs do not give human rights serious attention. Companies often try to increase their operational control in these circumstances.

**National authorities or international financial agencies may require stakeholders to be consulted on large projects and respondents often feel well placed to lead this process.**

Governments may require potentially affected groups to be consulted on large projects that are subject to investor-state agreements. The Guiding Principles also emphasise the importance of consulting potentially affected stakeholders, particularly in circumstances where the operating context poses risks of severe human rights impacts. As a matter of standard practice, companies are undertaking preliminary socio-economic baseline studies before beginning any activity, enabling them to identify relevant stakeholders to engage. Levels of government involvement and support for consultation processes vary considerably, from those that are well developed and government-led to those with no formal government involvement. Companies put their own consultations in place when not supported by the government, including in cases when they must find pragmatic ways to obtain information about perceptions and impacts.

Several respondents noted that they prefer to lead on consultation processes involving relocations and compensation, rather than leaving the process entirely to government, to ensure that consultations are carried out in accordance with international standards and expectations.

## Formalising the Relationship

### **Host states are not always equipped or willing to accommodate international and public expectations on human rights when negotiating agreements.**

Participants noted that there is very little standardisation globally of contract terms for investor-state contracts. Governments tend to develop agreements according to their particular country context and history. Respondents added that investment contracts do not generally refer to human rights issues specifically. They may however refer to international standards more broadly. They may also contain provisions on employment law, health and safety of employees, local content requirements, environmental and social considerations, and sometimes international conventions.

Several respondents noted that when attempting to include additional social and environmental clauses in investment contracts during negotiations, their government partner had resisted their inclusion. Respondents explained that they will often be presented with a pre-drafted agreement in which they have little capacity to add clauses. In some cases, respondents said they had been pressed to adopt text that referred to national law rather than to international standards, because the state concerned did not wish to reveal deficiencies in its domestic law.

In some instances, companies have successfully included their own environmental, labour, and land negotiation standards and processes that do not rely on national requirements in investment contracts. Contracts may also sometimes include references to the performance standards established by the IFC or the Equator Principles (references that are mandatory when securing financing from those institutions). In this way, investment contracts can form the basis for establishing higher standards of social and environmental performance.

At the same time, respondents recognised that it is not sufficient to simply insert references to human rights in contracts; on their own, contracts will not shape government behaviour. It is necessary to operationalise human rights standards and due diligence in the governance of the partnership, supported by training and awareness-raising, as well as on-going monitoring of the commitments according to the particular context.

### **Companies and external stakeholders often have different perceptions about the extent to which companies exert leverage with governments.**

Respondents noted that NGOs and civil society organisations commonly assume that private companies have more influence over government partners than company officials feel they may have in reality. Respondents described the different roles governments can play within investment activities, for example as legislator and regulator, judicial authority, business partner (such as a JV member), and provider of basic services. Governments also have many tools at their disposal to control inward investment: they can pass laws, restrict foreign shareholdings in national companies, curtail foreign ownership in privatised companies, and regulate joint ventures between foreign and local enterprises.

The respondents observed that a company's leverage with government changes, sometimes dramatically, after committing large up-front investments. Thereafter the investment is potentially vulnerable should disputes arise with the host government threatening termination or expropriation. Companies suggested that, for this reason, the negotiation of contracts remains a crucial phase. It provides the opportunity to lay down minimum standards and establish robust mitigation measures to reduce risks posed by business partners and the operating context, such as through specific organisational roles, assurances, as well as proactive training and education (often mandated) of local business partners. The UN SRSG's *Principles for Responsible Contracts* affirm the early opportunity investor-state contracts provide in establishing minimum standards and setting clear expectations during negotiation to the benefit of the project and partnership throughout the relationship cycle.

**Projects covered by investor-state contracts often require provision of public security. This raises challenges around state sovereignty and the duty to protect.**

Respondents agreed that the recruitment and management of government security forces is a particular challenge. It is often necessary to provide security for operations that are covered by investor-state contracts, and host governments will frequently offer or require that its police force or military is employed to protect projects, especially jointly owned assets. Yet, some participants noted, human rights risks are far higher with government forces, because companies have less leverage over them than over security providers they contract privately. Security negotiations with states are therefore doubly sensitive. Companies prefer to hire private security, because they are better able to control human rights and reputational risks; but governments tend to view security as a state responsibility, implicating its sovereignty. As such, participants reported that when they had proposed to provide private security for the project or operation, government negotiators would sometimes refuse the offer. In such circumstances, one respondent reported the practice of ensuring clear communication of company expectations to the government partner. Each partner's expectations and responsibilities around security provision would ideally be reflected in the contract itself, or a Memorandum of Understanding (MOU), followed by ongoing dialogue to ensure such expectations and responsibilities were reflected in day-to-day business and operations.

**Referring to MSIs can provide an avenue to reinforce human rights in investor-state agreements.**

Inserting references to multistakeholder initiatives in contracts can be a credible and effective way of building in human rights protections. Several participants noted that the Extractives Industries Transparency Initiative (EITI) (a coalition of governments, companies, investors, civil society and international organisations set up to promote transparency in oil, gas and mining) provided clear guidance and metrics useful to both companies and states. The Voluntary Principles on Security and Human Rights (VPs) initiative was similarly seen to provide an authoritative process for implementing their responsibility to respect in high-risk countries where enforcement of law was weak. One respondent consistently seeks to include an explicit reference to the VPs in MOUs covering public security forces with governments in high-risk areas.

## Managing the Relationship

### **Perceptions of the benefits from (and motives for) local content requirements are mixed.**

Governments frequently impose local content requirements within foreign direct investment regulation as a way to promote national employment and technology transfer. Participants considered that such requirements are an inevitable feature of the investment landscape, but differed in their assessment of the benefits. Some work closely with local business partners because they feel it is in their strategic interest to build and strengthen local firms' capacities on key compliance issues such as standards of production, worker safety, training and security. This was described by one respondent as a reverse incentive: companies had to bring local partners up to standard because of the restraints to recruiting outside expertise. Others considered local content requirements as beneficial because they promote the national and local industrial base and the skills of national and local partners. Quite a few of the participants who have international production also noted efforts around water use and conservation, agriculture and farming in order to build up the local skills base for more local sourcing. Some of the companies include such elements in their bid packages. In one case, after a five-year capacity-building period, one company was sourcing 95% of its inputs from local businesses.

### **"Additional goods and services" provisions can be seen to contribute positively to local development or inappropriately displace government's responsibility.**

States can require investors to provide non-commercial services or infrastructure (such as schools, healthcare facilities or roads) that are unrelated to its core project activity. Participants' had different views on the issue. Some run and finance various supplementary community projects, in association with local NGOs, on education, medical and agricultural projects. Others were hesitant to become involved with such arrangements out of concern of raising community or civil society expectations about their operational responsibilities or developing a potential reliance by the state for the private sector to deliver certain public services. The UN SRSG's *Principles for Responsible Contracts* notes that private provision of public goods and services can blur the roles, responsibilities and accountability of businesses and government, and emphasises that both parties retain their respective responsibility to respect and duty to protect human rights.

### **Contractual transparency expectations increase when working with governments.**

Contracts with governments may be subject to additional disclosure and reporting requirements, presenting a key difference as compared to contracting with purely private sector partners. Participants have observed a trend in some countries to make contracts public, particularly in the extractives sector, and publicise project and investment

agreements, for example in national parliaments and official gazettes.<sup>99</sup> Such disclosure is viewed as a means of decreasing corruption and improving good governance. Some states, however, prohibit the publication of contracts, putting companies in a difficult position on how to meet contrasting international expectations, and even opposing home and host state laws, on disclosure and transparency. As one participant remarked, this is “the dilemma of choice about which country’s jail the CEO ends up in”.

### Scrutiny of Investor-State Contracts is Increasing

- **The UN: the SRSG’s work on investor-state contract negotiations**

The UN SRSG’s *Principles for Responsible Contracts* notes that “[c]ontract terms, with exceptions for compelling justifications, should be disclosed in an accessible manner and seen as part of the community engagement plan for the project”<sup>100</sup> (see box on page 130: The UN SRSG’s work on investor-state contract negotiations for further background on the Principles’ aims and content).<sup>101</sup>

- **The World Bank Group: the International Finance Corporation**

The 2011 revision of the IFC Policy on Environmental and Social Sustainability<sup>102</sup> includes new provisions on sector-specific governance and disclosure. Until 2013, the IFC will encourage governments and corporations to make extractive industry contracts public; thereafter it will require publication of the principal contract with government that sets out the key terms and conditions under which a resource will be exploited, and any significant amendments to that contract. When the IFC invests in infrastructure projects that involve the final delivery of essential services to the general public under monopoly conditions (such as retail distribution of water, electricity, piped gas, and telecommunications), it encourages the public disclosure of information relating to household tariffs and tariff adjustment mechanisms, service standards, investment obligations, and the form and extent of any ongoing government support.

99 In addition to OECD states, the governments that publish their contracts with extractive companies include Peru, Liberia, and Timor-Leste; several more governments are moving in the same direction. Niger’s new constitution requires that all oil and mineral contracts are published in the official gazette. Sierra Leone passed a new petroleum act that requires publication of all oil contracts. Guinea passed a new mining code in 2011 that requires the publication of all contracts in the official gazette and on the government website. In Iraq, the Kurdish Regional Government publishes all its petroleum-sharing agreements with oil and gas companies.

100 At: <http://www.business-humanrights.org/media/documents/ruggie/report-principles-for-responsible-contracts-25-may-2011.pdf>.

101 The Principles were presented alongside the UN SRSG’s final report on the UN Guiding Principles but were not in the package of documents that was unanimously endorsed by the UN Human Rights Council.

102 At: [http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP\\_English\\_2012.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP_English_2012.pdf?MOD=AJPERES).

- **Civil society: work on investor-state contracts**

Civil society organisations are increasingly focusing on contracts, recognising that they shape business relationships and their impacts on local communities. For example:

- **Global Witness** investigates, campaigns and lobbies on natural resource-related conflict and corruption. Its contract analyses aim to build a body of knowledge that governments and communities can use during contract negotiations.
- **The International Institute for Environment and Development** works extensively on investor-state contracts and their implications for sustainable development.
- **The International Institute for Sustainability and Development**, amongst other work on the issue, has developed a toolkit on international investment agreements for country negotiators. It includes a model standard form agreement with provisions on contract and revenue transparency.<sup>103</sup>
- **Revenue Watch** undertakes research on disclosure and confidentiality in extractive industry contracts.

### **Demands for public reporting of revenue are also increasing.**

Participants noted that civil society organisations (such as the Publish What You Pay Coalition), but also international financial institutions such as the IFC,<sup>104</sup> are calling on companies to publicly report on and disclose information regarding their revenues and payments to host governments. They cited various new global and regional financial transparency laws, including the forthcoming EU country-by-country financial reporting requirements<sup>105</sup> (which require extractive and logging companies to declare taxes, royalties and bonuses paid to host countries, and will potentially be extended to the banking, telecoms and construction sectors) and the US Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>106</sup> (which requires extractive companies to disclose their payments to foreign governments annually to the US Securities and Exchange

103 At: [http://www.iisd.org/pdf/2005/investment\\_model\\_int\\_handbook.pdf](http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf).

104 IFC Policy on Environmental and Social Sustainability (2012) – Infrastructure Projects 49 states: “When IFC invests in projects involving the final delivery of essential services, such as the retail distribution of water, electricity, piped gas, and telecommunications, to the general public under monopoly conditions, IFC encourages the public disclosure of information relating to household tariffs and tariff adjustment mechanisms, service standards, investment obligations, and the form and extent of any ongoing government support. If IFC is financing the privatization of such distribution services, IFC also encourages the public disclosure of concession fees or privatization proceeds. Such disclosures may be made by the responsible government entity (such as the relevant regulatory authority) or by the client.” See: [http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP\\_English\\_2012.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/7540778049a792dcb87efaa8c6a8312a/SP_English_2012.pdf?MOD=AJPERES).

105 At: [http://europa.eu/rapid/press-release\\_IP-11-1238\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-11-1238_en.htm?locale=en).

106 At: <http://www.sec.gov/rules/final/2012/34-67717.pdf>.

Commission.<sup>107</sup> Respondents commonly felt that such legislative measures were often narrowly conceived, and could have unintended impacts on those who were expected to benefit. They considered MSIs like EITI (see box below) to be far more effective in increasing transparency and improving the governance and benefits of natural resources exploitation to foster growth and reduce poverty.

### Reporting on Revenue Transparency

The **Extractive Industries Transparency Initiative (EITI)** is a coalition of governments, companies, civil society groups, investors and international organisations. All countries implementing the EITI standard publish reports that disclose how much revenue governments receive from the extraction of natural resources, while companies disclose what they have paid in taxes, royalties and other fees. These two sets of figures are compiled and reconciled by an independent reconciler, making transparent for citizens and other stakeholders, often for the first time, what their government receives for their country's natural resources.

The EITI 2012 *Extracting Data Report*<sup>108</sup> is an overview of six years of EITI reports. It compiles key information, including total government revenues and company payments for 30 countries and data from more than 900 companies. Most reports cover the oil, gas and mining sectors, though some countries have included forestry and agriculture. Certain EITI reports go beyond revenue and payment information, with those on Ghana, Mongolia and Peru for example including data on extractive sector flows to local governments.

### Company operational level grievance mechanisms can provide a competitive advantage when working with government.

One participant noted the advantage their human rights due diligence and remediation processes offered when working with governments. In one instance the application of company resettlement requirements lead to the resolution of previously unaddressed resettlement issues in the area. This contributed to the award of a license, as the host government aligned with the company's priorities and standards around resettlement issues and procedures.

107 The American Petroleum Institute, the International Chamber of Commerce and two other industry associations challenged the rule before the US courts. <http://www.csrandthelaw.com/>.

108 At: <http://eiti.org/document/extracting-data>.

### **Ending or Renewing the Relationship**

#### **After a change of government, companies may have to build their relationships all over again.**

When the political party in power changes, companies may have to renew their relationships with government. Participants noted that new administrations would not necessarily be willing to agree to a relationship on the same terms or expedite negotiations as a result of previous dealings, no matter how positive they had been. One respondent pointed out, however, that because it had managed its reputational legacy carefully, the incoming government welcomed its subsequent return to the country. Many companies participating in the research agreed that companies must be prepared to forge relationships and agreements with states on a case-by-case basis.

#### **Legacy, and its reputational consequences, are highly correlated with country context.**

Respondents noted that at times they are met with strong pressure to disinvest from countries that have a poor human rights record. They agreed that numerous factors must be weighed when taking such a decision. In addition to considering longer-term prospects for political change and related social and economic factors, a company has a duty to take into account the fate of staff left behind and the identity and reputation of those who might take over its projects. Several participants observed that the incidence of human rights abuses tends to rise when a government or a government-favoured company takes over in such situations. All participants recognised this is a difficult dilemma, which generates reputational risks.

# Part III: Conclusion and Appendices

## Chapter Eleven: Conclusion and Ten Themes for the Next Five Years

### Conclusion

Based on the interviews and reflections on the fast evolving business and human rights landscape, the authors of this Report identified the following key messages, and themes for the future, regarding the corporate responsibility to respect human rights in business relationships.

The Report's first key message is that companies *are* increasingly considering human rights impacts with which they are involved through their business relationships, and taking note of the UN Guiding Principles on Business and Human Rights and the corporate responsibility to respect human rights as they do so. More tangibly, there are signs that addressing such impacts can find a place in business management systems. This includes the management of business relationships. More and more companies are recognising there are solid business reasons to work with business partners to ensure respect for human rights in the delivery of operations, products and services to which they are directly linked. None of the participating companies have fully integrated human rights concerns into their business relationships or into every stage of their life cycle. Work is developing – but more is needed – to reinforce human rights policy commitments, align incentives, embed human rights into management systems, and build capacity. Progress is being made.

The Report's second key message is that the spotlight is increasingly reaching a wider range of relationships and actors. Initially, the attention given to human rights and business relationships focused almost exclusively on supply chain relationships. It is likely that the next five years will involve a deepening of attention, knowledge and practice regarding the relationship types addressed in this Report (joint ventures, mergers and acquisitions, supply chain and service providers, licensing and franchising, direct customer and investor-state) and others. Contract farming, contract manufacturing, business process outsourcing, sponsorship and advertising (especially for major sporting events), and financial services (investment, insurance, export credit) are likely to follow soon.

Moreover, not only businesses involved in production will come under the spotlight. Professional legal, accounting, consulting, lobbying, and tax advisers have a responsibility to respect human rights as businesses in their own right. As highlighted in this Report, the responsibility extends to their operations and business relationships – i.e. the advice they give clients about business relationships. By way of example, in a 2012 resolution, the American Bar Association linked the UN PRR Framework and Guiding Principles to its own code of professional conduct, which requires US qualified lawyers to apply “independent professional judgment and render candid advice” and permits them to “refer not only to law but to other considerations such as moral, economic, social and political factors

that may be relevant to the client's situation".<sup>109</sup> This is significant recognition of the influence of legal practices, as businesses to which the Guiding Principles apply, and as advisers who help shape their clients' business relationship.

The Report's third key message is sobering. Too few companies seriously engage with human rights and address the impacts with which they are involved. The Guiding Principles state clearly that all businesses everywhere, large and small, have a responsibility to respect human rights. Consequently, when two or more companies come together in a business relationship, they have overlapping responsibilities to respect human rights that should mutually reinforce their commitment. Currently, however, due to lack of awareness, lack of capacity, unclear incentives or unwillingness to address human rights among a large majority of companies, it is too often a one-way flow of communication emanating from large companies, well versed in international standards and committed to respect human rights. Urgency and innovation are required from business, government and civil society to address this challenge.

Business relationships – and the daily interaction between companies of every size, in their many sectors and locations – are a key avenue for spreading awareness and implementation of the responsibility to respect human rights. Some large multinationals are taking steps to incorporate human rights issues into the enormous webs of business relationships they manage around the world, often applying a pragmatic, risk-based approach. Over time, they will reach and influence an increasing number of businesses. This is an important mechanism for implementing the Guiding Principles and contributing to a more level playing field based on respect for human rights.

## Looking Ahead: Ten Themes for the Next Five Years

**Theme 1. Multiple actors, including businesses, governments, multistakeholder initiatives, industry initiatives and civil society organisations, will shape what are considered reasonable expectations about adequate and effective human rights due diligence.**

The Guiding Principles have already become an authoritative focal point and have been incorporated in a range of other well-known international and regional standards such as the OECD Guidelines for Multinational Enterprises, the ISO 26000 Guidance Standard on Social Responsibility, the IFC's updated Performance Standards<sup>110</sup> and updated OECD Common Approaches for Officially Supported Export Credits and Environmental and Social

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109 American Bar Association, Resolution 109. At: [http://www.americanbar.org/content/dam/aba/administrative/human\\_rights/hod\\_midyear\\_109.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/human_rights/hod_midyear_109.authcheckdam.pdf).

110 See IFC, Performance Standard 1: Assessment and Management of Environmental and Social Risks and Impacts. At: [http://www1.ifc.org/wps/wcm/connect/3be1a68049a78dc8b7e4f7a8c6a8312a/PS1\\_English\\_2012.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/3be1a68049a78dc8b7e4f7a8c6a8312a/PS1_English_2012.pdf?MOD=AJPERES). See also its Guidance Note, at: [http://www1.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN\\_English\\_2012\\_Full-Documents.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/e280ef804a0256609709ffd1a5d13d27/GN_English_2012_Full-Documents.pdf?MOD=AJPERES).

Due Diligence.<sup>111</sup> As these standards are applied, a better understanding will emerge of their interpretation and application in particular contexts, sectors, and relationships.

In the 18 months that have passed since the UN Human Rights Council endorsed the Guiding Principles, it has become clear that a diverse set of actors are paying attention to their implementation, both in business-to-business and business-to-state relationships. Many of these actors, from business as well as civil society, are asking governments to fulfil their duty to protect people whose rights are harmed by negative impacts associated with economic growth and globalisation, not least by enforcing local law and using available policy tools.<sup>112</sup> Governments have begun to act. In some cases they are actively seeking to provide support and guidance to businesses on human rights and corporate responsibility.<sup>113</sup> In other cases, they are introducing new legislation or regulations that are grounded more specifically in the UN PRR framework and the Guiding Principles.<sup>114</sup>

Individual businesses and other actors are increasingly considering the implications of the Guiding Principles for their own operations and work with business partners. Industry initiatives are producing operational guidance on the Guiding Principles and considering how current codes and practices align.<sup>115</sup> Investors, and the financial sector more widely, are developing their own approaches.<sup>116</sup> Some initiatives, involving enterprises at different points in the value chain, are exploring how the Guiding Principles can inform their commitments and approaches.<sup>117</sup> Civil society organisations are investigating how

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111 Recommendation Of The Council On Common Approaches For Officially Supported Export Credits And Environmental And Social Due Diligence (The “Common Approaches”). At: <http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=TAD/ECG%282012%295&doclanguage=en>.

112 A recent civil society example is the Human Rights Due Diligence project of the International Corporate Accountability Roundtable. At: <http://accountabilityroundtable.org/campaigns/human-rights-due-diligence/>.

113 Examples include the European Commission-led guidance project for SMEs (at: [http://www.csreurope.org/news.php?type=&action=show\\_news&news\\_id=5069](http://www.csreurope.org/news.php?type=&action=show_news&news_id=5069)) and sector guidance project for the Oil & Gas, ICT, and Employment & Recruitment Agencies sectors (at: <http://www.ihrb.org/project/eu-sector-guidance/consultation-documents-and-reports.html>). See also the Danish Government’s Corporate Social Responsibility Action Plan 2012-2015. At: [http://www.samfundsansvar.dk/graphics/publikationer/CSR/ENG\\_Ansvarlig\\_Vaekst\\_2.pdf](http://www.samfundsansvar.dk/graphics/publikationer/CSR/ENG_Ansvarlig_Vaekst_2.pdf). See also the Indian Government’s National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, which reference the corporate responsibility to respect under the UN Framework. At: [http://www.mca.gov.in/Ministry/latestnews/National\\_Voluntary\\_Guidelines\\_2011\\_12jul2011.pdf](http://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf).

114 The Danish government’s reporting requirements will require large Danish companies and state-owned limited liability companies to state in their annual reports what measures they are taking to respect human rights. At: <http://www.csr.gov.dk/sw51190.asp>. See also the draft US reporting requirements for certain new investments in Burma, which will require companies to report on their use of the UN Guiding Principles framework. At: <http://www.humanrights.gov/wp-content/uploads/2012/07/Burma-Responsible-Investment-Reporting-Reqqs.pdf>.

115 See for example the work of the Global Social Compliance Program, IPIECA, the global oil and gas industry association for environmental and social issues, and the International Council of Mining and Metals. In financial sector, see the work of the *Thun Banks* and numerous investor initiatives.

116 *Investing the Rights Way: A Guide for Investors on Business and Human Rights*, Institute for Human Rights and Business, forthcoming 2012, At: [www.ihrb.org](http://www.ihrb.org).

117 See for example the work of the Electronic Industry Citizenship Coalition and Global e-Sustainability Initiative, and the work they are doing together.

the Guiding Principles can be applied to increase corporate accountability.<sup>118</sup> Trade unions are seeking to understand how the UN PRR Framework and Guiding Principles can advance labour rights, giving attention to business relationships.<sup>119</sup> Employer's organisations are also considering the implications of the Guiding Principles for employers, including in their value chains.<sup>120</sup>

What is clear is that multiple voices – not business, civil society or government alone – will shape good and effective practices in relation to corporate respect for human rights in business relationships. Aligning interpretations of the Guiding Principles can lead to a positive effect on human rights and business practices, by streamlining expectations, providing shared reference points for multistakeholder dialogue, and removing contradictory incentives and disincentives coming from the policies of investors, governments, and businesses themselves. Diverse interests leading to divergent interpretations are also quite possible. Constructive leadership and dialogue across government, business and civil society, including in multistakeholder contexts, will be critical to developing a coherent consensus on how to best achieve the goal of integrating human rights concerns into businesses. The UN Working Group on Business and Human Rights and annual UN Forum on Business and Human Rights<sup>121</sup> may have a role to play in helping to address any major divergences.

## **Theme 2. Demands for transparency and traceability around human rights conditions in value chains will also drive expectations about human rights in business relationships.**

Investors, consumers and civil society are increasingly looking for a message that translates the complexity of human rights impacts in value chains into a simple, understandable format that presents the consumer with a clear choice. The trend of consumer choice based on human rights in the value chain of particular brands is growing, but remains in its infancy. Businesses themselves also seek clear, credible information. Moves towards traceability and transparency build on recent consumer-driven certification schemes (such as Fair Trade), multistakeholder initiatives that seek to promote “clean” provenance (diamonds in the Kimberly Process, certain minerals in other conflict-free

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118 See International Corporate Accountability Roundtable, Human Rights Due Diligence project; and Theme 6 below.

119 *A Guide for Trade Unionists: The United Nations “Protect, Respect, Remedy” Framework for Business and Human Rights and the United Nations Guiding Principles for Business and Human Rights* addresses issues of business relationships, leverage and impact. At: [http://www.ituc-csi.org/IMG/pdf/12-04-23\\_ruggie\\_background\\_fd.pdf](http://www.ituc-csi.org/IMG/pdf/12-04-23_ruggie_background_fd.pdf). With respect to global framework agreements between trade unions and multinational enterprises (MNEs) “one of the frontiers of global agreements is the question of business partners, in other words, how to apply the agreement to enterprises that perform work for the MNE”: Jim Baker, Co-ordinator of the Council of Global Unions (CGU) in *Global Agreements and Protect, Respect, Remedy*. At: [http://www.ituc-csi.org/IMG/pdf/12-04-23\\_ruggie\\_background\\_fd.pdf](http://www.ituc-csi.org/IMG/pdf/12-04-23_ruggie_background_fd.pdf).

120 *Guiding Principles On Business And Human Rights: An Employers Guide* (2012). At: <http://lempnet.itcilo.org/en/hidden-folder/oe-guide-on-un-guiding-principles-human-rights>.

121 <http://www.ohchr.org/EN/Issues/Business/Pages/ForumonBusinessandHR2012.aspx>.

mineral programmes, timber under the Forest Stewardship Council<sup>122</sup>), and the publication of supplier lists and audits (in the electronic and apparel sector). The action taken by governments in certain instances (conflict minerals, forced labour and human trafficking in supply chains) indicates how much governments too can be responsive to targeted advocacy, and customer/consumer demand.<sup>123</sup>

The demand for transparency will extend beyond supply chain relationships. For instance, when governments required internet service providers to give them customer information and correspondence, the companies were pressed to publicly report such demands and some responded by participating in a multistakeholder initiative to examine the issue.<sup>124</sup> Investor-state relationships are also becoming the subject of advocacy by civil society groups, who often use right to information laws to obtain information on social and environmental impacts associated with the activities of the relationship. The significant nexus to a country's public assets (such as natural resources) and public services (even where provided by the private sector) underlie public demands for greater transparency in these areas.

As important as transparency is, it is not an end in itself. Transparency illuminates situations, thus enabling action. Multistakeholder initiatives and multilateral institutions will also play an important role. They can build on information revealed, and convene broad alliances of organisations and thereby assemble the consent and capacity that are required to resolve some of these deep-seated problems, such as exploitation and lack of social protection.

### **Theme 3. Governments will play an increasingly important role in stimulating demand for human rights due diligence, in their role as business partners.**

The Guiding Principles highlight that, through their own commercial relationships, governments can use their leverage to scale up corporate commitment and action to respect human rights. Though this Report identifies many approaches that can be used to structure business relationships with governments, it does not examine business relationships with governments specifically (except with respect to investor-state contracts). A number of questions will need to be fleshed out. What is distinctive about having a government as a business partner? What impact can government power have on the business relationship cycle? What are the effects of having a government partner on reputational risk?

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122 An example is OECD, *Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*. This makes specific recommendations on transparency in the mineral supply.

123 The Dodd-Frank Act requires companies to trace certain minerals through their supply chains, and is complemented by an MSI organised by the US Department of State. The Californian Transparency in Supply Chain Act requires disclosure and reporting on supply chain relationships where there is any risk of forced labour or human trafficking. In an effort to provide simple messages to inform consumer and business choices, the Brazilian and US governments publish lists of enterprises that have been found to use forced labour and child labour respectively. See the US Department of Labor list prohibiting the import of certain products made with child labour. At: <http://www.dol.gov/ILAB/regs/eo13126/main.htm>. In 2004, the Brazilian government's Ministry of Labour and Employment established a register of names of employers (persons or legal entities) caught exploiting workers in conditions analogous to slavery (the 'dirty list').

124 See for example the Google Transparency Report. At: <http://www.google.com/transparencyreport/removals/>.

At one end of the spectrum, businesses may work with government partners who are corrupt, uninterested in sustainable social or environmental approaches to enterprise management, and actively involved in violating human rights. At the other, governments can be a positive force, helping to integrate human rights in their different relationships with business. Governments might:

- Use government procurement to oblige businesses to pay attention to human rights.<sup>125</sup>
- Ensure that SOEs integrate the core steps of the corporate responsibility to respect, and report on their impacts and actions transparently.
- Ensure that export credit agencies, government lending arms and multilateral development banks do human rights due diligence on all loans or investments.<sup>126</sup>
- Oblige public private partnerships that deliver water, health, education and other services linked to human rights to provide these services consistent with the UN PRR Framework and Guiding Principles.

**Theme 4. Corporate commitment to respect human rights in business relationships may be driven by clearer and more tangible business opportunities, not just risk avoidance.**

Businesses that can “know and show” that they respect human rights will not only manage risk better but may be in a position to gain a competitive advantage. Strong human rights records may translate into public contracts and capital and investment opportunities, when governments are willing to weigh human rights considerations alongside the traditional drivers of cost. Traditional “value for money” considerations are beginning to give way to more informed and broader definitions of what “value” means in a sustainable society.

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125 For information on OECD countries see: <http://www.oecd-ilibrary.org/docserver/download/fulltext/4211011ec046.pdf?expires=1351529380&id=id&accname=guest&checksum=71EC47DEDE8FAF8E2CDF9907A072650A>. For a more global, but dated comparison, see: Audet, D. (2002), “Government Procurement: A Synthesis Report,” OECD Journal on Budgeting, 2(3): 149-194, OECD Publishing, Paris). “Based on this OECD work, the main estimates of the size of government procurement markets, expressed as percentage of 1998 GDP data or in billions of US dollars, are for OECD member countries as a whole, the ratio of total procurement (consumption and investment expenditure) for all levels of government is estimated at 19.96% or USD 4 733 billion and for non-member countries the ratio is estimated at 14.48% or USD 816 billion.” <http://www.oecd.org/governance/budgetingandpublicexpenditures/43506020.pdf>. The Netherlands’ incorporates the ILO core conventions and human rights standards into the social criteria for its procurement requirements At: <http://www.agentschapnl.nl/en/programmas-regelingen/criteria-development>. The US government recently announced forthcoming changes in its federal procurement regulations to strengthen protections against trafficking in persons in federal contracts see: <http://www.whitehouse.gov/the-press-office/2012/09/25/executive-order-strengthening-protections-against-trafficking-persons-fe>.

126 See *Recommendation Of The Council On Common Approaches For Officially Supported Export Credits And Environmental And Social Due Diligence* (The “Common Approaches”). At: <http://search.oecd.org/officialdocuments/displaydocumentpdf/?cote=TAD/ECG%282012%295&doclanguage=en>.

The number and breadth of certification schemes has dramatically expanded in recent years.<sup>127</sup> Certification can enable businesses to leverage their “know and show” record for business advantage, and become more attractive to partners and investors.

**Theme 5. Entering markets undergoing political and economic transition responsibly will be a major focus of government, business and civil society and will help define what is considered effective due diligence with business partners in challenging circumstances.**

The Arab Spring and developments in Burma/Myanmar have highlighted the challenges for companies of operating in countries that are in political, social and economic transition. Of course, this issue is not new (consider South Sudan recently and South Africa, Indonesia and the former Soviet Union in the 1990s). If the right conditions are in place, foreign investment and links to the global economy can positively improve a local human rights situation, by creating employment, raising living standards, and improving access to services and new technology. At the same time, countries in transition are governed by governments in transition that have limited capacity and weak standards to guide and regulate new economic growth in ways that ensures responsible behaviour.

The spotlight will therefore continue to focus more directly on business practices in challenging new markets. Rapid communication through social media and social networking creates new risks of exposure for companies that do not conduct sound human rights due diligence, or establish procedures for respecting human rights. US government reporting requirements mandating US-based companies making sizeable investments in Burma/Myanmar to report on certain aspects of their human rights due diligence will contribute to the transparency trend.

In environments where there is a high risk that human rights abuses will occur, companies will need to be particularly alert. *Red Flags: Liability Risks for Companies Operating in High-Risk Zones* and *From Red Flags to Green Flags: The Corporate Responsibility to Respect Human Rights in High Risk Countries* provide guidance in this area.<sup>128</sup> Companies will need to exercise heightened due diligence as they take the steps outlined in the Guiding Principles and in this Report. Companies will be expected to communicate their human rights expectations clearly to their business partners and conduct on-going due diligence; consider break clauses in contracts; use leverage; provide and cooperate in remediation; engage carefully and credibly with stakeholders; and communicate and report formally and regularly.

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<sup>127</sup> See for example, [www.standardsmap.org](http://www.standardsmap.org).

<sup>128</sup> *Red Flags* At: [http://www.redflags.info/index.php?page\\_id=11&style\\_id=0](http://www.redflags.info/index.php?page_id=11&style_id=0). *From Red Flags to Green Flags* At: [http://www.ihrb.org/news/2011/from\\_red\\_to\\_green\\_flags.html](http://www.ihrb.org/news/2011/from_red_to_green_flags.html).

Finally, how business relationships are ended when transitions stall is equally important. Exiting markets can affect employees but can also have a chilling effect on the lives of foreign workers, local suppliers and consumers benefiting from certain products and services. The human rights risks and dilemmas associated with closing a company or project, described in this Report, are also part of the human rights due diligence equation.

**Theme 6. “Access to Remedy” and allocation of liability will continue to be a matter of concern with respect to business relationships.**

Just as the first and second pillars of the UN PRR Framework provide a way to think about business relationships, the third pillar – Access to Remedy – is another part of the equation. More attention will be given in coming years to the third pillar, where business relationships are likely to be a central concern. Questions of accountability, fairness and compensation are not new, and are central human rights concerns. Many legal cases (in particular, but not limited to, the Alien Tort Claims Act cases in the United States) have examined the involvement of third parties with human rights abuses. Similarly, a considerable proportion of complaints under the OECD Guidelines similarly relate to human rights impacts in supply chains. It is clear that civil society actors will continue to press for increased corporate accountability and improved access to remedies for victims. A recent compendium on recourse mechanisms for human rights abuses suggested that “international law is being quietly revolutionized, to become more responsive to the challenges of economic globalization and to the weakening of the regulatory capacity of States”.<sup>129</sup>

It will be important to understand how recourse mechanisms, courts, and non-judicial bodies (such as the OECD National Contact Points, or national human rights institutions (NHRIs)) begin to apply concepts in the Guiding Principles (such as ‘degree of involvement’, ‘leverage’, ‘severity’) in their assessments.

Businesses themselves may also increasingly explore their role in remediation when they are involved with adverse human rights impacts. Under what circumstances should a company work with or require its business partners to set up effective operational-level grievance mechanisms? If a company has contributed to a negative human rights impact, what good practices will they develop for working with business partners to address grievances when they arise? Beyond grievance mechanisms, how will companies join with peers to support or promote access to remedy? How will companies seek to influence business partners whose record on remedies is poor?

Multistakeholder and industry initiatives will likely also explore their role in remediation and building accountability. They may do this by establishing standards for their members and by addressing complaints and instances of non-compliance.

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129 FIDH, *Corporate Accountability for Human Rights Abuses: A Guide for Victims and NGOs on Recourse Mechanisms* (2012). At: <http://www.fidh.org/Updated-version-Corporate-8258>.

**Theme 7. Understanding of risk will continue to broaden and will increasingly include human rights risk as a routine consideration in business relationships.**

A finding of the original *State of Play Report* is echoed here. “Most businesses interviewed understand that traditional business risk approaches are not adequate in understanding the risks people face, in particular those most vulnerable. In the medium or long-term, business risks and societal (or human rights) risks may converge – a business will eventually lose the ‘social license’ or even the ‘legal license’ to operate if it is routinely abusing the rights of those within or around its operations.”<sup>130</sup>

Some businesses are now working to give practical effect to this broader understanding of risk. On the one hand, this involves a change of mindset. On the other, companies will likely need to translate the significance and severity of adverse human rights impacts into existing systems in order that they “stick”. A particular challenge is how to turn human rights risk into measurable risk or quantifiable measures so that the magnitude, significance and severity human rights risks can begin to be incorporated into the relationship planning process in a more straightforward manner. At the same time, evaluating short-term business relationships, which are transient or poorly defined will always be a challenge. Managers in diverse functions and geographies will want decision matrices, risk mapping tools, rating frameworks and guidance to make decisions about the needs of business partners and the risks they present. This also plays into the effectiveness of action to prevent and mitigate human rights impacts. What qualitative and quantitative indicators will have the greatest practical relevance and application?

The human rights community has struggled for some time with the issue of indicators. It will not be an easier task in the business context. Collaboration between the human rights community (national human rights institutions, human rights NGOs) and the corporate community could be beneficial.

**Theme 8. In order to address a wider range of business relationships, companies will increasingly align their practice across corporate functions, business units and locations.**

Based on conversations with the respondent companies for this Report, it is fair to say that companies are increasingly engaging with human rights issues outside the traditional corporate social responsibility, sustainability, public affairs and corporate citizenship spheres. This trend will need to be supported: colleagues who select, start, formalise, manage, renew and end business relationships will require policy communication, training, and guidance. However, human rights will continue to compete for attention in a crowded corporate space.

Ideas for peer learning in the business community could include: briefings and guidance for key functions and departments (M&A, legal, procurement, sales and marketing); training modules that build on a company’s human rights policy commitment, clarify

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<sup>130</sup> See footnote 19, p. 13.

the business case, and propose clear and achievable strategies for specific departments and functions; and practical incentives and disincentives designed to improve the human rights performance of business partners, with time-lines. Vocal leadership by senior managers will be vital, to set priorities and ensure that human rights continue to be given attention by partners and the company.

**Theme 9. Companies and their stakeholders will be interested in examples of how businesses can create and exercise leverage with business partners.**

Establishing and applying leverage with business partners is essentially about encouraging, and if necessary enforcing, behaviours that respect human rights, while managing company risk. Businesses increasingly build “enforcement” into their relationships by referring to the Guiding Principles (and human rights standards) in contracts, in industry association initiatives, in multistakeholder initiatives and their contracts, and in operational performance standards. In this way they create a culture of expected adherence to and collaboration around the Guiding Principles. Continued interest in business-to-business learning on this is inevitable. External stakeholders will also want to understand the process. NGOs may seek evidence that a company has done all it practically can to advance respect for human rights, from the beginning and throughout its relationships. Governments and investors may need to understand how to use the tools at their disposal to reinforce respect for human rights in business relationships, while fulfilling their own duties and responsibilities.

A number of questions will need to be addressed in the coming five years. How are contracts and operating procedures used to create leverage? What degree of pressure or leverage is *reasonable* and *proportional* with respect to presumed human rights risks and potential impacts? What “techniques” in addition to contracts are being used effectively? If a company has or uses leverage, should it “show” this? How effective are drivers external to the relationship itself, such as multistakeholder initiatives, investor requirements, NGO campaigns, and industry initiatives? How will states play a stronger role and use their leverage given their State Duty to Protect (particularly through enforcement of existing laws)?

**Theme 10. Companies will continue to look for ways to access credible information and engage stakeholders as part of due diligence in business relationships.**

Companies and their stakeholders will increasingly seek meaningful dialogue around accessing credible information while balancing commercial protections and the importance of transparency.

It is now widely recognised (and an expectation of the Guiding Principles) that likely or actual human rights impacts are identified, assessed and addressed more effectively if stakeholders, including affected populations, are consulted. Where companies wholly own and operate projects, they are likely to have experience, procedures and capacity to consult stakeholders. As this Report has highlighted, impacts that involve products, services and operations with which a business is directly linked via a relationship present a challenge even for experienced companies. The challenge can be extremely complex in situations of conflict or high risk areas.

Several questions will need to be addressed in the next five years. What good practice options are available to a company whose business partner is not open to engaging stakeholders, or blocks access to affected stakeholders? What good practice rules should guide a company that wants to consult expert stakeholders before a contract has been signed? Are risk assessment organisations, or political and security or media intelligence experts effective and legitimate proxies for local stakeholders (vulnerable and affected communities, local civil society organisations, religious and community leaders)? What support should be expected (and accepted) from embassies, national human rights institutions, journalists and others? In high-risk situations and locations where stakeholders are unable to speak out, what good practice options are available?

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**The Institute for Human Rights and Business and the Global Business Initiative on Human Rights welcome feedback from businesses, governments, civil society organisations, trade unions and scholars on this Report. The task of developing guidance, methodologies, and tools for respecting human rights in business relationships, as well as for applying them, is too important for any single player; we all have an interest in its success.**



## Appendix A: The Corporate Responsibility to Respect Human Rights and Business Relationships in the UN Guiding Principles

This table was developed for this Report to outline the guidance the Guiding Principles provide regarding business relationships. Sometimes the Guiding Principles contain direct references to business relationships and in other cases the Guiding Principles are less direct about business relationships and so elaboration was deemed helpful (by the project team).

The table below quotes relevant text in the Guiding Principles and commentary when it comes to business relationships. Bulleted text has been developed to paraphrase or elaborate on this, and offers a suggested relevance for business relationships. Not all Guiding Principles are quoted to avoid unnecessary repetition.

### Foundational Principles

#### Guiding Principle 12: Scope and Definition of “Human Rights”

<b>Relevant Text</b>	<i>The responsibility of business enterprises to respect human rights refers to internationally recognised human rights – understood, at a minimum, as those expressed in the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization’s Declaration on Fundamental Principles and Rights at Work.</i>
<b>Relevant Commentary</b>	<i>Because business enterprises can have an impact on virtually the entire spectrum of internationally recognised human rights, their responsibility to respect applies to all such rights. In practice, some human rights may be at greater risk than others in particular industries or contexts, and therefore will be the focus of heightened attention. However, situations may change, so all human rights should be the focus of periodic review.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• As a starting point, businesses should consider all human rights when engaging business partners.</li> <li>• The activity (product, service or operation) and operating context of the business relationship should inform decisions about those rights that are most relevant in the specific relationship.</li> <li>• The situation, and company policy frameworks/tools to manage the situation, should be periodically reviewed with reference to all human rights.</li> </ul>

### Guiding Principle 13: Level Of Involvement // “Business Relationships” Defined

<b>Relevant Text</b>	<i>The responsibility to respect human rights requires that business enterprises: (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.</i>
<b>Relevant Commentary</b>	<i>Business enterprises may be involved with adverse human rights impacts either through their own activities or as a result of their business relationships with other parties. Guiding Principle 19 elaborates further on the implications for how business enterprises should address these situations. For the purpose of these Guiding Principles a business enterprise’s “activities” are understood to include both actions and omissions; and its “business relationships” are understood to include relationships with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• There are different levels of involvement that a business may have in relation to an adverse human rights impact therefore different appropriate action is expected.</li> <li>• The appropriate action expected depends on a business’s connection to the impact:             <ul style="list-style-type: none"> <li>• If <i>causing or contributing</i> (or potentially causing or contributing) then avoid and address;</li> <li>• If <i>directly linked</i> to the impacts (even where the business has not caused or contributed to the impact), then seek to prevent or mitigate.</li> </ul> </li> <li>• “Business relationships” is defined broadly i.e. this could include suppliers, customers, consumers, joint venture partners, service providers, franchises, governmental partners and others.</li> </ul>

**Guiding Principle 14: All Enterprises Have Responsibility // One Size Does Not Fit All**

<b>Relevant Text</b>	<i>The responsibility of business enterprises to respect human rights applies to all enterprises regardless of their size, sector, operational context, ownership and structure. Nevertheless, the scale and complexity of the means through which enterprises meet that responsibility may vary according to these factors and with the severity of the enterprise’s adverse human rights impacts.</i>
<b>Relevant Commentary</b>	<i>The means through which a business enterprise meets its responsibility to respect human rights will be proportional to, among other factors, its size. Small and medium-sized enterprises may have less capacity as well as more informal processes and management structures than larger companies, so their respective policies and processes will take on different forms. But some small and medium-sized enterprises can have severe human rights impacts, which will require corresponding measures regardless of their size. Severity of impacts will be judged by their scale, scope and irremediable character. The means through which a business enterprise meets its responsibility to respect human rights may also vary depending on whether, and the extent to which, it conducts business through a corporate group or individually. However, the responsibility to respect human rights applies fully and equally to all business enterprises.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• One size does not fit all and so it will be up to each group or each enterprise to determine how they address human rights in their business relationships. For instance, each industry and company will probably use a different mixture of policies, contractual arrangements, operating procedures, accountability arrangements, assessments, audits, management systems etc. to address human rights with business partners.</li> <li>• Enterprises of all sizes can be involved in adverse human rights impacts that are severe. Size or availability of resources has no bearing on a business’s Corporate Responsibility to Respect.</li> </ul>

## Operational Principles

### Guiding Principle 16: Policy Commitment

<b>Relevant Text</b>	<p><i>As the basis for embedding their responsibility to respect human rights, business enterprises should express their commitment to meet this responsibility through a statement of policy that...</i></p> <p><i>(c) Stipulates the enterprise's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services; (d) Is publicly available and communicated internally and externally to all personnel, business partners and other relevant parties; (e) Is reflected in operational policies and procedures necessary to embed it throughout the business enterprise.</i></p>
<b>Relevant Commentary</b>	<p><i>The statement of commitment should be publicly available. It should be communicated actively to entities with which the enterprise has contractual relationships; others directly linked to its operations, which may include State security forces; investors; and, in the case of operations with significant human rights risks, to the potentially affected stakeholders.</i></p> <p><i>Just as States should work towards policy coherence, so business enterprises need to strive for coherence between their responsibility to respect human rights and policies and procedures that govern their wider business activities and relationships. This should include, for example, policies and procedures that set financial and other performance incentives for personnel; procurement practices; and lobbying activities where human rights are at stake.</i></p> <p style="text-align: right;"><i>continued opposite</i></p>

**Suggested  
Relevance**

- Human rights policy commitments should include expectations for business partners.
- Human rights policy commitments should be communicated to business partners. This communication could occur through contracts, guidance, dialogue, training etc.
- Embedding human rights into existing policies, processes and management systems used to manage business relationships is encouraged so that human rights becomes part of day-to-day business rather than being treated as a one-off concern only at the start of a relationships.
- Internal coherence of policies, practices and incentives should be achieved. For business relationships this will likely mean focused work with multiple key functions in a company working on the business relationship so that they understand, and are incentivised to respect the company's human rights commitments (e.g. procurement, legal, M&A, sales, compliance, government relations, etc.).

**Guiding Principle 17: Human Rights Due Diligence // (What, When and Prioritisation)**

<b>Relevant Text</b>	<p><i>In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed. Human rights due diligence: (a) Should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships; (b) Will vary in complexity with, the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations; (c) Should be on-going, recognising that the human rights risks may changeover time as the business enterprise's operations and operating context evolve.</i></p>
<b>Relevant Commentary</b>	<p><i>Human rights due diligence should be initiated as early as possible in the development of a new activity or relationship, given that human rights risks can be increased or mitigated already at the stage of structuring contracts or other agreements, and may be inherited through mergers or acquisitions.</i></p> <p><i>Where business enterprises have large numbers of entities in their value chains it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all. If so, business enterprises should identify general areas where the risk of adverse human rights impacts is most significant, whether due to suppliers' or clients' operating context, the particular operations, products or services involved, or other relevant considerations, and prioritise these for human rights due diligence.</i></p> <p style="text-align: right;"><i>continued opposite</i></p>

**Suggested  
Relevance**

- The scope of due diligence does not include all actions or impacts of a business partners – just those in which the business may be involved. In practice, public opinion may not make such a distinction and it may be difficult to understand the impacts in which the business may be involved without a broader inquiry.
- If companies must prioritise attention to human rights in certain business relationships (and related operations, products and services) for due diligence because the company has a large number of entities in its value chain, the company should start with those relationships that pose the most significant and severe risks to human rights. Evidence should be developed concerning operating context, the products or services involved and other relevant considerations (including information in the public domain or provided by stakeholders).
- Prioritising relationships based on the volume or percentage of business without the further considerations identified above, may not be the most appropriate approach to prioritisation, from a human rights or business risk perspective.
- Once companies are finished with the highest prioritised business relationships, they should move on to the next set of priorities for due diligence as these may also carry risk of adverse human rights impacts (even if initially judged as less significant or severe).
- Due diligence should start as early as possible in new relationship to more easily avoid, prevent and mitigate adverse human rights impacts (e.g. during initial negotiations/ dialogue, prior to mergers/acquisitions, through contractual clauses, design of operating procedures, plans for third party monitoring...). At the same time, due diligence should not only take place early on in the relationship, but should be on going as situations change.

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**Guiding Principle 17: Complicity**

<b>Relevant Text</b>	–
<b>Relevant Commentary</b>	<p><i>Questions of complicity may arise when a business enterprise contributes to, or is seen as contributing to, adverse human rights impacts caused by other parties. Complicity has both non-legal and legal meanings. As a non-legal matter, business enterprises may be perceived as being “complicit” in the acts of another party where, for example, they are seen to benefit from an abuse committed by that party. As a legal matter, most national jurisdictions prohibit complicity in the commission of a crime, and a number allow for criminal liability of business enterprises in such cases. Typically, civil actions can also be based on an enterprise’s alleged contribution to a harm, although these may not be framed in human rights terms. The weight of international criminal law jurisprudence indicates that the relevant standard for aiding and abetting is knowingly providing practical assistance or encouragement that has a substantial effect on the commission of a crime. Conducting appropriate human rights due diligence should help business enterprises address the risk of legal claims against them by showing that they took every reasonable step to avoid involvement with an alleged human rights abuse. However, business enterprises conducting such due diligence should not assume that, by itself, this will automatically and fully absolve them from liability for causing or contributing to human rights abuses.</i></p>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• There may be both legal and non-legal forms of complicity. As a legal matter, most national jurisdictions prohibit complicity in the commission of a crime, and a number allow for criminal liability of business enterprises in such cases.</li> <li>• When it comes to non-legal complicity, human rights due diligence may be or become key in reducing legal risk and liability as it could demonstrate the standard of “<i>taking every reasonable step to avoid involvement</i>”. But the assumption that human rights due diligence will by itself automatically and fully absolve businesses from liability for complicity is cautioned against.</li> </ul>

### Guiding Principle 18: Identifying and Assessing Human Rights Impacts

<p><b>Relevant Text</b></p>	<p><i>In order to gauge human rights risks, business enterprises should identify and assess any actual or potential adverse human rights impacts with which they may be involved either through their own activities or as a result of their business relationships. This process should:(a) Draw on internal and/or independent external human rights expertise; (b) Involve meaningful consultation with potentially affected groups and other relevant stakeholders, as appropriate to the size of the business enterprise and the nature and context of the operation.</i></p>
<p><b>Relevant Commentary</b></p>	<p><i>The initial step in conducting human rights due diligence is to identify and assess the nature of the actual and potential adverse human rights impacts with which a business enterprise may be involved. The purpose is to understand the specific impacts on specific people, given a specific context of operations. Typically this includes assessing the human rights context prior to a proposed business activity, where possible; identifying who may be affected; cataloguing the relevant human rights standards and issues; and projecting how the proposed activity and associated business relationships could have adverse human rights impacts on those identified.</i></p> <p><i>In this process, business enterprises should pay special attention to any particular human rights impacts on individuals from groups or populations that may be at heightened risk of vulnerability or marginalisation, and bear in mind the different risks that may be faced by women and men. While processes for assessing human rights impacts can be incorporated within other processes such as risk assessments or environmental and social impact assessments, they should include all internationally recognised human rights as a reference point, since enterprises may potentially impact virtually any of these rights.</i></p> <p><i>Because human rights situations are dynamic, assessments of human rights impacts should be undertaken at regular intervals: prior to a new activity or relationship; prior to major decisions or changes in the operation (e.g. market entry, product launch, policy change, or wider changes to the business); in response to or anticipation of changes in the operating environment (e.g. rising social tensions); and periodically throughout the life of an activity or relationship.</i></p> <p style="text-align: right;"><i>continued opposite</i></p>

	<p><i>To enable business enterprises to assess their human rights impacts accurately, they should seek to understand the concerns of potentially affected stakeholders by consulting them directly in a manner that takes into account language and other potential barriers to effective engagement. In situations where such consultation is not possible, business enterprises should consider reasonable alternatives such as consulting credible, independent expert resources, including human rights defenders and others from civil society.</i></p> <p><i>The assessment of human rights impacts informs subsequent steps in the human rights due diligence process.</i></p>
<p><b>Suggested Relevance</b></p>	<ul style="list-style-type: none"> <li>• The impact on people of the products, services and operations associated with the relationship should be assessed. Guiding Principle 18 provide some guidance as to what this typically involves – “Typically this includes assessing the human rights context prior to a proposed business activity, where possible; identifying who may be affected; cataloguing the relevant human rights standards and issues; and projecting how the proposed activity and associated business relationships could have adverse human rights impacts on those identified”.</li> <li>• Because situations change, assessment should be carried out prior to major decisions or changes in business relationship operations; in response to or anticipation of changes in the operating environment and periodically throughout the life of a relationship (e.g. partner identification, contract signing, project phases, or relationship renewal).</li> <li>• Human rights expertise, stakeholder engagement, vulnerable groups and, as appropriate, engaging with potentially affected stakeholders should also be considered in the context of assessing actual and potential impacts associated with business relationships.</li> </ul>

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**Guiding Principle 19a): Integration of Findings and Responses**


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<b>Relevant Text</b>	<i>In order to prevent and mitigate adverse human rights impacts, business enterprises should integrate the findings from their impact assessments across relevant internal functions and processes, and take appropriate action (a) Effective integration requires that: (i) Responsibility for addressing such impacts is assigned to the appropriate level and function within the business enterprise; (ii) Internal decision-making, budget allocations and oversight processes enable effective responses to such impacts.</i>
<b>Relevant Commentary</b>	<p><i>The horizontal integration across the business enterprise of specific findings from assessing human rights impacts can only be effective if its human rights policy commitment has been embedded into all relevant business functions. This is required to ensure that the assessment findings are properly understood, given due weight, and acted upon.</i></p> <p><i>In assessing human rights impacts, business enterprises will have looked for both actual and potential adverse impacts. Potential impacts should be prevented or mitigated through the horizontal integration of findings across the business enterprise, while actual impacts – those that have already occurred – should be a subject for remediation (Principle 22).</i></p>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• Actions following assessment – whether a business causes, contributes or is directly linked to the situation – should be effectively integrated into business operations.</li> <li>• For business relationships this could involve budget, oversight and incentive discussions and decisions involving multiple key functions (e.g. procurement, legal, M&amp;A, sales, compliance, government relations, etc.).</li> <li>• Actual impacts that have already occurred should be the subject of remediation. See Guiding Principle 22.</li> </ul>

**Guiding Principle 19b): Appropriate Action**

<b>Relevant Text</b>	<i>Appropriate action will vary according to: (i) Whether the business enterprise causes or contributes to an adverse impact, or whether it is involved solely because the impact is directly linked to its operations, products or services by a business relationship; (ii) The extent of its leverage in addressing the adverse impact.</i>
<b>Relevant Commentary</b>	<p><i>Where a business enterprise causes or may cause an adverse human rights impact, it should take the necessary steps to cease or prevent the impact.</i></p> <p><i>Where a business enterprise contributes or may contribute to an adverse human rights impact, it should take the necessary steps to cease or prevent its contribution and use its leverage to mitigate any remaining impact to the greatest extent possible. Leverage is considered to exist where the enterprise has the ability to effect change in the wrongful practices of an entity that causes a harm.</i></p> <p><i>Where a business enterprise has not contributed to an adverse human rights impact, but that impact is nevertheless directly linked to its operations, products or services by its business relationship with another entity, the situation is more complex. Among the factors that will enter into the determination of the appropriate action in such situations are the enterprise's leverage over the entity concerned, how crucial the relationship is to the enterprise, the severity of the abuse, and whether terminating the relationship with the entity itself would have adverse human rights consequences. The more complex the situation and its implications for human rights, the stronger is the case for the enterprise to draw on independent expert advice in deciding how to respond. If the business enterprise has leverage to prevent or mitigate the adverse impact, it should exercise it. And if it lacks leverage there may be ways for the enterprise to increase it. Leverage may be increased by, for example, offering capacity-building or other incentives to the related entity, or collaborating with other actors. There are situations in which the enterprise lacks the leverage to prevent or mitigate adverse impacts and is unable to increase its leverage. Here, the enterprise should consider ending the relationship, taking into account credible assessments of potential adverse human rights impacts of doing so. Where the relationship is</i></p> <p style="text-align: right;"><i>continued opposite</i></p>

	<p><i>“crucial” to the enterprise, ending it raises further challenges. A relationship could be deemed as crucial if it provides a product or service that is essential to the enterprise’s business, and for which no reasonable alternative source exists. Here the severity of the adverse human rights impact must also be considered: the more severe the abuse, the more quickly the enterprise will need to see change before it takes a decision on whether it should end the relationship. In any case, for as long as the abuse continues and the enterprise remains in the relationship, it should be able to demonstrate its own on going efforts to mitigate the impact and be prepared to accept any consequences – reputational, financial or legal – of the continuing connection.</i></p>
<p><b>Suggested Relevance</b></p>	<ul style="list-style-type: none"> <li>• If a business is directly linked to an impact it is more complex. The enterprise is expected to prevent or mitigate the impact but this will often require action as well by the business partner. The case for independent expert advice is stronger the more complex the situation.</li> <li>• A number of factors and avenues should be considered in deciding on what action to take including: <ul style="list-style-type: none"> <li>• Extent of leverage.</li> <li>• How crucial the relationship is.</li> <li>• Severity of the abuse.</li> <li>• Human rights consequences of terminating.</li> </ul> </li> <li>• If a business has leverage it should use it and if necessary and possible, increase leverage (e.g. through incentives, capacity building or collaboration with other actors). Leverage is defined in the Guiding Principles as “the ability to effect change in the wrongful practices of an entity that causes harm”.</li> <li>• If the above is not effective, the businesses should consider ending the relationship. If, due to how crucial the relationship is (i.e. it is essential and there is no alternative), a business decides not to end the relationship then it should be prepared to: demonstrate on going efforts to mitigate the impact; and accept the consequences of the on going connection</li> <li>• Note that when considering to end a relationship or not, the severity of the abuse must be considered. The more severe, the more quickly the business would need to see change.</li> </ul>

**Guiding Principle 20: Tracking Effectiveness of Responses**

<b>Relevant Text</b>	<i>In order to verify whether adverse human rights impacts are being addressed, business enterprises should track the effectiveness of their response. Tracking should: (a) Be based on appropriate qualitative and quantitative indicators; (b) Draw on feedback from both internal and external sources, including affected stakeholders.</i>
<b>Relevant Commentary</b>	<i>Tracking is necessary in order for a business enterprise to know if its human rights policies are being implemented optimally, whether it has responded effectively to the identified human rights impacts, and to drive continuous improvement. Business enterprises might employ tools they already use in relation to other issues. This could include performance contracts and reviews as well as surveys and audits, using gender disaggregated data where relevant.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• Tracking the effectiveness of actions to prevent or mitigate impacts also applies to business relationships.</li> <li>• Where companies have in place key performance indicators (KPIs) or systems to review the actions of business partners, such as compliance audits in the supply chain or monitoring systems for joint ventures, these might be usefully adapted, in light of the points above, to cover human rights impacts in the business relationship.</li> <li>• Engagement with external sources, including affected stakeholders, should inform understanding of effectiveness of responses in the context of business relationships.</li> </ul>

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**Guiding Principle 21: Communicating**

<b>Relevant Text</b>	<i>In order to account for how they address their human rights impacts, business enterprises should be prepared to communicate this externally, particularly when concerns are raised by or on behalf of affected stakeholders.</i>
<b>Relevant Commentary</b>	<i>Showing involves communication, providing a measure of transparency and accountability to individuals or groups who may be impacted and to other relevant stakeholders, including investors.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• “Showing” may appropriately include communicating with business partners as well as with relevant stakeholders (e.g. civil society, government, affected stakeholders, investors etc.) about human rights due diligence efforts in the business relationship.</li> </ul>

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**Guiding Principle 22: Remediation**

<b>Relevant Text</b>	<i>Where business enterprises identify that they have caused or contributed to adverse impacts, they should provide for or cooperate in their remediation through legitimate processes.</i>
<b>Relevant Commentary</b>	<i>Where adverse impacts have occurred that the business enterprise has not caused or contributed to, but which are directly linked to its operations, products or services by a business relationship, the responsibility to respect human rights does not require that the enterprise itself provide for remediation, though it may take a role in doing so.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• Where adverse impacts have occurred and a business has caused or contributed then the business should provide for or cooperate in remediation through legitimate processes, even if the cause of the adverse impact was a business partner</li> <li>• Where a business is directly linked to the adverse impacts the Guiding Principles do not expect the business to provide for remediation, though it may take a role in doing so.</li> </ul>

## Issues of Context

<b>Guiding Principle 23: Conflict of Law // Gross Human Rights Abuses</b>	
<b>Relevant Text</b>	<i>In all contexts, business enterprises should: a) Comply with all applicable laws and respect internationally recognised human rights, wherever they operate; (b) Seek ways to honour the principles of internationally recognised human rights when faced with conflicting requirements; (c) Treat the risk of causing or contributing to gross human rights abuses as a legal compliance issue wherever they operate.</i>
<b>Relevant Commentary</b>	<i>Although particular country and local contexts may affect the human rights risks of an enterprise's activities and business relationships, all business enterprises have the same responsibility to respect human rights wherever they operate. Where the domestic context renders it impossible to meet this responsibility fully, business enterprises are expected to respect the principles of internationally recognised human rights to the greatest extent possible in the circumstances, and to be able to demonstrate their efforts in this regard. Some operating environments, such as conflict-affected areas, may increase the risks of enterprises being complicit in gross human rights abuses committed by other actors (security forces, for example). Business enterprises should treat this risk as a legal compliance issue, given the expanding web of potential corporate legal liability arising from extraterritorial civil claims, and from the incorporation of the provisions of the Rome Statute of the International Criminal Court in jurisdictions that provide for corporate criminal responsibility. In addition, corporate directors, officers and employees may be subject to individual liability for acts that amount to gross human rights abuses.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• In circumstances where national law conflicts with international human rights standards, the potential for risk from business relationships may be even higher. This is relevant to company policies towards business relationships – they should set out expectations of business partners in addressing these dilemmas.</li> <li>• Operating in conflict affected areas may provide strong incentive or even requirements for enhanced due diligence and binding contractual provisions on addressing potential and actual human rights impacts given the severity of risks and the heightened risk of liability.</li> </ul>

**Guiding Principle 24: Prioritising Based on Severity of Human Rights Impact**

<b>Relevant Text</b>	<i>Where it is necessary to prioritise actions to address actual and potential adverse human rights impacts, business enterprises should first seek to prevent and mitigate those that are most severe or where delayed response would make them irremediable.</i>
<b>Relevant Commentary</b>	<i>While business enterprises should address all their adverse human rights impacts, it may not always be possible to address them simultaneously. In the absence of specific legal guidance, if prioritisation is necessary business enterprises should begin with those human rights impacts that would be most severe, recognising that a delayed response may affect remediability. Severity is not an absolute concept in this context, but is relative to the other human rights impacts the business enterprise has identified.</i>
<b>Suggested Relevance</b>	<ul style="list-style-type: none"> <li>• If, in the context of a business relationship, a company must prioritise which human rights impacts to address first it should focus on those impacts that would be most severe where severity depends on             <ul style="list-style-type: none"> <li>• Scale of impact: the gravity of impact.</li> <li>• Scope of impact: the number of individuals impacted at present or the future.</li> <li>• Irremediable: Impacts that cannot be reversed or mitigated. This may include in particular right to life and health of individuals, fundamental effects on the welfare of entire groups or communities, gross human rights abuses and disproportionate impacts on the most vulnerable groups.</li> </ul> </li> </ul>



## Appendix B: The Business Relationship Cycle and the UN Guiding Principles

### Embedding

The Guiding Principles recognise that there are often different parts of a company that can play a role in having a positive or negative impact on human rights. This is a prime reason why the Guiding Principles call for a statement of policy that is approved at the most senior level of the company.<sup>131</sup> Effective embedding requires that responsibility for addressing human rights impacts is assigned to the appropriate levels and functions within the company, supported by internal decision making processes, budget allocations and oversight. Embedding should also help ensure internal coherence to reduce the chance that different parts of the organisation are working at cross-purposes to each other and to company policies, including a human rights policy. Appropriate incentives and disincentives can reinforce coherence across company operations and out into business relationships if they are aligned with company policies, including around a human rights policy. That coherence does not stop at the company gate – the Guiding Principles deliver the clear message that coherence and consistency on human rights should extend as far as a company’s direct linkages do.

### Selecting and Starting a Relationship

The Guiding Principles recognise that the start of a relationship is often an opportune moment for addressing human rights issues with business partners and that setting and communicating expectations early permits all parties to structure the contractual relationship as needed to address potential human rights issues.<sup>132</sup> Business partners may also already be addressing human rights issues as part of their own responsibility to respect, so communication can and should go both ways.<sup>133</sup> The Guiding Principles highlight that human rights due diligence can be folded into broader enterprise risk management systems, provided that it goes beyond simply identifying and managing risks to the company itself, to include risks to potentially affected stakeholders.<sup>134</sup> Not all human rights will be applicable to the relationship, but it is the assessment process itself that is used to determine that, narrowing down the issues for consideration based on analysis within the assessment process.<sup>135</sup> The depth and scope of human rights due diligence should be commensurate with the significance and severity of possible or actual harm.<sup>136</sup> Where vulnerable individuals or groups may be involved, the due diligence process should pay particular attention to any negative impacts on them.<sup>137</sup>

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131 Guiding Principle 16.

132 Guiding Principles 16 and 17.

133 Guiding Principle 14.

134 Guiding Principle 17.

135 Guiding Principle 17 and see: International Organisation of Employers, “Guiding Principles on Business and Human Rights: Employers Guide,” (2011), p. 5.

136 Guiding Principles 14 and 24.

137 Guiding Principle 12.

As the risks concern people, it is the people potentially affected who should be involved in discussions around the possible impacts and ways to deal with the impacts, working with business partners to ensure that relevant stakeholders or experts are consulted as appropriate.<sup>138</sup>

The Guiding Principles also recognise that if a company needs to prioritise its attention to human rights among relationships because it has such a large number of entities in its value chain, the most significant human rights risks should be prioritised. Taking a risk-based approach to prioritisation will require some initial assessment to identify the greatest areas of potential risk based on relevant factors such as the country of operation of the relationship, the sector, and the nature of the operations.<sup>139</sup> In all cases, potentially severe human rights impacts, and in particular the risk of involvement in gross human rights abuses, should be pushed to the top of the list of potential or actual human rights impacts to address first and addressed in the same way that companies would address other legal compliance issues.<sup>140</sup>

### **Formalising the Relationship**

The Guiding Principles recognise that the contract between business partners is an opportune place for communicating and addressing human rights issues with business partners.<sup>141</sup> Standard clauses on compliance with all applicable laws and respect for internationally recognised human rights can help set important baseline expectations for the partnership. If involvement in gross human rights abuses is possible, the contract is an important place to set out actions to avoid such abuses.<sup>142</sup>

### **Operating and Managing the Relationship**

One of the clear key messages of the Guiding Principles is that human rights due diligence is as much about managing on-going human rights impacts throughout a relationship as it is about getting the initial assessment of human rights issues in the relationship right. The Guiding Principles recognise that situations are dynamic so management and monitoring of situations should be as well.<sup>143</sup> The Guiding Principles link expected responses to each partner's involvement in the impact.<sup>144</sup> They very specifically moved away from an earlier version of gauging business responsibility by its proximity or leverage or sphere of influence, and instead set out an approach whereby responsibility is determined by the impact of an enterprise's activities on others, not by

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138 Guiding Principles 12 and 18.

139 Guiding Principle 17.

140 Guiding Principle 23.

141 Guiding Principle 17.

142 Guiding Principle 23.

143 Guiding Principle 18.

144 Guiding Principle 17.

leverage.<sup>145</sup> If a company does not have enough leverage over its business partner to persuade them to cease and remediate negative human rights impacts, the answer is that leverage must be increased or other choices made about the relationships, not that responsibility is diminished.<sup>146</sup> Leverage becomes a way of exercising the responsibility to respect, rather than determining it.

The Guiding Principles also highlight the importance of accountability for addressing human rights impacts and note that engagement plays an important role – with stakeholders and experts in preparing and conducting assessments, with stakeholders on feedback about managing on-going impacts, and with potential victims about grievances.<sup>147</sup> The Guiding Principles make the point that communication does not have to be complicated, but that communication and consultation is vital – without it, companies cannot show that they and business partners are taking actions and stakeholders have little basis to understand and assess what is going on.<sup>148</sup> When a business is directly linked to another business partner’s negative impacts, but did not contribute, the responsibility for addressing the grievance falls to the business partner. However, the Guiding Principles also take a pragmatic approach, noting that grievance mechanisms can be a valuable avenue for addressing concerns and resolving issues and therefore business partners may choose to engage in the process.<sup>149</sup>

### **Ending or Renewing the Relationship**

Following the central concept that human rights considerations come into play throughout a relationship, the Guiding Principles draw attention to the human rights considerations of terminations.<sup>150</sup> They also specifically contemplate that human rights abuses may be the specific reason for termination where a company may be involved in negative human rights abuses through a relationship and cannot persuade its business partner to cease such abuses and provide remediation. The pragmatic approach of the Guiding Principles recognises that there may be situations where companies have few options in finding other business partners, but that situation does not absolve the company of responsibility – instead, the Guiding Principles highlight that companies should seek to increase their leverage over the business partner or be ready to bear the consequences of association with the abuse.<sup>151</sup>

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145 “Clarifying the Concepts of ‘Sphere of influence’ and ‘Complicity’ Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises, John Ruggie\*” Summary, para 18. <http://198.170.85.29/Ruggie-companion-report-15-May-2008.pdf>, A/HRC/8/16 15 May 2008.

146 Guiding Principle 19.

147 Guiding Principle 21.

148 Guiding Principle 21.

149 Guiding Principle 22.

150 Guiding Principle 19.

151 Guiding Principle 19.

A defining characteristic of 21st century globalisation is the dramatic growth and increasing complexity of business relationships, including those that cross borders. This web of commercial transactions affects companies on every scale, and means that businesses have a direct or indirect relationship with hundreds and sometimes tens of thousands of enterprises that are not under their direct control or ownership. A single product, service or project can involve numerous companies in a web of multilateral business ties. These relationships can spur economic growth, improve efficiency, provide access to technologies and services, and generate opportunities for formal, safer employment. At the same time, business transactions are now frequent in regions where respect for the rule of law is limited or fragile, and where regulatory and policy frameworks are silent or regressive with regard to international human rights standards. This Report takes stock of a range of efforts employed by a group of companies to address the human rights impacts associated with their business relationships and explores the implications of the UN Guiding Principles on Business and Human Rights for business relationships.

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