

# Integrating Human Rights Due Diligence Into Model Supply Chain Contracts



**John F. Sherman, III**

Corporate Responsibility Initiative, Harvard Kennedy School

December 2022 | Working Paper No. 80

A Working Paper of the  
**Corporate Responsibility Initiative**



**HARVARD** Kennedy School

**MOSSAVAR-RAHMANI CENTER**  
for Business and Government

*CORPORATE RESPONSIBILITY INITIATIVE*

## **INTEGRATING HUMAN RIGHTS DUE DILIGENCE INTO MODEL SUPPLY CHAIN CONTRACTS**

**John F. Sherman, III<sup>1</sup>**

### **ABSTRACT**

A supply chain contract is a key form of leverage through which buyers can influence suppliers to improve their human rights performance. This paper reviews a 2021 draft of voluntary model supply chain clauses prepared by a Working Group of the Business Law Section of the American Bar Association. The draft attempts to incorporate the expectations of human rights due diligence (HRDD) within the meaning of the 2011 UN Guiding Principles on Business and Human Rights (UNGPs).

The model clauses are designed to address the long-standing problem of buyer contribution to supplier human rights impacts in supply chains, and the ineffective and counterproductive nature of top-down compliance contract models traditionally relied upon by buyers. The model clauses attempt to avoid this problem in three ways: (1) by moving the supply chain contract away from a traditional top-down representation and warranty regime to a shared responsibility regime based on human rights due diligence regime (2) by requiring both buyer and supplier to engage in responsible sourcing and purchasing practices; and (3) by conditioning conventional contract remedies between the parties on remediation of harm to stakeholders.

The need a new form of supply chain contract become increasingly important in order to meet the growing business case avoiding involvement in supply chain human rights abuse, evolving standards of corporate governance, the explosive growth of ESG investing, and the hardening of human rights due diligence into law, as seen by legislative initiatives in several European countries and the EU itself.

The model clauses are neither official ABA policy nor mandatory. Rather they are voluntary modular suggestions that enable contacting supply chain parties to choose the language that adapts best to their unique circumstances. In advising buyers on the model clauses, corporate counsel should act as wise counsel by basing their recommendations in the context of the client's need to prevent, mitigate, and address involvement in supply chain human rights, as well as existing or likely legal compliance requirements.

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<sup>1</sup> The author is a former senior legal advisor to the late Professor John Ruggie, the former Special Representative of the UN Secretary General on Business and Human Rights, and author of the 2011 UN Guiding Principles on Business and Human Rights ("UNGPs"). The author is also general counsel and senior advisor to Shift (the leading center of expertise on the UNGPs), a Senior Program Fellow of the Center for Business and Government at the Harvard Kennedy School, and an Executive Center at the Hoffman Center for Business Ethics at Bentley University. He advised the Working Group on the MCC's 2.0. The paper represents his own views only, and not those of any entity or person with whom he is or has been affiliated. The author gratefully acknowledges the comments of Professor David Snyder of American University Law School. All web links were accessed in March 2022.

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Human rights due diligence (HRDD) is at the core of the 2021 Model Supply Contract Clauses 2.0 (MCC's 2.0) of the Working Group of the Business Law Section. These clauses represent an extraordinary effort of creative lawyering.<sup>2</sup> That is, the MCC's 2.0 provide language for supply chain contracts that would adequately incentivize the parties to respect the internationally recognized human rights of supply chain workers, in alignment with the 2011 UN Guiding Principles on Business and Human Rights ("UNGPs") and the cognate human rights provisions of the 2011 OECD Guidelines for Multinational Enterprises for ("OECD Guidelines").<sup>3</sup>

This paper does not dive into the details of the contractual language of the MCC's 2.0. Rather, it discusses why procurement lawyers may wish to recommend the language suggested by the MCC's 2.0 to their clients. In short, doing so should better enable buyers to avoid and mitigate involvement in potential and actual human rights impacts in their supply chains and to comply with existing and likely future legal requirements to do so. The paper concludes by addressing the dual roles of corporate counsel in advising the company not only on the need to comply with the growing number of laws deriving from the UNGPs, but also providing wise counsel and leadership on what can be done to avoid and mitigate involvement in human rights abuse in the first place.

The MCC's 2.0 are intended to ensure that goods delivered under the contract are produced in accordance with the standard of human rights due diligence throughout the supply chain. The MCC's 2.0 create a Schedule P, which is an empty contractual vessel that the parties would fill with specific human rights requirements relevant to the transaction, other relevant normative instruments, buyer codes of conduct, particular regulations and statutes, and sector-specific norms, to name a few. MCC's 2.0 Section 1.2. The requirements of Schedule P for conforming goods would then cascade down from the initiating buyer-supplier contract to apply to all contracts in the supply chain.

The MCC's 2.0 would implement this requirement in three basic ways. First, they would move the contract away a traditional top-down representation and warranty regime to a collaborative human rights due diligence regime. Second, they would

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<sup>2</sup> David V. Snyder, Chair, Susan A. Maslow, Vice Chair, Principled Purchasing Project led by Sarah Dadush, Working Group to Draft Model Contract Clauses to Protect Human Rights in International Supply Chains American Bar Association Section of Business Law, *BALANCING BUYER AND SUPPLIER RESPONSIBILITIES Model Contract Clauses to Protect Workers in International Supply Chains*, Version 2.0 (2021) (MCC's 2.0), available at [https://www.americanbar.org/content/dam/aba/administrative/human\\_rights/contractual-clauses-project/mccs-full-report.pdf](https://www.americanbar.org/content/dam/aba/administrative/human_rights/contractual-clauses-project/mccs-full-report.pdf)

<sup>3</sup> UN Guiding Principles on Business and Human Rights, Guiding Principles ("UNGPs"), available at [https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr\\_en.pdf](https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf); OECD Guidelines for Multinational Enterprises, available at <https://www.oecd.org/corporate/mne/>.

require both buyer and supplier to engage in responsible sourcing and purchasing practices. And third, they would condition conventional contract remedies on remediation of harm to stakeholders.<sup>4</sup>

The MCC's 2.0 are not official ABA policy or a one-size-fits all document. They are modular recommendations that enable supply chain parties to choose the language that adapts best to their unique circumstances, recognizing that companies are in different places when with respect to size, organization, sector, and sophistication.

I. The MCC's 2.0's movement from a top-down representations and warranties regime to a collaborative human rights due diligence regime based on share responsibility.

As discussed at the outset, the MCC's 2.0 move from a representations and warranties regime to a regime of shared responsibility in line with the process of human rights due diligence, which a key component of the responsibility to respect human rights under the UNGPs and OECD Guidelines. Thus, Section 1.1 of the MCC's 2.0 explicitly provides that buyer and seller each covenant "to establish and maintain a human rights due diligence process appropriate to its size and circumstances to identify, prevent, mitigate, and account for how each of Buyer and Supplier addresses the impacts of its activities on the human rights of individuals directly or indirectly affected by their supply chains, consistent with the 2011 United Nations Guiding Principles on Business and Human Rights."

A. Human Rights Due Diligence

For those new to the field, the term "Human Rights Due Diligence" ("HRDD") will raise fundamental questions—what is HRDD, and how do we do it? The answers are reflected in the origins of the UNGPs, in their text, and in their implementation and interpretation by leading international businesses, multistakeholder institutions, governments, investors and lenders, judicial and quasi-judicial decision-making bodies and civil society from 2011 to the present. The paper distills this experience as an aid to the application and understanding of the MCC's 2.0.

Human rights are based on the simple proposition that all persons are entitled to be treated by businesses with respect and dignity. HRDD is a critical part of the business responsibility to respect human rights under the UNGPs. The UNGPs articulate the expectation of global society that businesses should not infringe on the internationally recognized human rights in their operations and value chains. The former UN High Commissioner for Human Rights, Zeid Ra'ad Al Hussein, described the UNGPs as "the

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<sup>4</sup> *Model Contract Clauses Version 2.0 and the Responsible Buyer Code, Executive Summary* (2021), available at [https://www.americanbar.org/content/dam/aba/administrative/human\\_rights/contractual-clauses-project/model-contract-executive-summary.pdf](https://www.americanbar.org/content/dam/aba/administrative/human_rights/contractual-clauses-project/model-contract-executive-summary.pdf).

global authoritative standard, providing a blueprint for the steps all States and businesses should take to uphold human rights.”<sup>5</sup>

### 1. The problem of human rights in the global supply chain

The UNGPs reflect an unprecedented consensus of states, businesses, civil society on the respective roles of states and businesses with respect to human rights, following six years of dozens of multistakeholder consultations, research, and pilot projects.

The UNGPs were designed to address a problem that originated from the expansion of global trade in the 1990s, which resulted in the fragmentation and outsourcing of production processes into lengthy and complex global supply chains. Eighty percent of global trade is linked to the production networks of global companies.<sup>6</sup> Global trade in intermediate goods is greater than trade in all other non-oil traded goods. For example, the iPhone 6 had 785 suppliers in 31 countries, not including the minerals that went into its components. The network included 60 US suppliers, who outsourced the fabrication of their components to supplies in Japan, South Korea, and Taiwan, which in turn sourced from lower cost locations in Southeast Asia. Foxconn, based in Taiwan with operations in China, assembled the final product.<sup>7</sup>

Global trade has huge impacts on workers involved all of these many production processes. The International Labor Organization estimated in 2015 that in 40 countries representing 85% of world gross domestic product there are 453 million formal sectors jobs related to global supply chains. This doesn't include casual and temporary work, forced and bonded labor, and work done at the bottom of the supply chain by women and children in homes.<sup>8</sup> Many supply chain workers have families who depend on them.

The increase in global trade raised the standard of living for many around the world, and reduced poverty levels worldwide. However, hundreds of millions of people have been cut off from the benefits of development and suffered human rights harm.<sup>9</sup> According to the International Labor Organization: 21 million people work in forms of forced labor and slavery; there are 168 million child workers, with 85 million in

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<sup>5</sup> Zeid Ra'ad Al Hussein, *Ethical Pursuit of Prosperity*, The Law Society Gazette, 23 Mar. 2015, available at <https://www.lawgazette.co.uk/commentary-and-opinion/ethical-pursuit-of-prosperity/5047796.article> (accessed October 2021).

<sup>6</sup> UNCTAD, *World Investment Report 2002* (Geneva 2002), at p. 7.

<sup>7</sup> John G. Ruggie, *Multinationals as global institution: Power, authority and relative autonomy* (2017), at p. 3, Regulation and Governance, available at [https://media.business-humanrights.org/media/documents/files/documents/Ruggie-2017-Regulation\\_Governance.pdf](https://media.business-humanrights.org/media/documents/files/documents/Ruggie-2017-Regulation_Governance.pdf)

<sup>8</sup> International Labor Organization, *World Employment Social Outlook: The Changing Nature of Jobs* (2015), available at [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms\\_368626.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_368626.pdf)

<sup>9</sup> Shift, *Business, Human Rights and the Sustainable Development Goals: Forging a Coherent Vision and Strategy*, (2016), commissioned by the Business and Sustainable Development Commission, (“SDGs and Human Rights”), available at notes 13-16, available at <https://www.shiftproject.org/resources/publications/business-human-rights-sustainable-development-coherent-strategy/>.

hazardous forms of work: more than 2.3 million people; more than 2.3 million people die every year from occupational accidents or work-related diseases, with 317 million on the job accidents; 170,000 annual worker related deaths occur in agricultural supply chains alone. These numbers grow when affected communities are added in.<sup>10</sup>

## 2. The UNGPs

To address human rights abuse in the supply chain and elsewhere in the global economy, in 2005 the then-UN Secretary General, Kofi Anan, appointed Harvard Kennedy School Professor John Ruggie as his Special Representative on Business and Human Rights (SRSG). The SRSG's first task was to develop a framework to fill what he identified as a gap in global governance with respect to business-related human rights abuse, resulting from the inability of states, businesses, and civil society, acting independently, to address the problem of human rights effectively.

In 2008, the SRSG developed an interdependent and mutually supporting three pillar Protect, Respect, and Remedy framework that welded together the strongest governance features of state legal duties, business self-regulation, and civil society advocacy: (1) the state duty to protect human rights from infringement by third parties, including by businesses; (2) the business responsibility to respect human rights in their operations and value chains; and (3) the need for greater access by victims to remedy, both judicial and nonjudicial.

After the predecessor to the UN Human Rights Council welcomed this framework in 2008, the SRSG drafted the UNGPs to implement the framework. The UN Human Rights Council unanimously endorsed the UNGPs in 2011. This was the first time that it or its predecessor endorsed any normative instrument unanimously, and the first time that it endorsed normative language not drafted and negotiated by the state members themselves.<sup>11</sup>

The three pillars of the UNGPs and their Framework are as follows:

*Pillar One* of the Protect, Respect and Remedy Framework—the state duty to protect human rights—sets out the legal duty of states under international treaties and conventions to protect the human rights of vulnerable people from abuse by third parties, including business. The duty is discharged by policy, legislation, investigation, and adjudication. UNGPs 1-10.

*Pillar Two* of the Framework—the business responsibility to respect human rights—is a non-legally binding responsibility (by itself) that expects businesses will respect internationally human rights in their operations and value chain (that is, not infringe upon them): (1) by publicly committing to respect human rights and embedding that commitment in their culture; (2) by exercising HRDD; and (3) by providing remedy where they caused or contributed to human rights harm. UNGPs 11-24.

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<sup>10</sup> Id., at notes 17-20.

<sup>11</sup> For a definitive history of the UNGPs by their author, see John Gerard Ruggie, *Just Business* (Norton, 2013).

*Pillar Three* of the Framework—the need for greater access to remedy—is addressed to both states (as part of their duty to protect) and to businesses (as part of their responsibility to respect). States have the primary duty under international law to ensure that victims of human rights have access to remedy, both judicial and nonjudicial. As noted, businesses are expected to provide access to remedy, as noted above, where they cause or contribute to harm. Businesses are also expected to participate in operational level grievance mechanisms (OLGMs) that catch problems early and serve as a feedback loop. UNGPs 25-31.

Nonjudicial grievance mechanisms under Pillar Three must meet specific effectiveness criteria (they must be legitimate, accessible, predictable, equitable, transparent, rights-compatible, and a source of continuous learning). For OLGMs, they must also be based on engagement and dialogue. UNGP 31.

MCC's 2.0 address each pillar of the UNGPs. The state duty to protect will be reflected in the laws and regulations that the contract incorporates as a standard of human rights performance in Schedule P. The business responsibility to respect will be reflected in the contractual obligation of both parties to exercise human rights due diligence. And the need for greater access to remedy will be reflected in the tying of contractual remedies under MCC's 2.0 to the provision of remedy of harm to stakeholders.

### 3. The elements of Human Rights of Due Diligence

HRDD is the process under Pillar Two through which businesses know and show that they are respecting human rights.<sup>12</sup> UNGPs 17-21. It expects that businesses: (1) will *identify* their human rights risks, both actual and potential; (2) will *respond* in an integrated fashion to their involvement in human rights impacts; (3) will *track* their performance; and (4) will be prepared to *disclose* their performance as appropriate. Businesses should conduct HRDD from the perspective of the affected stakeholder—the person whose rights are or will be or are affected—with priority attention given to the most likely severe impacts, also called “salient” risks.<sup>13</sup> Here is a diagram of the HRDD process:

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<sup>12</sup> For an authoritative discussion of the Responsibility to Respect Human Rights, including Human Rights Due Diligence, see UN Office of High Commissioner of Human Rights, THE CORPORATE RESPONSIBILITY TO RESPECT HUMAN RIGHTS: An Interpretive Guide (2012), available at <https://www.ohchr.org/sites/default/files/Documents/Issues/Business/RtRInterpretativeGuide.pdf> (“Interpretive Guide”).

<sup>13</sup> *Interpretive Guide* at pp. 8, 28





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Under HRDD, the response of businesses to involvement in human rights harm depends on their mode of involvement; namely, whether they *caused*, *contributed to*, or are directly *linked* to such involvement by their products and services that they did not cause or contribute to. HRDD expects that businesses: (1) should *stop* their own conduct that causes or contributes to human rights abuse; (2) should provide or contribute to the *remedy* of victims for such abuse; and (3) should exercise or build *leverage* to influence value chain entities to improve their human rights performance. UNGP 13.<sup>14</sup>

Where the business is only linked directly through its services or products to human rights impacts that it did not cause or contribute to, they are nevertheless expected to exercise to exercise leverage, and may choose to play a role in remedy. Termination of the relationship is a last resort, particularly where termination itself will likely result in human rights impacts. UNGP 19.<sup>15</sup>

The distinction between contribution and linkage in HRDD is important because involvement by contribution triggers the need for the business to provide remedy but involvement by linkage does not. There is no hard and fast line between whether a business contributed to or is merely linked to a human rights impact. Contribution and linkage sit on two ends of a continuum. Where they sit depends on “the extent to which a business enabled, encouraged, or motivated human rights harm by another; the extent to which it could or should have known about such harm; and the quality of any mitigating steps it has taken to address it.”<sup>16</sup>

From the outset, the UNGPs recognized that in the supply chain context, a buyer can contribute to human rights harm caused by a supplier when its purchasing practices undermine the supplier’s ability to respect human rights. This can be done, for example,

<sup>14</sup> See also, *Interpretive Guide* at pp. 15-18.

<sup>15</sup> See also, *Interpretive Guide* at pp. 49-50

<sup>16</sup> John G. Ruggie, *Comments on Thun Group of Banks, Discussion Paper on the Implications of UN Guiding Principles 13 & 17 In a Corporate and Investment Banking Context* (February 21, 2017), available at [https://media.business-humanrights.org/media/documents/files/documents/Thun\\_Final.pdf/](https://media.business-humanrights.org/media/documents/files/documents/Thun_Final.pdf/)

by changing purchase orders at the last minute, causing suppliers to require workers to work around the clock, cut safety corners, and use potentially unauthorized and unsafe subcontractors in order to keep the business UNGP 13.<sup>17</sup> Buyers can also contribute to human rights harm by using their economic leverage to drive the prices low-margin suppliers so low that they cannot pay a living wage to their workers.

Using HRDD, a supply chain buyer should exercise or try to build leverage to influence suppliers whether it contributed to the supplier's human rights abuse or is directly linked to such abuse that it did not cause or contribute to. UNGP 19.<sup>18</sup>

## B. Leverage

Supply chain contracts that memorialize the commercial relationship between buyer and suppliers are an essential source of a buyer's leverage. A buyer can build or exercise leverage in its supply chain relationships in many ways, including:

- identifying the salient risks of human rights harm in the relationship at all supply chain tiers.
- selecting buyers who have the financial and managerial capacity to address identified risks.
- helping to provide capacity to suppliers through training and other resources where needed to increase the capacity of the suppliers to respect human rights.
- setting forth clear expectations in pre-bidding qualifications and in the contract as to the human rights performance required by the parties to address identified risks.
- providing effective incentives in the contract's formation and implementation for both sides to address identified risks.
- using audits to understand the root causes of human rights risks in the supply chain in order to address them.
- ensuring that the buyer's purchasing practices support, and do not undermine, the ability of its suppliers to address identified risks.
- ensuring that legitimate and effective mechanisms are in place to provide remedy to workers and other stakeholders who may be harmed by human rights abuse caused or contributed to by the supplier.
- identifying, considering, and trying to mitigate adverse impacts on workers and others when terminating the contract prematurely based on *force majeure* clauses, contract breach, or other reasons.<sup>19</sup>

Under the UNGPs, HRDD is the individual responsibility of every business enterprise, and should not be delegated to others.<sup>20</sup> Consequently, a contract should not be used to offload the human rights due diligences responsibilities of the buyer onto

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<sup>17</sup> See also, Interpretive Guide, p. 17.

<sup>18</sup> See also, Interpretive Guide p. 49.

<sup>19</sup> See Shift, *Using Leverage in Business Relationships to Reduce Human Rights Risks* (2013), available at [https://shiftproject.org/wp-content/uploads/2013/11/Shift\\_leverageUNGPs\\_2013.pdf](https://shiftproject.org/wp-content/uploads/2013/11/Shift_leverageUNGPs_2013.pdf) ("Using Leverage").

<sup>20</sup> Interpretive Guide, p. 35.

its suppliers. Moreover, human rights clauses in contracts should not become superficial paper tick box exercises that do not address the real human risks of the relationship.

Contracts with suppliers are essential but may not be sufficient by themselves as effective leverage. For example, salient human rights risks may exist in more remote tiers of a supply chain where cascaded contractual terms between the buyer and its direct supplier may not effectively reach. Or human rights risks may arise from the lack of effective building and fire safety in a country, the corruption of public officials, and other factors beyond the effective reach of the contracting parties.

Many companies may perceive that they do not have sufficient leverage outside of their contracts to address human rights issues throughout their entire supply chains. However, the UNGPs reject the concept that if a company has no existing leverage, it has no responsibility to try to build leverage. Where it currently lacks leverage, it is expected to take reasonable steps to try to build it.

There are various ways for a company to creatively exercise and build noncontractual leverage, depending on their size, sophistication, sector, and the unique circumstances of their supply chain, among other factors. They can include peer to peer relationships, engagement in multistakeholder standard-setting initiatives, and engagement with civil society and governments. In such cases, companies should act creatively to exercise or attempt to build noncontractual leverage, with a priority emphasis on addressing severe impacts.<sup>21</sup> For example:

- Within the constraints of competition laws, companies can attempt to build leverage with business peers to establish common requirements among suppliers, including model contract clauses, which level the playing field where buyers have an overlapping supply base.
- Buyers can engage bilaterally with peers to share lessons learned and develop potential solutions in order to tackle endemic human rights issues.
- Companies can engage in multistakeholder initiatives with peers, governments, civil society, and others to develop shared and credible standards that help to level the playing field. Some examples include: the Voluntary Principles on Security and Human Rights;<sup>22</sup> the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas and its two supplements;<sup>23</sup> the Principles of Fair Labor and Responsible Sourcing developed by the Fair Labor Association;<sup>24</sup> and the 2013 Accord on Fire and Building Safety in Bangladesh,<sup>25</sup> in order to level the playing field with standards that are seen as credible.

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<sup>21</sup> See Shift, *Using Leverage*, n. 25 above.

<sup>22</sup> *Voluntary Principles on Security and Human Rights*, available at <http://www.voluntaryprinciples.org/>.

<sup>23</sup> *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* (2<sup>nd</sup> ed., OECD Publishing, 2013), available at <http://www.oecd.org/corporate/mne/mining.htm>.

<sup>24</sup> Fair Labor Organization, (2012), available at <http://www.fairlabor.org/>.

<sup>25</sup> Business and Human Rights Resource Centre, *The Accord on Fire and Building Safety in Bangladesh* (April 23, 2016), available at <https://www.business-humanrights.org/en/latest-news/the-accord-on-fire-and->

Such noncontractual efforts to exercise or build leverage do not substitute for, but rather complement the company's ability to exercise leverage through bilateral contracts with its top tier suppliers.

### C. Termination

Where a company has tried unsuccessfully for some time to use or build leverage to prevent or mitigate human rights harm by a third party, it may need to consider ending the relationship before the contract's expiration, particularly if the impact is severe. Consideration of termination should factor in potential adverse human rights impacts in order to prevent or mitigate them. For example, abruptly terminating a relationship with a supplier that uses child labour would deprive the children's families of wages, putting them in an even more precarious position. Thus, steps should be taken to identify, assess and mitigate the human rights impacts of termination.<sup>26</sup> However, termination may be highly problematic if the relationship is crucial to the business, or if it is constrained by contract or law from terminating the relationship. UNGP 19, commentary.<sup>27</sup>

### D. Evolution of the UNGPs from soft to hard law

Although HRDD is a key part of the business responsibility to respect human rights—a voluntary, non-binding standard by itself—it should not be viewed in isolation of the state duty to protect human rights and the need for greater access to remedy. Through a process of interaction between states, business, and civil society, HRDD has spread far beyond its UN origins as a soft law norm to become the basis for binding legal duties.

Since their unanimous endorsement by the UN Human Rights Council in 2011, the UNGPs, and particularly HRDD, have enjoyed deep and wide uptake in the ten years. They are reflected or incorporated in the public policy of dozens of countries; in multiple laws and regulations; in multistakeholder norms (such as the OECD Guidelines; in the policies and guidance of leading national and international bar associations (including the American Bar Association and the International Bar Association, among others);<sup>28</sup> in

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[building-safety-in-bangladesh/](#) The Bangladesh Accord is an agreement between about 200 Western garment companies from twenty Western countries and trade unions, whose purpose is to raise factory safety improvements in the wake of the 2013 collapse of Rana Plaza factory building.

<sup>26</sup> See SOMO Discussion Paper, *Should I stay or should I go: Exploring the role of disengagement in human rights due diligence*, April 2016, available at <https://www.somo.nl/should-i-stay-or-should-i-go-2/>.

<sup>27</sup> See also, *Interpretive Guide*, p. 50.

<sup>28</sup> ABA, *House of Delegates Resolution 109* (2012), ("ABA UNGP Endorsement") available at [https://www.americanbar.org/content/dam/aba/administrative/human\\_rights/hod\\_midyear\\_109.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/administrative/human_rights/hod_midyear_109.authcheckdam.pdf); IBA, *Business and Human Rights Guidance for Bar Associations* (October 2015) available at <https://www.ibanet.org/Document/Default.aspx?DocumentUid=B9719C7C-212B-4717-8C66-FD028ABD6C6A>; IBA, *Practical Guide on Business and Human Rights for Business Lawyers* (adopted 28 May 2016) available at <https://www.ibanet.org/MediaHandler?id=d6306c84-e2f8-4c82-a86f-93940d6736c4>; The Law Society of England & Wales, *Business and Human Rights, A Practical Guide*, available at <https://www.business-humanrights.org/en/pdf-business-and-human-rights-a-practical-guide>; Japan Federation of Bar Associations, *Guidance on Human Rights Due Diligence* (January 2015), available at

the policies and practices of leading multinational businesses,<sup>29</sup> in judicial and quasi-judicial decisions<sup>30</sup>; in commercial and financial transactions; in the investment decisions of the rapidly increasing number of ESG investors (where the “S” or Social Impact factor is populated heavily by human rights)<sup>31</sup>; in corporate governance standards<sup>32</sup>; and in the advocacy of civil society.

### 1. The business case for respecting human rights

No responsible business wants to be surprised to learn from social media that the goods that it purchased have been produced with slave or child labour, that it has done little to prevent that harm, and that it has contributed to this harm through its purchasing practices.

The business case for avoiding involvement includes ensuring the license to operate, securing sustainable supply chains, increasing productivity, acquiring, and maintaining customers, improving reputation, engaging, and retaining talented employees, strengthening consumer loyalty, anticipating new regulations, honoring

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[https://www.nichibenren.or.jp/library/en/document/data/150107\\_guidance.pdf](https://www.nichibenren.or.jp/library/en/document/data/150107_guidance.pdf); Illustre Colegio de Abogados de Madrid and Sustentia, *Guidance in Business and Human Rights for European Law Societies* (June 2017) (approved by the Human Rights and Freedom European Bars Federation Commission), available at <http://www.sustentia.com/wp-content/uploads/2018/02/GUIDE-ON-BUSINESS-HUMAN-RIGHTS-ICAM-FBE-January-2018-Sustentia-English.pdf>.

<sup>29</sup> E.g., see World Business Council for Sustainable Development (“WBCSD”), *Scaling up Action on Human Rights: Operationalizing the UN Guiding Principles for Business and Human Rights* (2014), available at <https://www.wbcsd.org/Programs/People-and-Society/Tackling-Inequality/Resources/Operationalizing-the-UN-Guiding-Principles-for-Business-and-Human-Rights>, which reflects the experience in implementing the UNGPs by ABB, Anglo American, ArcelorMittal, Coca-Cola, DSM, Eni, HEINEKEN, Hitachi, Holcim, JPMorgan Chase, Michelin, Nestlé, Novartis, RWE, Total, Unilever, and Vale. See also, WBCSD, *CEO Guide to Human Rights* (2019) (“CEO Guide”) available at [https://docs.wbcsd.org/2019/06/CEO\\_Guide\\_to\\_Human\\_Rights.pdf](https://docs.wbcsd.org/2019/06/CEO_Guide_to_Human_Rights.pdf), which is a “call to action” on human rights signed by the CEOs of thirty-five multinational companies.

<sup>30</sup> In its 2021 report, prepared for the UN Business and Human Rights Working Group, the law firm Debevoise & Plimpton researched references to the UNGPs in judicial and quasi-judicial bodies around the world. It found few direct references so far, but predicted that the lack of direct references would change over time, based on such factors as legislation that makes human rights due diligence mandatory or otherwise refers to the UNGPs; the advocacy of the UNGPs by plaintiffs and civil society; and the utilization by international courts and tribunals of the UNGPs as a standard to hold States accountable for failing to prevent adverse human rights abuse by businesses. Debevoise & Plimpton *UN Guiding Principles on Business and Human Rights at 10: The Impact of the UNGPs on Courts and Judicial Mechanisms* (2021), at pp. 15-16, available at <https://www.debevoise.com/insights/publications/2021/07/un-guiding-principles>.

<sup>31</sup> See, e.g., *ESG assets may hit \$53 trillion by 2025, a third of global AUM* Bloomberg Intelligence (February 23, 2021), <https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/>. See also, Andrew Ross Sorkin, etc., *Wall Street Rebels Against Exxon: A small activist investment fund scored a huge win* (May 27, 2021), available at <https://www.nytimes.com/2021/05/27/business/dealbook/exxon-mobil-engine-no-1.html?searchResultPosition=1> (accessed October 2021).

<sup>32</sup> COSO and WBCSD, *Enterprise Risk Management—Applying enterprise risk management to environmental, social and governance-related risks*, (2018), available at <https://www.coso.org/Documents/COSO-WBCSD-ESGERM-Guidance-Full.pdf>

commitments to business partners, reducing the cost of capital, and minimizing the risk of litigation.<sup>33</sup>

Finally, it is estimated that over one third of the market capitalization of FTSE350 companies is attributed to reputation, which is at risk when companies are involved in deaths to workers from the collapse of factories where workers are assembling their garments, or in sourcing from suppliers that use child or slave labor.<sup>34</sup>

## 2. Mitigating and Preventing Supply Chain Disruption Due to Labor Protests

The collapse of the global supply chain triggered by the COVID 19 Pandemic has highlighted the extreme fragility of a highly fragmented supply chain to disruption, which is harmful to buyers as well as supply chain workers. The pandemic highlighted systemic problems in the flexibility global supply chain which had been building for years. To quote the consulting firm McKinsey:

“Businesses that successfully implemented a lean, global model of manufacturing achieved improvements in indicators such as inventory levels, on-time-in-full deliveries, and shorter lead times.

However, these operating model choices sometimes led to unintended consequences if they were not calibrated to risk exposure. Intricate production networks were designed for efficiency, cost, and proximity to markets but not necessarily for transparency or resilience. Now they are operating in a world where disruptions are regular occurrences. Averaging across industries, companies can now expect supply chain disruptions lasting a month or longer to occur every 3.7 years, and the most severe events take a major financial toll.”<sup>35</sup>

Labor protests of working conditions that do not meet basic international human rights standards contribute significantly to global supply chain disruptions, which is harmful to buyers as well as workers. Examples include factory strikes and protests in China, caused by unpaid wages and factory closures; wildcat strikes in Vietnam caused by poverty level wages, chronic overtime, abusive managers, poor food quality, and ineffective trade unions; anti-union violence in Honduras; and around 130 strikes in

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<sup>33</sup> See *CEO Guide*, n. 36 above; and *SDGs and Human Rights*, n. 13 above at p. 9.

<sup>34</sup> For a fuller description of these costs and the research that supports it, see *SDGs and Human Rights*, at n. 13 above. See also: OECD and Columbia/SIPA *Quantifying the Costs, Benefits and Risks of Due Diligence for Responsible Business Conduct, Framework and Assessment Tool* (June 13, 2016) available at <https://www.oecd.org/industry/inv/mne/Quantifying-the-Cost-Benefits-Risks-of-Due-Diligence-for-RBC.pdf>; and Rachel Davis and Daniel Franks, *Costs of Company-Community Conflict in the Extractive Sector*, (2014), available at <https://shiftproject.org/resource/costs-of-company-community-conflict-in-the-extractive-sector/>.

<sup>35</sup> McKinsey Global Institute Report, *Risk, Resilience, and Balancing in Global Value Chains* (6 August 2020), available at <https://www.mckinsey.com/business-functions/operations/our-insights/risk-resilience-and-rebalancing-in-global-value-chains>

Cambodia resulting from poverty level wages to 400,000 mostly female garment workers, resulting in cancellation of orders for U.S. buyers worth USD\$200 million.<sup>36</sup>

### 3. Corporate Governance and ESG Investment

Good corporate governance also argues in favor of avoiding involvement in supply chain human rights abuse. The affirmative duty of corporate fiduciaries to act affirmatively to further the best interests of the corporation imposes a “normative obligation” on fiduciaries “to try to avoid the regulatory penalties, managerial turnover, stakeholder backlash, and overall reputational and financial harm that occurs when companies violate laws essential to society.”<sup>37</sup> Complying with legal standards is a bedrock foundation for good corporate governance. But corporate fiduciaries (including corporate legal officers) also have a duty of good faith to look to relevant soft law standards, such as HRDD, if doing so will fulfill the corporation’s best interests.<sup>38</sup>

The duty of corporate fiduciaries to act in the best interests of the corporation by implementing HRDD is particularly important for the skyrocketing number and size of investors who take ESG (standing for Environmental, Social, and Governance) factors into account in their investment decisions. Investment funds that use ESG criteria grew from 50 in year 2000 to nearly 1,100 in year 2016. The largest passive investors globally have shown an increasing interest in ESG. E.g., Blackrock--\$US 6.3 assets under management (AUM); State Street Global advisors--\$US2.8 trillion AUM; Government Pension Fund of Japan--\$US1.4 trillion AUM. A 2020 Report of on Sustainable and Impact Investing Trends states that as of year-end 2019, “investors are considering ESG factors across \$17 trillion of professionally managed assets, a 42 percent increase since 2018.”<sup>39</sup> The COVID 19 pandemic has accelerated the growth of ESG investment.<sup>40</sup>

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<sup>36</sup> See: Peter Zsomer and Hul Readsmeay, *Garment Strike Cost Industry \$200 Million, GMAC Says*, The Cambodia Daily (January 7, 2014), available at <https://english.cambodiadaily.com/news/garment-strike-cost-industry-200-million-gmac-says-50222/>; Mark Anner, *Wildcat strikes and Better Work bipartite committees in Vietnam*, Better Work (2017), available at <https://betterwork.org/wp-content/uploads/2020/01/DP-24-Anner-Strikes-Vietnam-proofread-FINAL-31.05.2017.pdf>; Business and Human Rights Resource Center, *China: China: Increasing number of strikes & protests take place as more workers are left unpaid amid economic downturn & factory closures* (February 8, 2016), available at <https://www.business-humanrights.org/en/latest-news/china-increasing-number-of-strikes-protests-take-place-as-more-workers-are-left-unpaid-amid-economic-downturn-factory-closures/>; and Tula Connell, *DESPITE THREATS, HONDURAN UNION LEADER SEES HOPE IN SOLIDARITY*, (July 21, 2021), available at <https://www.solidaritycenter.org/despite-threats-honduran-union-leader-sees-hope-in-solidarity/>.

<sup>37</sup> Chris Brummer and Leo E. Strine, Jr., *Duty and Diversity*, U of Penn, Inst for Law & Econ Research Paper No. 21-08; Columbia Law and Economics Working Paper No. 642, Vanderbilt Law Review (March 2021), forthcoming (“Brummer and Strine”), available at <https://corpgov.law.harvard.edu/2021/03/04/duty-and-diversity/>

<sup>38</sup> John F. Sherman, III, *Human Rights Due Diligence and Corporate Governance*, Section II, forthcoming in 2022 in an ABA book to be published on Human Rights Due Diligence.

<sup>39</sup> USIF, *Report on US Sustainable and Impact Investing Trades 2020*, available at <https://www.ussif.org/files/Trends%20Report%202020%20Executive%20Summary.pdf>

<sup>40</sup> Georg Kell, *Covid-19 is Accelerating ES investing and Corporate Sustainability Practices* (Forbes, May 19, 2020), available at <https://www.forbes.com/sites/georgkell/2020/05/19/covid-19-is-accelerating-esg-investing-and-corporate-sustainability-practices/?sh=55071ab926bb>.

The ‘S’, or social impact factor in ESG measures ‘how well a company manages its risks to people connected with its core business’ and is therefore, ‘heavily populated with labour and human rights elements’.<sup>41</sup> As a result, company alignment with the UNGPs helps investors to predict the likelihood of its ability to prevent or mitigate its involvement in supply chain human rights abuse. A company’s likely involvement in severe human rights abuse is a leading indicator to ESG investors of the likelihood of risks to the business, leading ultimately to lower ESG investment ratings. To lower prevent and mitigate such involvement, companies must take HRDD seriously and not treat it as a paper tick-box exercise. HRDD should be embedded firmly in corporate governance and leadership (the G or Governance factor) if it is to be judged effective.<sup>42</sup>

#### 4. The developing hard law of Human Rights Due Diligence

For the first five years after 2011, States encouraged voluntary business action by promulgating National Action Plans that outline their plans to implement the UNGPs.<sup>43</sup> In addition, States, particularly in the EU, required companies to report on their human rights performance.<sup>44</sup> Government procurement processes were drafted to require sellers of products to the federal government to eliminate human rights trafficking from their supply chains and to demonstrate their plans and procedures for doing so.<sup>45</sup> There has also been a sharp increase in the seizure of goods manufactured with human rights abuse. The UK has authorized the seizure of imported goods manufactured in a manner involving human rights abuse.<sup>46</sup> In 2021, the U.S. Customs Office increased its seizure of goods manufactured by companies engaged in forced labor or other human rights abuses.<sup>47</sup>

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<sup>41</sup> See John G Ruggie and Emily K Middleton, *Money, Millennials and Human Rights: Sustaining “Sustainable Investing”* (2019) 10 Global Policy 144, available at <https://onlinelibrary.wiley.com/doi/abs/10.1111/1758-5899.12645>

<sup>42</sup> Shift, “*Signals of Seriousness*” for Human Rights Due Diligence: HOW CAN NATIONAL REGULATORS BEST ASSESS THE QUALITY OF A COMPANY’S HRDD EFFORTS UNDER POTENTIAL EU LEGISLATION? (February 2021), available at <https://shiftproject.org/resource/signals-draft1/> (“Signals of Seriousness”).

<sup>43</sup> See UN Working Group on Business and Human Rights, *Guidance on National Action Plans on Business and Human Rights*, OHCHR (2016), available at [https://www.ohchr.org/Documents/Issues/Business/UNWG\\_NAPGuidance.pdf](https://www.ohchr.org/Documents/Issues/Business/UNWG_NAPGuidance.pdf) .

<sup>44</sup> Id.

<sup>45</sup> In 2012, the U.S. adopted the U.S. Federal Acquisition Regulation, *Combatting Trafficking in Persons*, FAR Subpart 22.17 and Part 52 (2012), available at <https://www.federalregister.gov/documents/2015/01/29/2015-01524/federal-acquisition-regulation-ending-trafficking-in-persons>, which requires all US government contractors to take detailed actions to eliminate human trafficking at all levels of their supply chains, including the development and implementation of compliance plans, with significant sanctions for non-compliance.

<sup>46</sup> In 2017, the UK adopted the Criminal Finances Act of 2017, available at <https://www.legislation.gov.uk/ukpga/2017/22/contents/enacted> (accessed October 2021), which authorizes UK prosecutors to seize property that was obtained by or “in connection with” gross human rights abuse, regardless of when the property was obtained.

<sup>47</sup> See U.S. Customs and Border Protection, *CBP issues Region-Wide Withhold Release Order on Products Made by Slave Labor in Xinjiang* (January 13, 2021), available at <https://www.cbp.gov/newsroom/national-media-release/cbp-issues-region-wide-withhold-release-order-products-made-slave> . See also, Scott Murdoch, etc., *Top Glove's \$1 billion Hong Kong listing delayed amid U.S. ban imbroglio – sources*, (June 1,



More recently, states have begun to require corporations to engage in mandatory human rights due diligence. This started with France in 2016,<sup>48</sup> followed by The Netherlands in 2019,<sup>49</sup> and Germany and Norway in 2021.<sup>50</sup> Similar mandatory due diligence legislative initiatives are underway in Austria, Denmark, Finland, Switzerland, the UK, and elsewhere, and most significantly, in the EU.<sup>51</sup> The French<sup>52</sup> and Dutch<sup>53</sup> laws, as well as the proposed EU legislation, have considerable extraterritorial impact.

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2021), available at <https://www.nasdaq.com/articles/top-gloves-%241-blN-hong-kong-listing-delayed-amid-u.s.-ban-imbroglio-sources-2021-06-01-0>

<sup>48</sup> French Law on the Corporate Duty of Vigilance (2017), *Loi no. 2017-399 d 27 Mars 2017 relative au devoir de vigilance des sociétés meres et des entreprises donneuses d'ordre*, available at <https://www.legifrance.gouv.fr/loda/id/JORFTEXT000034290626/>. The French Law imposes human rights and environmental due diligence obligations on large French companies (including foreign firms with a significant French presence), with legal consequences for their violation. See Business and Human Rights Resource Center, *France's Duty of Vigilance Law* (March 16, 2021), available at <https://www.business-humanrights.org/en/latest-news/frances-duty-of-vigilance-law/>.

<sup>49</sup> The Netherlands Child Labor Duty of Care Act, available at [https://zoek.officielebekendmakingen-nl.translate.google.com/translate/stb-2019-401.html?x\\_tr\\_sl=auto&x\\_tr\\_tl=en&x\\_tr\\_hl=en&x\\_tr\\_pto=nui](https://zoek.officielebekendmakingen-nl.translate.google.com/translate/stb-2019-401.html?x_tr_sl=auto&x_tr_tl=en&x_tr_hl=en&x_tr_pto=nui) (English translation) requires companies that sell goods to Dutch consumers (including foreign companies) to determine whether child labour occurs in their supply chains, and if so, to set out a plan of action on how to combat it and issue a statement showing its due diligence investigation and plan, violation of which would incur criminal penalties. See Business and Human Rights Resource Center, *Dutch Senate votes to adopt child labour due diligence law* (March 16, 2021), <https://www.business-humanrights.org/en/latest-news/dutch-senate-votes-to-adopt-child-labour-due-diligence-law/>.

<sup>50</sup> See: German Act on Corporate Due Diligence Obligations in Supply Chains of July 16, 2021, (*Lieferkettensorgfaltspflichtengesetz-LkSG*), available at <https://www.bmas.de/SharedDocs/Downloads/DE/Internationales/act-corporate-due-diligence-obligations-supply-chains.pdf;jsessionid=4A3584DB6A2336FB861F7175C08F4C0E.delivery1-replication?blob=publicationFile&v=2>); and Norway Act relating to enterprises' transparency and work on fundamental human rights and decent working conditions, LOV-2021-06-18-99. Unofficial English translation available at: <https://lovdata.no/dokument/NLE/lov/2021-06-18-99#:~:text=The%20Act%20shall%20promote%20enterprises,fundamental%20human%20rights%20and%20decent>. For a comparison of the two Acts, see Markus Krajewski, Kristel Tonstad, and Fraziska Wohltmann, *Mandatory Human Rights Due Diligence in Germany and Norway: Stepping, or Striding, in the Same Direction?*, *Business and Human Rights Journal*, Volume 6, Issue 3, October 2021, pp. 550 – 558, available at <https://www.cambridge.org/core/journals/business-and-human-rights-journal/article/mandatory-human-rights-due-diligence-in-germany-and-norway-stepping-or-striding-in-the-same-direction/85815FE5F1D1F64208B0068B7FBBEFC8>.

<sup>51</sup> Business and Human Rights Resource Center, *National & regional movements for mandatory human rights & environmental due diligence in Europe* (2019), available at <https://www.business-humanrights.org/en/latest-news/national-regional-movements-for-mandatory-human-rights-environmental-due-diligence-in-europe/>.

<sup>52</sup> The French Plan of Vigilance law applies to direct or indirect subsidiaries of certain French companies that are organized and operate outside France, as well as to the activities of certain of their subcontractors and subsidiaries outside France. ReedSmith Client Alert, *The new duty of vigilance adopted in France covers much broader issues than anti-bribery compliance and will have significant extraterritorial application* (2017), <https://www.mondaq.com/france/human-rights/576816/the-new-duty-of-vigilance-adopted-in-france-covers-much-broader-issues-than-anti-bribery-compliance-and-will-have-significant-extraterritorial-application>.)

<sup>53</sup> The Dutch Child Labor law has broad extraterritorial reach. See n. 57, above. See also, Ropes & Gray Alert, *Dutch Child Labor Due Diligence Act Approved by Senate – Implications for Global Companies* (2019),

## E. Mandatory human rights due diligence in the EU

The big news is the potential enactment of mandatory human rights environmental due diligence legislation in the European Union (EU), which is the world's largest trading bloc. On February 23, 2022, the European Commission issued its Draft Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence (CSDD).<sup>54</sup> The CSDD sets forth a legislative proposal for adoption by the European Parliament and the Member States (the Council). The Parliament and the Council must agree upon a final text, which then must be transposed into national law of the Member States. The process could take several years.

The CSDD would impose wide-ranging human rights and environmental due diligence duties that are derived from the UNGPs and the OECD Guidelines. It would apply to about 13,000 large EU companies and about 4,000 large third country companies doing business in the EU, and smaller companies in high-risk sectors. It would require them to identify, mitigate, prevent and remedy actual and potential adverse impacts on human rights in the environment and in the companies' own operations, and their subsidiaries and supply chains.

EU enactment of human rights and environmental due diligence legislation would likely have a global impact, particularly because it would apply explicitly to large non-EU businesses doing business in the EU market. This global impact is often referred to as the "Brussels Effect" in which EU regulation has become externalized in the practices of companies from other countries, as has already happened in various markets, such as privacy and consumer goods.<sup>55</sup>

The CSDD would allow for civil liability claims against companies for failing to prevent or cease harm caused by their failing to conduct adequate due diligence with regards to its "established" direct and indirect business relationships. (pp. 16-17). As a defense, the CSDD would allow companies to rely upon appropriately verified contractual assurances from their established direct suppliers, of compliance with the company's code of conduct and preventative action plan, where the direct supplier cascades the contractual assurance requirement down the supply chain. The CSDD does

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available at <https://www.ropesgray.com/en/newsroom/alerts/2019/06/Dutch-Child-Labor-Due-Diligence-Act-Approved-by-Senate-Implications-for-Global-Companies> (accessed October 2021).

<sup>54</sup> The CSDD followed from a consultation process launched in 2020 on a comprehensive, EU-wide mandatory HRDD directive that would align with the UNGPs and the OECD Guidelines. European Commission, *Sustainable corporate justice*, DG Justice, A3 Company Law unit, Legislative and possible guidance, Q1 2021, Ref. Ares (2020) 4034032 - 30/07/2020, available at <https://media.business-humanrights.org/media/documents/files/documents/090166e5d21fb60c.pdf>. The initiative received strong support from the EU Parliament, which on March 10, 2021, voted overwhelmingly in favor of a resolution recommending enactment of such legislation. European Parliament, *Corporate due diligence and corporate accountability, European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability (2020/2129(INL))* available at [https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html).

<sup>55</sup> Anu Bradford, *The Brussels Effect*, Northwestern University Law Review, Vol 107, No. 1 (2012), available at [https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1275&context=faculty\\_scholarship](https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1275&context=faculty_scholarship),

not specify the content of these contractual assurances. It charges European Commission with the responsibility to develop suggested model contract clauses.<sup>56</sup>

The contractual assurance defense must be reasonable. That is, the defense applies “unless it was unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimize the extent of the adverse impact.” (Article 22(1)). Presumably, the purpose of this reasonableness standard is to prevent the contractual assurance and verification from becoming a formalistic, tick-box exercise that lacks substance.

The CSDD’s primary reliance on contractual assurances with essential direct suppliers as a defense to liability has generated concerns. Three leading international standard setting authorities—the International Labor Organization (ILO), the Organization for Economic Co-operation and Development (OECD), and the UN Office of the High Commissioner on Human Rights (UNOHCHR), have warned against the risk of “box-ticking compliance approaches and overreliance on contractual assurances” and urged coherence with international standards.<sup>57</sup> The United Nations Principles for Responsible Investments (UNPRI) echoed this concern.<sup>58</sup> The NGO Amnesty International expressed unease that the CSDD would restrict “access to remedy for victims of corporate human rights abuses by allowing companies to shift their responsibilities on to business partners using contractual assurances.”<sup>59</sup> The French NGO Sherpa noted the historic ineffectiveness of reliance on company codes of conduct referenced in contracts and the audits of contract compliance as a means of improving human rights performance.<sup>60</sup> Shift has echoed these and other concerns, noting that MCC’s 2.0, addresses the concern that other types of contracts ignore buyer contributions to human rights impacts in the supply chain.<sup>61</sup>

As a result, the CSDD’s contractual assurance defense mechanism, and the content of any model contract clauses, are likely to be the subject of debate within the EU Parliament and the European Council. This article argues that the HRDD regime of

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<sup>56</sup> CSDD Article 12, p. 59.

<sup>57</sup> *Joint letter by ILO, OECD, OHCHR regarding the European Commission’s proposal for a corporate sustainability due diligence directive* (March 7, 2022), downloadable at [https://www.ilo.org/global/docs/WCMS\\_839276/lang--en/index.htm](https://www.ilo.org/global/docs/WCMS_839276/lang--en/index.htm)

<sup>58</sup> *PRI Statement: European Commission Proposal on Corporate Sustainability Due Diligence* (March 2, 2022), available at <https://www.business-humanrights.org/en/latest-news/pri-statement-european-commission-proposal-on-corporate-sustainability-due-diligence/>.

<sup>59</sup> Amnesty International, *EU: Due diligence proposal ‘a missed opportunity’* (February 23, 2022), available at <https://www.amnesty.org/en/latest/news/2022/02/eu-due-diligence-proposal-a-missed-opportunity/>.

<sup>60</sup> Sherpa, *Directive on Corporate Sustainability Due Diligence: the proposal finally unveiled by the Commission must be improved* (February 23, 2022), available at <https://www.asso-sherpa.org/directive-on-corporate-sustainability-due-diligence-the-proposal-finally-unveiled-by-the-commission-must-be-improved>

<sup>61</sup> Shift, *The EU Commission’s Proposal for a Corporate Sustainability Due Diligence Directive* (March 2022), (“Shift CSDD Response”), at note 16, available at <https://shiftproject.org/resource/eu-csdd-proposal-analysis/>.

MCC's 2.0 may be a useful model for the EC to consider as it drafts model contracts, since it is designed to address many of the concerns expressed by these comments.

#### F. Human Rights Due Diligence as a legal duty of care

Apart from statutory mandates, HRDD also has the potential to become the basis for a common law or unwritten legal duty of care owed by corporations to avoid harming persons and society. Common law courts have long-used normative standards as the basis for establishing tort-based legal duties of care to injured persons under domestic law.<sup>62</sup>

To date, violations of internationally recognized human rights laws have not been invoked to establish a common law duty of care. That may change as HRDD becomes more deeply embedded in law, policy, and corporate practice. The change would be highly significant, since the majority of multinational corporations are headquartered in common law jurisdictions, such as those in the U.S., the UK, and Canada. Professor Emeritus Douglas Cassel of Notre Dame Law School argues that all of the elements are in place (foreseeability, proximity, and public interest) to establish a common law duty of care claim against a parent company for injuries to people and communities that result from its failure to conduct HRDD with respect to the operations of its foreign subsidiary.<sup>63</sup>

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<sup>62</sup> As Justice Learned Hand famously wrote in 1932, "Courts must in the end say what is required; there are precautions so imperative even their universal disregard will not excuse their omission." *The T. J. Hooper*, 60 F.2d 737, 738 (2d Cir. 1932) (Hand, J.).

<sup>63</sup> Doug Cassel, *Outlining the Case for a Common Law Duty of Care to Exercise Human Rights Due Diligence* (2016) 1(2) *Business and Human Rights Law Journal* 179–202, available at [https://scholarship.law.nd.edu/cgi/viewcontent.cgi?article=2267&context=law\\_faculty\\_scholarship](https://scholarship.law.nd.edu/cgi/viewcontent.cgi?article=2267&context=law_faculty_scholarship)

Although no courts have yet held that a common law duty of care to exercise HRDD exists, the Canadian Supreme Court set the stage for it in *Nevsun Resources, Inc. v. Araya*<sup>63</sup> *Nevsun Resources Ltd. v. Araya*, 2020 SCC 5 (*CanLII*), available at <https://www.canlii.org/en/ca/scc/doc/2020/2020scc5/2020scc5.html> There, the Court recognized that customary international laws, including crimes against humanity, forced labor, and torture, are part of Canadian law, and that Canadian companies may be liable for the breach of these standards as a result of their overseas operations (in that case, arising from a Canadian company's mining operations in Eritrea).

In addition, duty of care claims based on the UNGPs can also arise under statutes that set forth very broad, undefined duties of care to society. On May 26, 2021, the Hague District Court in The Netherlands ordered Royal Dutch Shell to reduce its CO2 emissions, after concluding that the company breached its duty of care imposed by a rule of unwritten law relating to social conduct under Dutch Civil Code Article 6:162. In so doing, the Court used the UNGPs and other soft law instruments to define Shell's duty of care. *VERENIGING MILIEUDEFENSIE, etc. v. Royal Dutch Shell PLC*, Court of The Hague, Case No. C/09/571932 / HA ZA 19-379 (English version) (May 26, 2021), available at [https://uitspraken-rechtspraak-nl.translate.google.com/inziendocument?id=ECLI:NL:RBDHA:2021:5339&x\\_tr\\_sl=auto&x\\_tr\\_tl=en&x\\_tr\\_hl=en&x\\_tr\\_pto=nui](https://uitspraken-rechtspraak-nl.translate.google.com/inziendocument?id=ECLI:NL:RBDHA:2021:5339&x_tr_sl=auto&x_tr_tl=en&x_tr_hl=en&x_tr_pto=nui). In so doing, the Court used the UNGPs and other soft law instruments to define RDS's duty of care.

## II. The MCC's 2.0 as effective leverage within the meaning of Human Rights Due Diligence.

The MCC's 2.0 are an example of how a buyer can use its contracts as effective leverage to improve the human rights performance of its suppliers in alignment with HRDD. The traditional approach of contracts would be to treat the problem of human rights in supply chain contracts like any other issue of supplier performance, i.e., by requiring the supplier to make representations and warranties as to its human rights performance, violations of which would entitle the buyer to the full range of contract remedies, including the right to terminate, damages, and indemnification, among other remedies. Meeting these representations and warranties is typically tied to complying with the buyer's supply chain code of conduct and other internal and external standards, as determined by periodic compliance audits during the contract's performance.

### A. The problem with a top-down compliance approach based on representations and warranties.

Unfortunately, a top-down approach is ineffective and counterproductive, particularly where a low-margin supplier lacks the financial and managerial capacity to behave responsibly when it comes to human rights. The approach induces the supplier to cheat and cut corners on human rights performance where necessary to keep the business.<sup>64</sup>

The Better Buying Index (an independent, supplier-centric rating agency that identifies and ranks buyers) ranks buyers by seven purchasing and sourcing practices that can contribute to human rights harm by suppliers: planning and forecasting, design and development, cost and cost negotiation, sourcing and order placement, payment and terms, management of the purchasing process, and harmonization with the company's CSR practices.<sup>65</sup> When buyers do not pay sufficient attention to the impacts of these practices on suppliers, doing so undermines the suppliers' ability to meet contractual human rights performance standards.

The so-called "fast fashion" business model of the garment industry is a good example. A 2019 report by the civil society organization Human Rights Watch<sup>66</sup> identifies how buyer purchasing and sourcing practices in the apparel industry may incentivize low-margin suppliers to engage in dangerous conduct, such as subcontracting to unauthorized sources. The most notorious example of this was the Rana Plaza tragedy in 2013, which resulted in over 1,000 deaths and 2,000 injuries to workers when a structurally unsafe factory building collapsed. Even though a contract may require a supplier to meet the buyer's specified standards, both suppliers know this

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<sup>64</sup> See research cited at footnote 14 of *Shift CSDD Response*, above at n. 73.

<sup>65</sup> Better Buying Partnership Index™ Report 2022, available at <https://betterbuying.org/research-tools/better-buying-partnership-index/>

<sup>66</sup> Human Rights Watch, "Paying for a Bus Ticket and Expecting to Fly" How Apparel Brand Purchasing Practices Drive Labor Abuses (April 23, 2019), available at <https://www.hrw.org/report/2019/04/23/paying-bus-ticket-and-expecting-fly/how-apparel-brand-purchasing-practices-drive>.

won't happen because the supplier doesn't have the capacity to do so and also meet the contract's commercial performance requirements. It's like "paying for a bus ticket and expecting to fly" according to Human Rights Watch.

### B. The advantages of a collaborative contract regime based on shared responsibility to respect human rights.

In contrast, the experience of leading companies indicates that a collaborative approach to solving human rights supply chain problems is much more likely to produce sustainable improvement in human rights performance than a top-down, compliance approach. As Shift observed in its 2013 report, *From Audit to Innovation: Advancing Human Rights in Global Supply Chains*,<sup>67</sup> buyers often have limited visibility into their supply chains, many suppliers lack capacity to fix problems, and many suppliers lack incentives to commit to improve social performance. Moreover:

- *"Many [supply chain] issues are systemic in nature, beyond the direct control of suppliers: While audits may reveal issues related to unsatisfactory working conditions, the root causes of many of these practices can be traced to structural or systemic issues, beyond the direct control of individual suppliers, requiring systemic responses – including social context, regulatory environments, and the broader labor relations context in the country."*
- *"Companies often fail to recognize their own role in contributing to adverse impacts on workers: At the same time that brands and retailers preach social compliance, their own purchasing practices too often undercut their stated commitments to better social performance in their supply chains and contribute directly to the impacts they are intent on preventing. Companies may change designs, production volumes, and production schedules, without adjusting prices or timeframes, and without a clear understanding of the implications of these practices for their suppliers."*

Determining the right response to a supplier violation of the contract's human rights performance responsibilities should require a collaborative approach by buyer and supplier to determine the root cause of the problem. It makes little sense to terminate a supplier without first doing such an analysis, since substitution of a different supplier facing the same pressures may yield the same result. Moreover, terminating a supplier runs the risk of causing human rights harm by shutting down a factory and throwing people out of work.

### C. The importance of finding the root cause of human rights problems.

The MCC's 2.0 require the parties to engage in a collaborative fact-finding exercise to determine the root cause of the impact in order to fix it. MCC's 2.0 Section 2.2. Where disputes remain, they are to be resolved by dialogue, mediation, and if agreed upon, by mediation, before going to court. MCC's 2.0 Section 8. The root cause analysis

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<sup>67</sup>Shift, *From Audit to Innovation: Advancing Human Rights in Global Supply Chains* (August 2013), available at [https://shiftproject.org/wp-content/uploads/2013/08/Shift\\_audittoinnovationsupplychains\\_2013.pdf](https://shiftproject.org/wp-content/uploads/2013/08/Shift_audittoinnovationsupplychains_2013.pdf).

may reveal that the actual and potential human rights impacts are caused by the combined actions of both buyer and seller and perhaps external parties, such as governments and trade unions.

In such cases, the MCC's 2.0 provide that in the case of an unremedied violation by the supplier of the contract's Schedule P human rights standards, the buyer may in collaboration with other buyers, and where legally appropriate, prepare a Remediation Plan.<sup>68</sup> Unfortunately, MCC's 2.0 doesn't contemplate the need, where appropriate, to build leverage with multiple parties, such as governments, trade unions, standard setting entities and others, it doesn't preclude that where it is necessary. This is an oversight that could be corrected.

#### D. The need for responsible purchasing practices

The MCC's 2.0 call upon buyers take affirmative steps to ensure that their purchasing practices support and do not undermine their suppliers' human rights performance, in six ways: (1) following a proposed buyers' code of conduct; (2) offering assistance and training to the supplier; (3) agreeing upon a contract price that would accommodate minimum wage and health and safety costs; (4) considering the human rights impacts of and mitigating the material impacts design and supply changes; (5) excusing nonperformance of specified commercial standards where doing so would breach the supplier's human rights obligations; and (6) requiring the buyer to exit responsibly by considering and mitigating the likely human rights impacts.<sup>69</sup>

As to the last point, the COVID 19 pandemic has heightened focus on the human rights impact of premature contract termination on supply chain workers. The pandemic triggered the collapse of global supply chains, whose fragility was noted earlier. The world economy went into free fall. In order to preserve cash liquidity, many Western buyers reflexively relied on the *force majeure* provisions of their contracts to cancel or curtail purchase orders that were completed or in process, without assessing or attempting to mitigate the impact on vulnerable workers in their supply chain. Tens of thousands of workers were suddenly unemployed, with no savings, no severance payments, and no government safety net.<sup>70</sup>

Penn State Professor Mark Anner calculated that USD\$16 billion of workers' wages in the garment industry was lost between April and June 2020 as the result of order

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<sup>68</sup> MCC's 2.0 Section 2.3(a). The references to "legally appropriate" cautions the buyer to take in mind applicable antitrust or competition laws. Section 2.3(a), n. 66.

<sup>69</sup> MCC's 2.0, Responsible Purchasing Code of Conduct: Schedule Q, version 1.0 (2021), [https://www.americanbar.org/content/dam/aba/administrative/human\\_rights/contractual-clauses-project/scheduleq.pdf](https://www.americanbar.org/content/dam/aba/administrative/human_rights/contractual-clauses-project/scheduleq.pdf).

<sup>70</sup> Corina Ajder et al, European Center for Constitutional and Human Rights (ECHR), *Garment Supply Chains in Intensive Care? Human Rights Due Diligence in Times of (Economic) Crisis* (2020), available at [https://www.echr.eu/fileadmin/Publikationen/ECCHR\\_PP\\_SUPPLYCHAINS\\_COVID\\_EN.pdf](https://www.echr.eu/fileadmin/Publikationen/ECCHR_PP_SUPPLYCHAINS_COVID_EN.pdf). See also, John F. Sherman, III, *Irresponsible Exit: Exercising Force Majeure Provisions in Procurement Contracts*, Business and Human Rights Journal, Volume 6, Issue 1, February 2021, pp. 127 – 134, available at <https://doi.org/10.1017/bhj.2020.27>.

cancellations.<sup>71</sup> The impact of these actions on workers was exacerbated the fact that buyers have for years pushed costs and risks down to workers to the bottom of the supply chain, leaving suppliers with no margin to pay severance benefits. Furthermore, according to Professor Anner, “chronic low tax revenues from buyers have left exporting country governments with weak social safety nets to assist workers in this time of crisis.”<sup>72</sup>

Failure to consider the human rights impacts of termination generated strong criticism, particularly after one U.S. department store abruptly cancelled its clothing orders from Korean and Bangladeshi suppliers and weeks later paid its shareholders a USD\$109 million dividend.<sup>73</sup>

E. Tying the buyer’s contractual remedies to the remedy of harm of workers, and disclaiming liability to buyers to claims by stakeholders.

In a typical supply contract, violations for contractual breach are designed to make the harmed party whole, not to remedy harm to parties external to the contract such as workers and others whose human rights are nevertheless impacted by the contract’s performance. MCC’s 2.0 would fix that problem by addressing remediation of harm to stakeholders specifically and extensively.

Here are four examples: First, the contract would require the supplier to establish and implement operational level grievance mechanisms that meet the effectiveness criteria of the UNGPs, in order to identify and solve problems early and serve as a feedback loop. Second, the contract would require suppliers to establish implement a remediation plan for unremedied harm to stakeholders in order to make them whole. Where the buyer caused or contributed to the harm, the buyer would be expected to help create and implement the remediation plan proportionate to its contribution. Third, the buyer’s entitlement to money damages would be adjusted downwards in proportion to the harm that it caused or contributed to. Fourth, the contract would give the buyer the ability to require the termination by supplier of subcontractors, factory affiliations, and employees in the event of breach by the supplier of Schedule P. MCC’s 2.0 Section 2.

As to the last point, the ability of the buyer to require the termination of a subcontractor, factory affiliation, or employee is designed to prevent future Rana Plaza

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<sup>71</sup> Mark Anner, *Unpaid Billions: Trade Data Show Apparel Order Volume and Prices Plummeted through June, Driven by Brands’ Refusal to Pay for Goods They Asked Suppliers to Make*, Center for Global Workers Rights) (6 October 2020) [https://www.workersrights.org/wp-content/uploads/2020/10/Unpaid-Billions\\_October-6-2020.pdf](https://www.workersrights.org/wp-content/uploads/2020/10/Unpaid-Billions_October-6-2020.pdf) .

<sup>72</sup> Id.

<sup>73</sup> Mei-Ling McNamara, *Anger at Huge Shareholder Payout as US chain Kohl’s Cancels \$150m in Orders: Retailer Paid \$109m in Dividends Just Weeks After Cancelling Clothing Orders, Leaving Suppliers in Bangladesh Facing Financial Crisis* (June 2020), available at <https://www.theguardian.com/global-development/2020/jun/10/anger-at-huge-shareholder-payout-as-us-chain-kohls-cancels-150m-in-orders> See also, Workers Rights Consortium, *Covid-19 Tracker: Which Brands Are Acting Responsibly toward Suppliers and Workers?* (October 2020), available at <https://www.workersrights.org/issues/covid-19/tracker/> .



tragedies, where unauthorized subcontracting to unsafe factories was a contributing factor. This is in tension with various disclaimers in Section 7 of the MCC's 2.0. that are intended to shield the buyer from legal liability to stakeholders that may arise from assuming any duty under the contract: to cause the termination of subcontractors and others; to monitor suppliers or workplace for compliance with laws protecting workers; to control the work of suppliers; to disclose the results of audits, or to third party beneficiaries. Such undertakings are explicitly disclaimed, in order to avoid claims of undertaking liability or liability under the peculiar risk doctrine. MCC's 2.0 n. 99.

As the footnote commentary to MCC's 2.0 recognizes, there is a tension between these disclaimer clauses and the requirements of HRDD generally, of mandatory human rights due diligence statutes, and of other provisions of the MCC's 2.0, the ability to cause the termination of subcontractors and factories. MCC's 2.0 n. 90. Moreover, there is also a tension with the authenticity of a company's public commitment to respect human rights.

It is a truism that corporate culture eats strategy for breakfast. Culture means the company's authentic norms and values, or the way things are actually done. A rights respecting culture is the key leading indicator for ESG investors and others of a company's future human rights performance. That culture has four core norms and values: respect and empathy for all people, openness and learning, individual empowerment and responsibility, and coherence.<sup>74</sup>

Coherence ensures that the company walks the talk on human rights despite competing corporate pressures. Not walking the talk leads to skepticism of the authenticity of its commitment or to claims of greenwash. This can happen as a result of the tension between a company's public commitment to respect human rights and its contractual disclaimer of an obligation to do so.

Internal tension in a contract is a drafting problem for lawyers that can be resolved with careful language. But the more complicated and subtle the contract language is, the more that buyer's internal procurement team may be confused as to how far they should go to assess and address supply chain issues. In particular cases, it becomes a matter of balancing the need to prevent and mitigate involvement in human rights abuse against the need to defend against legal liability to external stakeholders if such involvement occurs.

Since the provisions of MCC's 2.0 are modular, corporate counsel must, recommend which provisions they think best suits their client's needs. That recommendation should not be made in isolation, but should be informed by the seriousness of the commitment by the company to respect human rights, as evidenced

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<sup>74</sup> John F. Sherman, III, *RIGHTS-RESPECTING CORPORATE CULTURE--Identifying the cultural norms and values that underpin business respect for human rights*, Shift Valuing Respect Project (2019) , available at <https://shiftproject.org/resource/rights-respecting-corporate-culture-cultural-norms-values-that-underpin-business-respect-for-human-rights/>

its leadership, governance, and culture, as well as existing or likely legal compliance requirements.<sup>75</sup>

### III. Guidance for Corporate Lawyers in using MCC's 2.0

Deciding which contractual provision to recommend to a client involves a careful balancing of the corporate lawyer's traditional desire to enable the client to comply with hard law, and the need to advise on steps necessary to serve the client's best interests that are reflected in soft law.

Drawing on the work of the Harvard Law School Center for the Legal Profession, the International Bar Association (IBA) concluded on the contest of providing guidance on the UNGPs, that a corporate lawyer acts in three roles: (1) as a technical legal expert; (2) as a wise counsellor; and (3) a leader.<sup>76</sup>

The corporate counsel, acting as technical legal expert, advises the company on what it can and cannot do legally under current law. Considering the increasing incorporation of HRDD into hard law, understanding its requirements is becoming a matter of basic legal competence.<sup>77</sup>

The corporate counsel, acting as wise counsellor advises the client not only on technical legal compliance, but also works with executive management to help to decide what is right or fair in the business's sustainable interest, including whether to follow soft law norms, such as the UNGPs, even where they are not reflected in hard law. This is because soft law can have a hard bite; what is soft law today can become hard law tomorrow. This has been the historical arc of the UNGPs.

The corporate counsel, acting as leader, often exercises executive leadership in a company, both in the legal advice and services that they are responsible for rendering throughout the company, and in the way that they shape corporate culture. For example, corporate lawyers should avoid fostering a closed culture of secrecy

The ABA's Model Rule of Professional Conduct 2.1 provides that lawyers should advise their clients not only on the law, but also on relevant context, including the impact of a client's proposed action's impact on stakeholders. In the comment, it observes that "Advice couched in narrow legal terms may be of little value to a client,

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<sup>75</sup> *Signals of Seriousness*" above at n. 50.

<sup>76</sup> *Reference Annex to the IBA Practical Guide on Business and Human Rights for Lawyers* (2016), prepared by the IBA Business and Human Rights Working Group in collaboration with the IBA Legal Policy and Research Unit, section 4.2, ("IBA Reference Annex") available at <https://www.ibanet.org/LPRU/Business-and-Human-Rights-for-the-Legal-Profession.aspx>

<sup>77</sup> See: ABA Model Rule of Professional Conduct 1.1 (Competence) available at [https://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_1\\_1\\_competence/comment\\_on\\_rule\\_1\\_1/](https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_1_competence/comment_on_rule_1_1/); and IBA, *International Principles on Conduct for the Legal Profession* (25 May 2019) at p. 31, principle 9 (Competence) [https://regionallawyersnetwork.coe.int/images/Standarts-International-NGOs/12\\_IBA-International\\_Principles\\_on\\_conduct\\_for\\_the\\_legal\\_profession.pdf](https://regionallawyersnetwork.coe.int/images/Standarts-International-NGOs/12_IBA-International_Principles_on_conduct_for_the_legal_profession.pdf) .

especially where practical considerations, such as cost or *effects on other people*, are predominant.”<sup>78</sup> The ABA cited Model Rule 2.1 in its 2012 endorsement of the UNGPs.<sup>79</sup>

According to the UN Office of the High Commissioner on Human Rights, corporate lawyers are often seen to impede the effective implementation of HRDD for their clients through an overly narrow focus on avoiding legal liability.<sup>80</sup> The tendency of corporate legal officers to focus mainly on liability avoidance or delay in the short term has resulted in their paying too little attention to their affirmative duty to promote the best interests of the corporation, whether or not that interest is spelled out by hard law.<sup>81</sup> Such a myopic view tends not to focus on what a corporation can do affirmatively unless to confirm that the client’s decided course of action is rational; rather it focuses more on what a client should do to avoid legal liability, which is “typically, the most conservative path available”.<sup>82</sup>

The MCC’s 2.0 try to take a middle path that balances the legitimate interests of avoiding legal liability to shareholder for involvement in human rights abuse against the need to take steps to prevent such involvement in the first place and the need to ensure that harmed stakeholders are provided with remedy.

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<sup>78</sup> ABA, Model Rule of Professional Conduct Rule 2.1 Advisor (comment) available at [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_2\\_1\\_advisor/comment\\_on\\_rule\\_2\\_1\\_advisor.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_2_1_advisor/comment_on_rule_2_1_advisor.html) (emphasis added); see also *IBA, Reference Annex*, n. 35 above, section 4.

<sup>79</sup> *ABA UNGP Endorsement*, n. 35 above, at p. 5 footnote 15.

<sup>80</sup> United Nations General Assembly, *The Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises* (16 June 2018) UN Doc A/73/163 para 41, filename A\_73\_163-EN.pdf, available at <https://digitallibrary.un.org/record/1639520> .

<sup>81</sup> *Brummer and Strine*, n. 45 above, at p. 64.

<sup>82</sup> Edward J. Waitzer and Douglas Sarro, *In Search Of Things Past And Future: Judicial Activism And Corporate Purpose*, *Osgood Hall Law Journal*, Volume 55 Issue 3, Article 5, p. 804 (Summer 2018) , <https://digitalcommons.osgoode.yorku.ca/ohlj/vol55/iss3/5/> .