

Human Rights Due Diligence and Corporate Governance



John F. Sherman III

Corporate Responsibility Initiative, Harvard Kennedy School

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John F. Sherman, III*

Abstract

To meet its responsibility to respect human rights under the 2011 UN Guiding Principles and Business and Human Rights, a corporation must conduct human rights due diligence. To be effective, human rights due diligence must be embedded into corporate culture through effective leadership that is firmly grounded in corporate governance. Even in the most shareholder-protective jurisdiction (the U.S. State of Delaware), corporate fiduciaries have a duty of loyalty to act affirmatively in good faith to promote the best interests of the corporation.

Meeting this fiduciary duty means applying recognized corporate governance management systems to identify and address the strong business case for respecting human rights, as well as the wide ranging mixture of legal risks of corporate involvement in business in human rights abuse. Legal risks are increasingly arising from the evolution of human rights due diligence from soft law to hard law, and include mandatory human rights due diligence laws, evolving legal standards of duty of care, and private law.

As corporate fiduciaries, corporate legal officers play key roles in integrating human rights due diligence into corporate governance, not only by advising the board and senior management on their legal duties, but also by exercising their leadership roles within the company. Examples of leadership by corporate legal officers include going beyond advising on how to avoid legal liability, taking the organizational lead in avoiding involvement in gross human rights abuse, and not abusing legal privilege to chill open discussion of human rights problems.

Going forward, two issues to watch closely are the fate EU directors’ duties reform initiative, and the use of human rights due diligence as a defense to legal liability.

*The author is a Senior Program Fellow at the Harvard Kennedy School Corporate Responsibility Initiative, a Senior Adviser and General Counsel of Shift, and a former senior legal advisor to the former Special Representative of the United Nations (“UN”) Secretary General on Business and Human Rights, Harvard Kennedy School Professor John Ruggie. This chapter reflects the author’s personal views only, and not those of any person or entity with whom he is or has been affiliated.

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I. Context

As the 10th Anniversary of the 2011 UN Guiding Principles on Business and Human Rights (“*UNGPs*”)¹ approaches, I have been thinking about my own small contribution to the development of what has since become the global standard on business and human rights. In the mid 1990s and early 2000s, I was an inside corporate counsel to a U.S. electric utility, with leadership responsibilities for two of the company’s corporate governance systems—its due diligence program to prevent involvement in crime, and its Enterprise Risk Management program (“*ERM*”). After I retired from the company in 2008, I became a senior legal adviser to Professor John Ruggie, the former UN Special Representative on Business and Human Rights (“*SRS*”), who authored the *UNGPs*.

As a former corporate lawyer with experience in corporate governance, I outlined to the *SRS* and his team in 2010 how key elements of those two corporate governance systems could be used help to shape the development of human rights due diligence, or HRDD.² In the ten years that have passed since the unanimous endorsement of the *UNGPs* by the UN Human Rights Council in 2011, the widespread uptake of HRDD has made integration of HRDD into corporate governance increasingly important.

In this chapter, I try to answer the question, what is the right relationship between corporate governance and HRDD? HRDD is a human rights management system for businesses that forms a key part of the business responsibility to respect human rights under the *UNGPs*. It enables businesses to know and show that they are respecting human rights. As discussed in further detail, the success of HRDD depends in large part on how deeply it is embedded in the culture of the company, which in turn depends upon effective leadership that is grounded in corporate governance.³

A. The UN Guiding Principles on Business and Human Rights

Since this chapter is about *corporate governance*, it is critical to understand that the *UNGPs* were designed to address a gap in *global governance* with respect to business involvement in human rights abuse. The Guiding Principles combine into a mutually supporting framework three independent sources of governance: (1) voluntary business

¹ UN Guiding Principles on Business and Human Rights: Implementing the “Protect, Respect, and Remedy Framework” (2011) (“*UNGPs*”)

https://www.ohchr.org/documents/publications/guidingprinciplesbusinessshr_en.pdf.

² John F. Sherman, III, *Exploring Human Rights Due Diligence*, Discussion Paper, Expert Meeting of North American Corporate and External Counsel (April 30, 2010), <https://media.business-humanrights.org/media/documents/29c0373597a09aa834f2bdf87e93070fb6db345e.pdf>

³ John G. Ruggie, Caroline Rees, Rachel Davis, *Making ‘Stakeholder Capitalism Work: Contribution from Business & Human Rights*, Harvard Kennedy School Working Paper No. 76 (2020), p. 11, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/CRI_WP76.pdf. Professor Ruggie authored the *UNGPs* as the former Special Representative of the UN Secretary General on Business and Human Rights.

practices and policies and self-regulation (often known as corporate social responsibility, or CSR); (2) State enforcement of laws to protect people from business-related human rights abuse; and (3) the robust advocacy by civil society. Each is necessary to prevent and address the problem of global business-related human rights abuse. Yet none is sufficient by itself to solve the problem.⁴

To fill the governance gap, the SRSG concluded that in order to move past the logjam resulting from the bitter debate over voluntary and mandatory measures, an authoritative normative framework had to combine these three distinct governance systems in a manner that draws on their strengths. The result is the interdependent, mutually supporting, three-pillar Protect, Respect, and Remedy framework. Pillar One is the State duty to protect human rights, which reflects the State's legal duty under international treaties and covenants to protect persons from human rights abuse by third parties, including businesses. Pillar Two is the non-legally binding business responsibility to respect human internationally-recognized rights, which expects that businesses will not infringe upon human rights in their operations and business relationships. Pillar Three is the need for greater access to remedy by persons whose human rights have been harmed by business, which is a responsibility of both States and businesses.

Pillar II, the business responsibility to respect human rights, expects that corporate governance will provide a strong foundation to enable the corporation to avoid, mitigate, and remedy its involvement in human rights abuse. Pillar II therefore expects that the board will approve and promulgate a public policy commitment to respect human rights, and ensure that the policy is embedded throughout the corporation, from top to bottom.⁵ This means embedding the policy in the corporation's culture, that is, its authentic norms and values, i.e., the way things are actually done.⁶ I will discuss the elements of a rights-respecting culture later.

HRDD is an essential component of the business responsibility to respect human rights. It should be embedded in formal corporate governance processes and reflected in effective leadership. HRDD expects that through engagement with stakeholders, a corporation will take the following steps: it will identify the risks of its involvement in human rights abuse from the perspective of the stakeholder; it will take integrated and appropriate responses to those involvement in those risks; it will monitor its human rights

⁴ See: John G. Ruggie, *Just Business* (Norton, 2013); John G. Ruggie, *Life in the Global Public Domain: Response to Commentaries on the UN Guiding Principles and the Proposed Treaty on Business and Human Rights* (2015) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=25547; and John G. Ruggie, *The Social Construction of the UN Guiding Principles on Business and Human Rights*, 12 Jun. 2017, Harvard Kennedy School Faculty Research Working Paper Series, HKS Working Paper No. RWP17-030, <https://www.hks.harvard.edu/publications/social-construction-un-guiding-principles-business-human-rights>.

⁵ UNGP 16.

⁶ See: John F. Sherman, III, *Rights-Respecting Corporate Culture: Identifying the cultural norms and values that underpin business respect for human rights* (2019), Shift Valuing Respect Project, <https://shiftproject.org/resource/rights-respecting-corporate-culture-cultural-norms-values-that-underpin-business-respect-for-human-rights/> ("Valuing Respect") and Shift, *Leadership and Governance Indicators of a Rights Respecting Culture: 22 practices and behaviors that help foster business respect for human rights* (2021), <https://shiftproject.org/resource/lg-indicators/foreword/> ("Leadership and Governance Indicators").

performance; and it will be prepared to disclose its human rights performance publicly, particularly to stakeholders where the risks of harm are severe.⁷

B. Corporate Governance (and Culture)

Corporate governance is the strategy through which a corporation manages the relationships among its senior management, its board of directors, its shareholders, customers, employees, and other stakeholders, in order to meet the corporation's goals.⁸ The board of directors is ultimately responsible for corporate governance, including the establishment of the corporation's goals. The corporation's senior officers are responsible for designing and implementing corporate governance systems, in order to provide assurance that the corporation will be able to meet those goals. As corporate fiduciaries, the general counsel and other top corporate legal officers also play an essential role in corporate governance by advising the board and senior management on what is legal and what is right in the corporation's best interests.⁹

Although this paper is not about corporate culture, it is important not to lose sight of the fact that a key goal of corporate governance is to combine with effective leadership to embed the corporation's norms and values deeply into the organization. It is a truism that 'culture eats strategy for breakfast.' As a result, the board and senior management are responsible for getting the culture right. Corporate culture is actual, not aspirational, since it is 'the way things are done'. As a result, achieving the right culture through corporate governance and leadership is the ultimate responsibility of the board and senior management.¹⁰

1. Purpose of the Corporation

A threshold corporate governance issue is the purpose of the corporation. Is its sole purpose to maximize shareholder wealth? Or is its purpose to encourage corporations to address risks to all stakeholders? This issue has been the subject of heated debate, which has intensified in recent years.

The late economist Milton Friedman wrote in 1970 that the social responsibility of the corporation is to increase its profits.¹¹ According to Martin Lipton of the Wall Street law firm of Wachtel, Lipton, Rosen & Katz, the

"Friedman doctrine was a precursor to, and became a doctrinal foundation for an era of short-termism, hostile takeovers, extortion by corporate raiders, junk bond financing and the erosion of protections for employees, the environment and

⁷ UNGPs 17-21.

⁸ European Commission, *Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies*, COM(2010) 284 <https://op.europa.eu/en/publication-detail/-/publication/1788e830-b050-447c-8214-77ed51b13241>,

⁹ Ben J. Heineman, Jr., *The Inside Counsel Revolution: Resolving the Partner-Guardian Tension*, American Bar Association (2016).

¹⁰ See *Valuing Respect and Leadership and Governance indicators*, supra.

¹¹ Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), p. 3, <http://www.umich.edu/~thecore/doc/Friedman.pdf>.

society generally, all in support of increasing corporate profits and maximizing value for shareholders.”¹²

As a consequence, some of the world’s leading business associations have sharply criticized the doctrine of shareholder primacy, as seen by the 2019 statement of the U.S. Business Roundtable on the purpose of the corporation.¹³ This led to a mainstream debate on the subject, which shifts the question from *whether* corporations should consider stakeholder interests to *how* they should do so.¹⁴

An extended discussion of the corporate purpose debate is beyond the scope of this chapter. Instead, I focus on whether, how, and the extent to which, the most shareholder-protective State (Delaware) in the most shareholder-protective country (the U.S.) encourages corporations to address the risks of their involvement in human rights abuse as a matter of corporate governance.

2. Corporate Governance Management Systems

Two complementary management systems are critical to effective corporate governance—Internal Control systems and Enterprise Risk Management, or ERM. The board has responsibility for overseeing the effectiveness of both, and senior management is responsible for their effective design and implementation. Both systems were developed by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), and are widely followed in and outside of the U.S. COSO started as an initiative of five major private accounting and auditing associations formed in 1985 to combat corporate fraud, in response to major corporate financial scandals at the time. COSO has continued to develop authoritative frameworks and guidance on internal control, enterprise risk management, and fraud prevention.

In 1992, COSO published *Internal Control: Integrated Framework* (“*Internal Control Framework*”), which COSO has updated it most recently in 2013.¹⁵ The Internal Control Framework is not legally binding by itself, but it has been widely followed; a key example is the U.S. Sarbanes Oxley Act of 2002, which requires publicly-traded U.S. companies to maintain systems of internal control.¹⁶

¹² Martin Lipton, *The Friedman Essay and the True Purpose of the Business Corporation* (September 17, 2020), Wachtel, Lipton, Rosen & Katz (2020) <https://corpgov.law.harvard.edu/2020/09/17/the-friedman-essay-and-the-true-purpose-of-the-business-corporation/> . See also, Malcolm Rogge, *Bringing Corporate Governance Down to Earth: From Culmination Outcomes to Comprehensive Outcomes in Shareholder and Stakeholder Capitalism*, Corporate Responsibility Initiative, Harvard Kennedy School April 2020 Working Paper No. 72,

https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/CRI_WP_72_Rogge.pdf

¹³ Business Roundtable, *Corporate governance: Statement on the Purpose of a Corporation* (2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>

¹⁴ John G. Ruggie, Caroline Rees, and Rachel Davis, *Ten Years After: From UN Guiding Principles To Multi-Fiduciary Obligations*, Business Human Rights Journal, First View, pp. 1-19 (May 3, 2021), <https://doi.org/10.1017/bhj.2021.8> .

¹⁵ COSO, *Guidance on Integrated Control, Integrated Control—Integrated Framework* (2013), <https://www.coso.org/pages/ic.aspx> .

¹⁶ Section 404(b) of the Sarbanes-Oxley Act of 2002, Public Law 107-204 (July 30, 2003), 116 Stat. 745, 16 U.S.C. s. 7262(b), <https://www.govinfo.gov/content/pkg/PLAW-107publ204/pdf/PLAW-107publ204.pdf> .

In 2004, COSO published its *Enterprise Risk Management—Integrated Framework* which complements its Internal Control Framework by focusing more extensively on the management of risks to the enterprise.¹⁷ COSO updated its ERM Framework in 2017.¹⁸ In 2018, COSO and the World Business Council for Sustainable Development, or WBSCD, published a guidance for applying ERM to ESG (environmental, social and government) risks, which explicitly recommends applying HRDD to the management of human rights risks (“*ESG ERM Framework*”).¹⁹

a) *Internal Control Framework*

The Internal Control Framework outlines a management system framework that enables a corporation to provide reasonable assurance to the external world regarding the achievement of its objectives, based on its control environment, risk assessment, control activities, information and communication, and monitoring.²⁰

“Control environment” as used above is the first component of internal control, and forms the foundation for the others; it sets the tone at the top and comprises the integrity and ethical values of the organization.²¹ Since the control environment includes a corporation’s commitment to ethics and integrity, it would naturally also include the corporation’s top-level commitment to respect human rights.

(1) The U.S. Sentencing Guidelines for Organizational Defendants as an example of internal control

One of the best-known examples of an internal control system is the United States Sentencing Guidelines for Organizational Defendants (“*Sentencing Guidelines*”).²² Although they are not legally binding by themselves, the Sentencing Guidelines establish a normative standard for an internal control system to prevent corporate involvement in crime.

The Sentencing Guidelines guide U.S. federal judges in sentencing corporations that are convicted of crimes.²³ Under the Sentencing Guidelines, a corporation receives a lower sentence if can show that it had an effective compliance and ethics program to

¹⁷ COSO, *Enterprise Risk Management—Integrated Framework* (2004), <https://www.coso.org/Documents/COSO-ERM-Executive-Summary.pdf>.

¹⁸ COSO, *Enterprise Risk Management—Integrating with Strategy and Performance* (2017), <https://www.coso.org/Pages/erm.aspx>.

¹⁹ COSO and WBSCD, *Enterprise Risk Management—Applying enterprise risk management to environmental, social and governance-related risks*, (2018), <https://www.coso.org/Documents/COSO-WBCSD-ESGERM-Guidance-Full.pdf>. As discussed later, the ‘S’ of ESG is heavily populated with human rights risks.

²⁰ Melvin Eisenberg, *Corporate Governance: The Board of Directors and Internal Control*, 19 *Cardozo L. Rev.* 237 (1997) (“*Eisenberg*”), p. 242, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=11400.

²¹ Institute of Internal Auditors, *Sarbanes-Oxley Section 404: A Guide for Management by Internal Controls Practitioners* (2d Ed., 2008), p. 15. Professor Michael Power states that internal control systems are “at the heart of a process by which organizations are being turned inside out and made into newly responsible actors” in order to meet the external expectations of society. Thomas Power, *Organized Uncertainty, Designing a World of Risk Management* (Oxford U. Press, 2007), p. 42.

²² See: United States Sentencing Commission Guidelines Manual, Chapter 8B.2.1, <https://guidelines.ussc.gov/gl/§8B2.1>, and *Eisenberg*, supra, p. 255-256.

²³ *Eisenberg*, supra, p. 256.

prevent criminal conduct by its employees.²⁴ In such a program, an organization must “exercise *due diligence* to prevent and detect criminal conduct” and “otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”²⁵ (Emphasis added).

The Sentencing Guidelines due diligence program consists of seven steps: (1) the organization should establish appropriate standards and procedures to reduce the likelihood of its involvement in crime; (2) the organization should administer the program by high level persons; (3) the organization should ensure that the board is knowledgeable about the program and exercises reasonable oversight regarding its implementation and effectiveness; (4) the organization should communicate its standards widely; (5) the organization should monitor and audit compliance with these standards; (6) the organization should respond appropriately when violations occur, in order to prevent future ones; and (7) the organization should periodically assess the risk of criminal conduct and make changes as appropriate.²⁶

(2) The use of the Sentencing Guidelines to inform Delaware fiduciary duty law

In its landmark *Caremark* case,²⁷ the Delaware Court of Chancery addressed the importance of the Sentencing Guidelines to the board’s fiduciary duty of loyalty to act in good faith to further the company’s best interests. The case is important because the majority of U.S. corporations are registered in the U.S. State of Delaware, and because Delaware has the most highly developed law in the U.S. for the protection of shareholder interests.²⁸

Caremark arose from a lawsuit by shareholders of Caremark, a health care company, against the company’s board of directors, to recover losses arising from the company’s indictment for violations by the company of U.S. criminal laws, which had resulted in huge fines of over USD \$250 million.²⁹ The shareholders alleged that the board breached its fiduciary duty by failing to inform itself and senior management promptly about the likelihood of the company’s involvement in criminal activities. The Court agreed that the board had such a duty, but held that the board could be legally liable for the loss only if “utterly failed” to ensure that a reasonable information and reporting system was in place. In *Caremark*, the Court held that the plaintiff shareholders did not meet this burden, and dismissed the lawsuit.³⁰

In its decision, the Court pointed to the Sentencing Guidelines, and the “powerful incentives” they provide for corporations to have compliance programs to detect legal violations, to report them to public authorities, and to take prompt action to remedy

²⁴ The reference to “ethics” was added in 1994.

²⁵ Sentencing Guidelines, *supra*, Section 8B2.1(a).

²⁶ Sentencing Guidelines, *supra*, Section 8B2.1(b).

²⁷ *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (“*Caremark*”)

²⁸ *Caremark*, *supra*, 692 A.2d at 970.

²⁹ *Caremark*, *supra*, 698 A.2d at 961.

³⁰ In *Stone v. Ritter*, 911 A.2d 362, 369 (2006), the Delaware Supreme Court confirmed that the Court of Chancery had applied the correct standard in *Caremark*. It characterized the board’s fiduciary duty of good faith as part of its duty of loyalty.

them.³¹ It concluded that “any rational person attempting in good faith to meet an organizational governance authority would be bound to” take the Sentencing Guidelines into account.³²

The Court’s use of the Sentencing Guidelines shows how a soft law standard for an internal control system can shape a corporate fiduciary’s responsibility. The Sentencing Guidelines are not legally binding on corporations, and are a feature of U.S. federal law, not state corporation law. They come into play only where a corporation has been convicted of a federal crime. As a result, the Sentencing Guidelines are, in effect, soft law. But as is often the case, ignoring soft law can have a sharp bite.³³

(3) The fiduciary duty to affirmatively advance the best interests of the corporation

Since the Court required proof that the board “utterly failed” in its oversight responsibilities, *Caremark* is typically cited for the proposition that it is extremely difficult to prove facts sufficient to hold a board legally liable for money damages for its failure of oversight. That is true, even though recent decisions of the Court of Chancery have denied motions to dismiss *Caremark* claims against boards and officers.³⁴

However, *Caremark* also stands for the proposition that in order to fulfill their duty of loyalty, fiduciaries have an affirmative duty of good faith to look to relevant soft law standards, if doing so will further the corporation’s best interests.³⁵ Georgetown Law Center Professor Chris Brummer, and former Delaware Supreme Court Judge Leo Strine, Jr. argue (in the context of furthering the human rights-infused goals of diversity, inclusion, and equity),³⁶ that this affirmative duty imposes a “normative obligation” on directors “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.”³⁷ This affirmative duty requires corporate fiduciaries to pay close attention to relevant soft law norms.

³¹ *Caremark*, supra, 698 A.2d at 969.

³² *Caremark*, supra, 698 A. 2d at 970.

³³ 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, <https://corpgov.law.harvard.edu/2021/03/04/duty-and-diversity/> (“Brummer and Strine”)

³⁴ E.g., *Teamsters Local 443 Health Svcs & Ins. Plan v. Chou*, Court of Chancery, C.A. No. 2019-0816-SG (Memorandum Opinion, August 24, 2020), <https://courts.delaware.gov/Opinions/Download.aspx?id=309790> .

³⁵ Claire A. Hill, *Caremark as Soft Law*, 90 Temple Law Review 681 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3240667.

³⁶The corporate goal of Diversity, Inclusion and Equity (DEI) supports respect for internationally recognized human rights laws and the achievement of several sustainable development goals (SDGs). United Nations Office of the High Commissioner on Human Rights (OHCHR), *Empowerment, Inclusion, Equality: Accelerating sustainable development with human rights*, <https://www.ohchr.org/Documents/Issues/MDGs/Post2015/EIEPamphlet.pdf> .

³⁷ *Id.*

(4) Comparing Human Rights Due Diligence and the US Sentencing Guidelines

Although they have different purposes, both HRDD and the Sentencing Guidelines are both internal control systems that are essential to corporate governance. Both are soft law systems that are designed to enable corporations to manage critical corporate risks. Both must be integrated into corporate governance and both require high level attention within the corporation. Both are grounded in the expectation of a lawful and ethical corporate culture. Both are ongoing rather than single-shot due diligence processes. And both are ‘knowing and showing’ systems that provide prompt information to the board and management regarding the corporation’s major risks: by assessing and identifying them; by monitoring the company’s performance; by taking appropriate preventative actions; and by reporting on violations.

The focus of the Sentencing Guidelines is to prevent corporate involvement in crime. To accomplish this goal, the affirmative duty of loyalty to act in good faith to further the best interests of the corporation expects that the corporation should do more than insist solely on bare legal compliance with criminal laws. Rather, this duty also requires the corporation to protect the corporation from financial, management, reputational, and other adverse consequences that can harm the corporation, by going beyond the minimum needed to avoid legal liability.³⁸

Like the Sentencing Guidelines, HRDD is also predicated on compliance with the law. However, since HRDD’s focus is on identifying and addressing corporate involvement in human rights abuse, HRDD is not limited by what the law requires to prevent and address such harm, even where applicable law is absent or insufficient to protect human rights.³⁹ Nevertheless, HRDD does not operate in a law-free zone. Prior to the promulgation of the UNGPs in 2011, numerous laws protected people from business-related human rights abuse in such fields as workplace and public safety, antidiscrimination, privacy, and environmental protection, to name a few.

Because the Sentencing Guidelines and HRDD have different objectives and origins, they are not identical. However, there are strong parallels between them. Both are soft law internal control systems with heavy normative weight that enable companies to manage their operations in ways that reflect the expectations of society as to responsible business conduct. They therefore inform the responsibility of corporate fiduciaries to act affirmatively in good faith to further the best interests of the corporation.

b) Enterprise Risk Management (ERM)

The second relevant COSO framework is Enterprise Risk Management, or ERM. ERM complements internal control systems. ERM is focused on the identification and assessment of strategic risks to the organization, which if not properly identified and

³⁸ *Brummer and Strine*, supra, pp. 8-9.

³⁹ UNGPs 17 and 23.

managed, will prevent the organization from achieving its core goals.⁴⁰ In other words, ERM “helps an entity to go where it wants to go and avoid pitfalls and surprises along the way.”⁴¹

Like internal control systems, ERM also has a social and ethical dimension. It is one thing for a corporation to assess and tolerate risks to itself or other parties with whom it can share, shift, or hedge the risk. It is quite another for a corporation to manage risk in ways that stakeholders are forced to assume involuntarily and sometimes unknowingly.⁴²

The 2018 ESG Risk Framework, referenced earlier, explicitly addresses how companies should manage their ESG risks, which include human rights risks. ESG stands for Environmental, Social and Governance. 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.” Since the UNGPs are the authoritative global standard on business and human rights, company alignment with the UNGPs gives investors a better tool to use to predict a company’s future human rights performance.⁴³

In addition, HRDD is also relevant to the G, or governance factor of ESG. Since HRDD must be integrated into corporate governance in order to be effective, the failure of a company to do so will likely reduce a company’s Governance, or G factor as well.

Finally, HRDD is relevant to a company’s E, or environmental factor, because severe human rights harm can result from environmental impacts, such as climate change and reduction in biodiversity. As to climate change, on May 26, 2021, the Hague District Court in The Netherlands ordered Royal Dutch Shell (“SDS”) to reduce its CO₂ emissions, after concluding that RDS 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 RDS’s duty of care.⁴⁴ As to the loss of biodiversity (seen a contributor to pandemic disease such as

⁴⁰COSO, *ERM—Integrating Strategy with Strategy and Performance* (2017)

<https://www.coso.org/Documents/2017-COSO-ERM-Integrating-with-Strategy-and-Performance-Executive-Summary.pdf>

⁴¹ Committee of the Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management — Integrated Framework* (2004) (“ERM Risk Framework”) p.1, <https://www.coso.org/Documents/COSO-ERM-Executive-Summary.pdf>

⁴² John R. Boatright, *The Ethics of Risk Management in the Information Age*, Bentley University Center for Business Ethics, (2010), p. 25, <http://d2f5upgbvkvx8pz.cloudfront.net/sites/default/files/inline-files/ns-monograph.pdf>.

⁴³ John G. Ruggie and Emily K. Middleton, *Money, Millennials and Human Rights: Sustaining ‘Sustainable Investing’* (2019) 10(1) Global Policy p. 144, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working_papers/CRI69_FINAL.pdf See also, the UN Guiding Principles Reporting Framework, www.ungpreporting.org.

⁴⁴ See Office of the High Commissioner on Human Rights, *OHCHR’s role in promoting rights-based climate action*, <https://www.ohchr.org/EN/Issues/HRAndClimateChange/Pages/PromotingRightsBasedClimateAction.aspx>. On May 26, 2021, the Hague District Court in The Netherlands ordered Royal Dutch Shell (“SDS”) to reduce its CO₂ emissions, concluding that RDS 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 RDS’s duty of care. Clifford Chance, *Climate Change*,

COVID-19), the UN Special Rapporteur on human rights and the environment observed that businesses have been involved in reducing biodiversity through “deforestation, land-grabbing, extracting, transporting and burning fossil fuels, industrial agriculture, intensive livestock operations, industrial fisheries, large-scale mining and the commodification of water and nature.”⁴⁵

The ESG Risk Framework notes that ESG risks, which were once considered ‘black swans’, are now common and manifest quickly and significantly.⁴⁶ The ESG Risk Framework points out the increasing attention paid by investors to ESG factors, including by the largest passive investors globally, such as BlackRock (USD \$6.3 trillion in assets under management), State Street Global Advisors (USD\$ 2.8 trillion), and the Government Pension Fund of Japan (USD\$ 1.4 trillion).⁴⁷ Very recently, Exxon’s shareholders voted to install two new board directors who are more focused on the need for the company to effectively address its climate change risk. Exxon’s management strongly opposed the proposal and major institutional investors, such as BlackRock, strongly supported it. As stated in the New York Times, “To corporate America, the upset was a clear sign that company boards and leaders need to pay attention to environmental, social and governance issues (known as E.S.G.) — or suffer rebukes.”⁴⁸

With respect to human rights specifically, in March 2021, BlackRock issued its new policy regarding engagement with companies on human rights impacts, which states that as a matter of sound corporate governance and long-term value creation, companies should “implement processes to identify, manage, and prevent adverse human rights impacts that are material to their business, and provide robust disclosures on these practices” that align with the UNGPs, even though they are not legally binding.⁴⁹

The ESG Risk Framework includes: (1) governance and culture; (2) strategy and objective setting; (3) performance; (4) review and revision; and (5) information, communication, and reporting.⁵⁰ The ESG Risk Framework focuses first on the need for systems and processes for effective corporate governance, “which provides the oversight,

Human Rights and Corporate Duties – Dutch Court Issues Landmark Decision, (May 27, 2021), <https://www.cliffordchance.com/insights/resources/blogs/business-and-human-rights-insights/climate-change-human-rights-and-corporate-duties-dutch-court-issues-landmark-decision.html> .

⁴⁵ See the Report of the Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, health and sustainable environment, *Human rights depend on a healthy biosphere* David R. Boyd (July 15, 2020), A/75/161, <https://undocs.org/A/75/161>, paragraphs 76-77; See also, Office of the High Commissioner on Human Rights, *Human Rights at the Heart of the Response: Human Rights, the Environment, and Covid-19: Key Messages*, (2021), <https://www.ohchr.org/Documents/Issues/ClimateChange/HR-environment-COVID19.pdf> .

⁴⁶ *ESG Risk Framework*, supra, p. 2.

⁴⁷ *ESG Risk Framework*, supra, p. 4.

⁴⁸ Andrew Ross Sorkin, Jason Karaian, Sarah Kessler, Michael J. de la Merced, Lauren Hirsch and Ephrat Livni, *Wall Street Rebels Against Exxon: A small activist investment fund scored a huge win* (May 27, 2021), <https://www.nytimes.com/2021/05/27/business/dealbook/exxon-mobil-engine-no-1.html?searchResultPosition=1> .

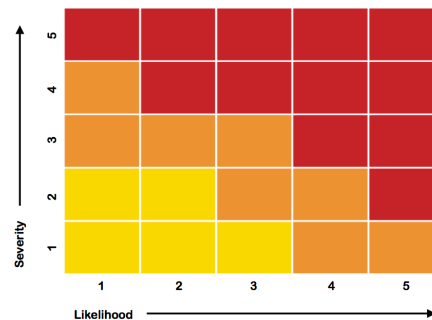
⁴⁹ BlackRock, *Our approach to engagement with companies on their human rights impacts Investment Stewardship* (March 2021), <https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-human-rights.pdf> .

⁵⁰ *ESG Risk Framework*, supra, p. 9.

structure and culture needed to establish the goals of the organization, the means to pursue them and the ability to understand any associated risks.”⁵¹

Unsurprisingly, the ESG Risk Framework points to the unique features of risk assessment under HRDD to evaluate and manage the company’s involvement in human rights risks.⁵² The UNGPs allow human rights risks to be included within broader ERM systems, “provided that the ERM identifies risks to rights-holders.”⁵³ Therefore, the ESG Risk Framework recommends that in accordance with HRDD, corporations should prioritize attention to the risks of involvement in human rights abuse by the severity of the risk to the stakeholder. The ESG Risk Framework notes that risk management under HRDD is characterized by assessing risk from the perspective of the stakeholder, that stakeholder engagement is critical, and that findings of a risk assessment should be shared with stakeholders.⁵⁴

Graphically, the ESG Risk Framework shows how to assess risks under HRDD by using a risk heat map that displays the relationship between the likelihood and severity of a human rights risk as follows:



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Risks within the darkest shaded blocks draw management’s attention to the most severe stakeholder impacts; they require prioritized attention, even if they are relatively unlikely. That is, a highly unlikely risk of catastrophic harm to people (e.g., such as the failure of a tailings dam, the collapse of an oil drilling platform, or the meltdown of a nuclear power plant) nevertheless deserves priority attention by the corporation from an HRDD perspective.⁵⁵

3. The evolution of Human Rights Due Diligence from soft to hard law.

The UNGPs originated as a soft law norm. However, since their unanimous endorsement by the UN Human Rights Council in 2011, the UNGPs have enjoyed broad and swift uptake. The UNGPs are increasingly incorporated or reflected in law, regulation, judicial and administrative decision-making, public policy, multistakeholder norms, commercial and financial transactions, the practices and policies of leading

⁵¹ *ESG Risk Framework*, supra, p. 13.

⁵² *ESG Risk Framework*, supra, p. 54.

⁵³ UNGP 17, Commentary.

⁵⁴ *ESG Risk Framework*, supra, p. 54.

⁵⁵ *ESG Risk Framework*, supra, p. 55.

companies, and the advocacy of civil society.⁵⁶ The former UN High Commissioner for Human Rights, Zeid Ra'ad Al Hussein, described the UNGPs as “the global authoritative standard, providing a blueprint for the steps all States and businesses should take to uphold human rights.”⁵⁷

Although HRDD is soft law by itself, it does not operate in a law free zone. A corporation’s responsibility to respect human rights has always existed in a mixed hard law and soft law environment, as I discussed earlier. Since the promulgation of the UNGPs in 2011, HRDD has become reflected or incorporated in public policy and hard law around the world. 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.⁵⁸

In addition, States, particularly in the EU, requires companies to report on their human rights performance.⁵⁹ The U.S, in its own procurement processes, requires sellers of products to the federal government to eliminate human rights trafficking from their supply chains.⁶⁰

Beyond reporting, the UK authorized the seizure of imported goods manufactured in a manner involving human rights abuse.⁶¹ Recently, the U.S. Customs Office has increased its seizure of goods manufactured by companies engaged in forced labor or other human rights abuses.⁶²

⁵⁶ John F. Sherman, III, *Beyond CSR: The Story of the UN Guiding Principles on Business and Human Rights*, in Ray Lindsay, and Roger Martella, *Corporate Social Responsibility – Sustainable Business-Environmental, Social and Governance Frameworks for the 21st Century* (Wolters Kluwer, 2020), Section 20.04, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/programs/crj/files/CRI_71.pdf (“*Beyond CSR*”).

⁵⁷ 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>

⁵⁸ See UN Working Group on Business and Human Rights, *Guidance on National Action Plans on Business and Human Rights*, OHCHR (2016), https://www.ohchr.org/Documents/Issues/Business/UNWG_NAPGuidance.pdf.

⁵⁹ *Id.*

⁶⁰ In 2012, the U.S. adopted the U.S. Federal Acquisition Regulation, ‘Combating Trafficking in Persons’, FAR Subpart 22.17 and Part 52 (2012), <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.

⁶¹ In 2017, the UK adopted the Criminal Finances Act of 2017, <https://www.legislation.gov.uk/ukpga/2017/22/contents/enacted>, 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.

⁶² Luciano Racco and Anna Maria Annino, *A Review of CBP Actions on Forced Labor in 2020 and Outlook for 2021* (February 4, 2021), *Foley Hoag Trade Sanctions and Export Controls Alert*, <https://foleyhoag.com/publications/alerts-and-updates/2021/february/a-review-of-cbp-actions-on-forced-labor-in-2020-and-outlook-for-2021>. The threat of seizure can have serious adverse financial impacts; e.g., a Malayan company’s USD \$1 billion listing in Hong Kong was delayed in order to resolve a U.S. import ban based on multiple indicators of forced labour in its production processes. Scott Murdoch, Liz Lee and Anshuman Daga, *Top Glove's \$1 billion Hong Kong listing delayed amid U.S. ban imbroglio – sources*, *NASDAQ* (June 1, 2021), <https://www.nasdaq.com/articles/top-gloves-%241-bln-hong-kong-listing-delayed-amid-u.s.-ban-imbroglio-sources-2021-06-01-0>.

a) *Mandatory Human Rights Due Diligence*

More recently, States have moved beyond National Action Plans, reporting requirements, and asset seizures to require corporations to engage in mandatory due diligence, starting with France in 2016⁶³ and then the Netherlands in 2019.⁶⁴ These statutes apply to companies domiciled or doing business in those countries. Similar due diligence legislative initiatives are underway in Austria, Denmark, Finland, Germany, Switzerland, Norway, the UK, and elsewhere.⁶⁵

Since the EU is the world's largest trading block, its policies and laws have enormous global reach that reach beyond the EU's borders. In 2020, the EU launched a consultation process, framed as an initiative on sustainable corporate governance, on a comprehensive, EU-wide mandatory HRDD directive, a draft of which is expected in 2021, that would be implemented by all EU member States into national law.⁶⁶

The initiative has received strong support from the EU Parliament, which on March 10, 2021, voted overwhelmingly in favor of a resolution recommending enactment of such legislation.⁶⁷ The adopted resolution provides that the legislation would apply to non-EU companies that sell goods or services into the EU market.⁶⁸ The extraterritorial impact of the EU HRDD legislation would be huge for U.S. and UK companies that do

⁶³ The French Duty of Vigilance 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), <https://www.business-humanrights.org/en/latest-news/frances-duty-of-vigilance-law/>.

⁶⁴ The Dutch Child Labour Diligence Law 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/>.

⁶⁵ See Business and Human Rights Resource Center, *National & regional movements for mandatory human rights & environmental due diligence in Europe* (May 19, 2019), <https://www.business-humanrights.org/en/latest-news/national-regional-movements-for-mandatory-human-rights-environmental-due-diligence-in-europe/>

⁶⁶ European Commission, *Sustainable corporate justice*, DG Justice, A3 Company Law unit, Legislative and possible guidance, Q1 2021, Ref. Ares (2020) 4034032 - 30/07/2020, <https://media.business-humanrights.org/media/documents/files/documents/090166e5d21fb60c.pdf>. The initiative draws upon a European Commission 2020 study of due diligence in the supply chain, <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en> and a European Commission 2020 study on directors' duties and sustainable corporate governance, <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en>. The EU proposed to look separately at the questions of human rights due diligence and requiring company directors to integrate stakeholder impacts into their fiduciary duty of care.

⁶⁷ 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)) ("*European Parliament Resolution*"). https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html

⁶⁸ Under Article 2, Paragraph 3 of the European Parliament Resolution, *supra*, the due diligence requirement "shall also apply to ... undertakings, ... which are governed by the law of a third country and are not established in the territory of the Union when they operate in the internal market selling goods or providing services."

business in the EU. For example, in 2019, U.S. exports to the EU were USD \$598 billion.⁶⁹ As a result, U.S. and UK companies selling into the EU would likely be scrutinized for evidence that their exported goods and services were produced in accordance with meaningful HRDD processes.

b) *Duty of care*

In addition to State efforts to codify HRDD into statutes, HRDD has the potential to become the basis for a 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. As Justice Learned Hand wrote in the famous *T.J. Hooper* case 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.”⁷⁰ To date, violations of internationally recognized human rights laws have been rarely invoked to date to establish a common law duty of care, but that will likely 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.

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 *Araya v. Nevsun Resources*. 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).⁷¹ Professor Emeritus Douglas Cassel of Notre Dame Law School argues that all of the elements are in place 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.⁷²

In addition, duty of care claims based on the UNGPs and HRDD can arise under statutes, too. I earlier discussed the very recent Dutch case involving Royal Dutch Shell, where the Court explicitly relied on the UNGPs to conclude that RDS has breached its

⁶⁹ Office of the U.S. United States Trade Representative, European Union, <https://ustr.gov/countries-regions/europe-middle-east/europe/european-union>

⁷⁰ *The T. J. Hooper*, 60 F.2d 737, 738 (2d Cir. 1932) (Hand, J.), <https://law.justia.com/cases/federal/appellate-courts/F2/60/737/1542549/> “ [I]n most cases reasonable prudence is in fact common prudence; but strictly it is never its measure; a whole calling may have unduly lagged in the adoption of new and available devices. It may never set its own tests, however persuasive be its usages. *Courts must in the end say what is required; there are precautions so imperative even their universal disregard will not excuse their omission.*” (emphasis added). The case is discussed in *Waitzer and Stoller*, supra, p. 825.

⁷¹ *Araya v. Nevsun Resources, Ltd.*, 2016 BCSC 1856 (2016), <https://www.cciij.ca/content/uploads/2016/10/BCSC-Nevsun-judgment-Oct-2016.pdf>.

⁷² That is, there would be a proximate connection between the parent’s conduct and the injury, the injury would be foreseeable, and liability would serve the public interest. 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, http://journals.cambridge.org/abstract_S2057019816000158.

duty of care under a rule of unwritten law relating to social conduct under the Dutch Civil Code by not taking sufficient steps to reduce its CO2 emissions.

Similarly, plaintiffs are trying to import HRDD as a duty of care under the U.S. Trafficking Victims Protection Reauthorization Act (“TVPRA”). The statute provides that companies can be held civilly liable if they participated in a venture, that engaged in forced labor, where the company knowingly received anything of value from the venture or “knew, or should have known” that the venture had engaged in forced labor.⁷³ In a pending TVPRA class action against Apple, Google, and Tesla, the alleged class consists of children who claim to have been enslaved and injured while mining cobalt in the Congo for ultimate use in the assembly of lithium ion storage batteries in defendants’ products. Plaintiffs claim that defendants knew, *or should have known through the exercise of HRDD*, that their products were manufactured with child and slave labor.⁷⁴

c) *Private law*

In addition to common law or statutory legal liability, private commercial law is increasingly incorporating UNGPs and HRDD concepts into contracts and agreements; this is creating a new *lex mercatoria*, or private commercial law, of human rights. For example, when huge global business organizations such as FIFA (the world’s largest and richest sports organization), require partners and suppliers to comply with these standards, including in FIFA World Cup tournaments, the results cascade throughout the supply chain.⁷⁵

When huge multinational enterprises require their contractual counterparties to comply with the UNGPs, procurement lawyers are incentivized to address the deficiencies of current supply chain contracts from an HRDD perspective. These contracts are typically based on buyer-enforced supplier representations and warranties to meet human rights standards in the contract. However, the representations and warranties approach of existing supply chain contracts has been largely ineffective to improve human rights performance by suppliers; this is because so many suppliers lack the managerial and financial capacity to comply with both human rights and commercial performance standards (such as price, quantity, and timing of delivery of goods). Moreover, buyers often undercut the ability of low-margin suppliers with prices that make it impossible for workers to enjoy a living wage, and by last-minute changes in design and quantity. Doing so makes cheating and unauthorized subcontracting inevitable, if the supplier wants to keep the business. Under such circumstances, the

⁷³ 18 U.S.C. § 1595 et. seq.

⁷⁴ Class Action Complaint, *Jane Doe I, etc. v. Apple Inc I, etc.*, U.S. District Court for the District of Columbia, 16 December 2019, https://www.classaction.org/media/does-et-al-v-apple-inc-et-al_1.pdf.

⁷⁵ John G. Ruggie and John F. Sherman, III, *Adding Human Rights Punch to the New Lex Mercatoria: The Impact of the UN Guiding Principles on Business and Human Rights on Commercial Legal Practice* (2015) 6(3) *Journal of International Dispute Settlement* 455–461, available at https://scholar.harvard.edu/files/john-ruggie/files/adding_human_rights_punch_to_the_new_lex_mercatoria.pdf

buyer's expectations of suppliers with respect to human rights performance is like "paying for a bus ticket and expecting to fly."⁷⁶ Buyers get what they pay for.

As a result, a Working Group of the Business Section of American Bar Association has drafted model supply chain contracts that would shift contracts from a representations and warranties approach to a human rights due diligence regime, in which buyers and suppliers would share the responsibility of addressing supply chain human rights abuse.⁷⁷ The model contract clauses are suggestive only, but indicate the need for corporate lawyers to address more effectively the problem of supply chain human rights abuse by incorporating HRDD principles into supply chain contracts.

Finally, private arbitration is increasingly being used to resolve business related human rights disputes. Two examples are (a) the Bangladesh Accord, an agreement between about 200 Western garment companies and two trade unions to raise factory safety improvements in the wake of 2014 Rana Plaza factory collapse, which is enforceable by arbitration; and (b) foreign investor host State bilateral treaty arbitration, which may involve allegations that a State's increased efforts to protect human rights violates the rights of investors under bilateral treaties.⁷⁸

4. The business case

Complying with public or private legal standards that reflect or incorporate HRDD is foundational for corporate governance. However, legal compliance is hardly the only reason for corporate fiduciaries to act affirmatively to ensure that HRDD is implemented into corporate governance. Furthering the best interests of the corporation also requires understanding the business case for HRDD that goes beyond avoiding legal liability.

The importance to ESG investors of company involvement in human rights abuse to investors has been discussed earlier, since such involvement implicates at least the 'S' factor, and perhaps the E and G factors as well. A company's involvement in human rights abuse is a leading indicator to ESG investors of the likelihood of risks to the business, and ultimately lower ratings in potentially all three factors. Human rights can harm the corporation's operations, finances, legal costs and liabilities, reputation, or staff recruitment and retention, among other things.

For example, conflicts between extractive companies and communities, and labor strikes and disruptions in the supply chain, can be very expensive. These conflicts disrupt production, prevent products from coming to market, jeopardize reputations and divert senior management attention. The disruption of the global supply chain as a result of the

⁷⁶ Human Rights Watch, *'Paying for a Bus Ticket and Expecting to Fly': How Apparel Brand Purchasing Practices Drive Labor Abuses* (April 2019) available at <https://www.hrw.org/report/2019/04/23/paying-bus-ticket-and-expecting-fly/how-apparel-brand-purchasing-practices-drive> .

⁷⁷ John F. Sherman, III, *No Need to Reinvent Wheels: Drafting Meaningful Human Rights Due Diligence through Model Suggested Supply Chain Contract Clauses*, Shift Viewpoint (March 2001), <https://shiftproject.org/aba-contract-clauses/> .

⁷⁸ *Beyond CSR*, supra, Section 20.04[K][2].

COVID 19 pandemic has highlighted the fragility of supply chains to disruption.⁷⁹ In one famous case, an extractive company calculated that the cost of disruption from disputes with communities, spread out over all its facilities over a two-year period, cost USD \$6,500,000,000. Similar in terms of magnitude is the value of reputation.

Finally, it is estimated that over 1/3 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.⁸⁰

II. The Corporate Legal Officer's Role.

Under Delaware law, corporate officers are also fiduciaries, who owe the same duties of care and loyalty to the corporation as board members.⁸¹ Officers include corporate general counsel and other legal officers, provided that they are acting in their capacity as officers.⁸² Although corporate legal officers partner with the CEO and other senior officers to manage the corporation's strategic risks, their affirmative fiduciary duty of loyalty and care is to the corporation itself. This creates an inevitable tension, where the general counsel and other inhouse lawyers must “reconcile the dual—and at times contradictory—roles of being both a partner to the business leaders and a guardian of the corporation's integrity and reputation.”⁸³

As corporate fiduciaries, corporate legal officers have an affirmative duty to exercise their leadership of the legal function to further the best interests of the

⁷⁹ John F. Sherman, III, *Irresponsible Exit: Exercising Force Majeure Provisions in Procurement Contracts*, Business and Human Rights Journal, Cambridge University Press vol. 6, issue 1, 127-134 (2021), <https://www.cambridge.org/core/journals/business-and-human-rights-journal/article/abs/irresponsible-exit-exercising-force-majeure-provisions-in-procurement-contracts/A1206F08637B7353E652857B9CDC9720>.

⁸⁰ For a fuller description of these costs and the research that supports it, see Shift, *Business, Human Rights and the Sustainable Development Goals: Forging a Coherent Vision and Strategy* (2016), commissioned by the Business and Sustainable Development Commission, Section 4, <http://s3.amazonaws.com/aws-bsdc/BSDC-Biz-HumanRights-SDGs.pdf>. 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) <https://www.oecd.org/industry/inv/mne/Quantifying-the-Cost-Benefits-Risks-of-Due-Diligence-for-RBC.pdf>; Rachel Davis and Daniel Franks, *Costs of Company-Community Conflict in the Extractive Sector*, (2014), <https://shiftproject.org/resource/costs-of-company-community-conflict-in-the-extractive-sector/>.

⁸¹ *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), <https://caselaw.findlaw.com/de-supreme-court/1129452.html>.

⁸² Under Delaware law, a corporation cannot exculpate officers from liability for money damages for breach of the duty of care, as they can for board members. Edward B. Micheletti, Bonnie W. David, Andre D. Kinsey, *Recent Trends in Officer Liability*, Skadden, Arps, Slate, Meagher & Flom (December 18, 2020), <https://www.skadden.com/insights/publications/2020/12/insights-the-delaware-edition/recent-trends-in-officer-liability>.

⁸³ Ben W. Heineman, Jr., *The Inside Counsel Revolution: Resolving the Partner-Guardian Tension* (ABA, 2016) p. 55. See also, Malcolm Rogge, *Vesting Transnational Corporate Responsibility in Natural Persons v. Legal Persons – What Matters Today?*, Forthcoming in *Corporate Citizen: New Perspectives on the Globalized Rule of Law*, (Oonagh Fitzgerald, ed.) CIGI-McGill-Queen's University Press, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3570105

corporation when it comes to avoiding involvement in human rights abuse. There are many steps that a corporate legal officer can take to do so,⁸⁴ but here are three: (1) not focusing exclusively on the narrow issue of avoiding legal liability; (2) treating the potential for involvement in gross human rights abuse as a matter of legal compliance; and (3) not using legal privilege to chill the open discussion of human rights problems in the corporation in order to find and fix them.

A. Going beyond liability avoidance.

According to the UN Office of the High Commissioner on Human Rights, corporate lawyers can impede the effective implementation of HRDD for their companies through an overly narrow focus on avoiding legal liability.⁸⁵ 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 corporation⁸⁶

Osgoode Law School Professor Edward J. Waitzer and Ontario Securities Commissioner Douglas Sarro argue that corporate lawyers tend not to focus on what a corporation can do, unless to confirm that the client's decided course of action is rational. Rather, they focus more on what a client should do to avoid legal liability, which is "typically, the most conservative path available".⁸⁷

Such reasoning often can be used to justify short term decision-making that can severely harm people. For example, Waitzer and Sarro point a study on deterrence by Roy Shapira and Luigi Zingales, which showed that the chemical company DuPont consciously avoided disclosing for many years the severe health impacts of releasing toxic Teflon waste from its West Virginia plant into community water supplies. The decision would have likely been considered to be rational from the short-term financial perspective of the company, because the "immediate costs of polluting would be borne by others, and any damages, penalties, or reputational harm for which the company or its managers ultimately might be accountable are discounted by both the probability of detection and the time lags between the decision to pollute and the detection of pollution, and between detection and enforcement."⁸⁸

Ultimately, the company paid approximately USD \$670 million to settle personal injury claims brought by community members, who were successful in large part because

⁸⁴ The leadership role of corporate counsel with respect to human rights is discussed in detail in *The Corporate General Counsel Who Respects Human Rights*, Legal Ethics Journal (forthcoming in 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3624331 ("Corporate Counsel").

⁸⁵ United Nations General Assembly (UNGA), *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, <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N18/224/87/PDF/N1822487.pdf?OpenElement>

⁸⁶ *Brummer and Strine*, supra, p. 64.

⁸⁷ Edward J. Waitzer and Douglas Sarro, *In Search Of Things Past And Future: Judicial Activism And Corporate Purpose*, Osgoode Hall Law Journal, Volume 55 Issue 3, Article 5, p. 804 (Summer 2018) , <https://digitalcommons.osgoode.yorku.ca/ohlj/vol55/iss3/5/> ("Waitzer and Sarro").

⁸⁸ *Waitzer and Sarro*, supra, at 797, citing Roy Shapira and Luigi Zingales, *Is Pollution Value-Maximizing? The DuPont Case*, NEBR Working Paper 23866 (2017), <https://www.nber.org/papers/w23866> ("Shapira and Zingales")

they were (luckily) able to hire an experienced lawyer who had previously worked to defend chemical companies, and because (fortuitously), they were able to sue in a state (West Virginia) that happened to recognize medical monitoring as recoverable damages.⁸⁹ Otherwise, they would probably have lost the litigation.

The logic that likely supported the company's decision not to disclose the severe health risk of toxic pollution would have been consistent with a primary focus on delaying and avoiding short term legal liability. However, not disclosing the risks would ignore the need to prevent and remedy harm to community members who would be sickened and die from toxic waste from the company's operations.

B. The potential for involvement in gross human rights abuse.

The UNGPs specifically address the need for the legal function to take a leadership role in preventing the corporation's involvement in the most egregious forms human rights abuse. When corporations operate in areas of conflict, there is often a grave risk of gross human rights abuses, such as murder, rape or torture, and corresponding impunity on the part of the relevant actors (which often include public security forces or armed groups). UNGP 23(c) therefore provides that businesses should treat "the risk of causing or contributing to gross human rights abuses as a legal compliance issue wherever they operate."

The Commentary to UNGP 23(c) provides that treating the risk of involvement in gross human rights abuses as a matter of legal compliance is required, "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 establishing specific corporate criminal responsibility and the jurisdiction of the International Criminal Court for those offences. In addition, corporate directors, officers and employees may be subject to individual liability for acts that amount to gross human rights abuses."

UNGP 23(c) therefore directly asks the general counsel's office to take the lead in ensuring that the potential of involvement in gross human rights abuses is treated as a matter of legal compliance, rather than allowing other functions to decide whether the risk of such involvement to the company outweighs the costs of the risks to people.

C. Not chilling open discussion of human rights problems.

As fiduciaries, corporate legal officers should help to foster, and not undermine, a culture that respects human rights. One of the core norms and values of a rights-respecting culture is openness and learning.⁹⁰ This means searching out problems, tries to understand them, and fix them, which is effective leadership that embeds HRDD into corporate culture. An open and learning culture means (a) actively searching for human rights problems of which the corporation is not already aware (for example, abuse in the remote tiers of its supply chain); (b) accepting responsibility when things go wrong (for

⁸⁹ The case was dramatized in the 2019 movie, *Dark Waters*, <https://www.focusfeatures.com/dark-waters> .

⁹⁰ The other three authentic norms and values of a rights respecting culture are respect for the dignity of all individuals and empathy with them, individual empowerment and responsibility, and coherence. *Corporate Counsel*, supra.

example, by providing remedy when the corporation causes or contributes to abuse); and (c) being transparent about problems, even when they are not yet resolved.⁹¹

A notorious example of a closed culture fostered by the corporate legal team is the General Motors ignition key scandal, where the GM product safety and legal teams used legal privilege to slow-walk the investigation, discovery, and public disclosure of a design defect for 10 years. The defect had caused airbags not to deploy in accidents when the ignition key became loose and moved. This resulted in the deaths of 124 people, the recall of 300 million cars worldwide, and the payment of \$900 million in a Deferred Prosecution Agreement to the US. government. An independent report to GM's Board strongly criticised the role of the legal department in fostering a closed culture, which chilled candid internal discussion and investigation of safety issues out of fear that discovery of problems could result in increased product liability awards in court.⁹²

Of course, there is an inevitable tension between promoting the value of openness and learning, and the need for clients to be able to communicate in confidence with their legal counsel to assess their compliance with new mandatory HRDD laws.⁹³ This is particularly true as HRDD becomes mandatory, and the threat of legal violations becomes more widespread. Companies have an interest in protecting the “legitimate requirements of commercial confidentiality” under UNGP 17. This includes confidential attorney client communications. Such communications need not be disclosed to affected stakeholders.

In this exercise of its fiduciary duty, the General Counsel should therefore ensure that even where the exercise of legal privilege may be technically justified, the organization does not use legal privilege reflexively to chill internal discussions that would identify and resolve human rights problems and build trust with external stakeholders.⁹⁴

III. Two Issues to Watch

Going forward, there are at least two issue to watch for with respect to corporate governance: the EU directors' duties reform initiative, and the use of HRDD as a defence to liability.

⁹¹ Id.

⁹² Anton R Valukas (Jenner & Block), *'to Board of Directors of General Motors Company Regarding Ignition Switch Recalls* (Attorney's Information Exchange Group, 29 May 2014), <https://www.aieg.com/wp-content/uploads/2014/08/Valukas-report-on-gm-redacted2.pdf> (redacted copy).

⁹³ Yousuf Aftab and Jonathan Drimmer, *Expert ESG Attorneys: How Corporate Sustainability Creates Legal Risk* (Corp Gov, 11 February 2020) <https://corpgov.com/lessons-from-cobalt-in-the-congo-how-corporate-sustainability-creates-legal-risk/>.

⁹⁴ John F Sherman, III and Amy Lehr, *Human Rights Due Diligence: Is it Too Risky?* (2010) HKS Corporate Social Responsibility Initiative Working Paper No 55, 15ff https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/programs/crri/files/workingpaper_55_shermanlehr.pdf.

A. The EU Directors' Duties Reform Initiative

The first issue is the separate EU initiative to require company directors to take a long-term view of stakeholder impacts.⁹⁵ The directors' duty reform initiative is proceeding separately from its due diligence initiative, and due diligence is on a faster track. For non-EU registered companies that do businesses in or with the EU, the directors duty initiative would not have quite the same extraterritorial impact as mandatory HRDD, since the law of corporate fiduciary duty depends on the jurisdiction where the corporation is registered. Thus, the EU initiative on directors duties would not apply legally to US corporations registered in the State of Delaware, for example. However, for EU-registered subsidiaries and affiliates of US corporations, the EU initiative on directors duties might well apply.

The shape and details of any EU directors duty legislation remain to be seen. One problem, as Professor Ruggie has noted, is the linking of mandatory HRDD legislation with directors duties legislation. The reformation of directors' duties is more controversial than mandatory HRDD, because the proposed reformation is not based on the same global consensus that produced the UNGPs. As a result, Professor Ruggie voiced concern that linkage of the EU of directors' duty reform with mandatory HRDD legislation might derail the passage of effective mandatory HRDD legislation.⁹⁶ Indeed, the proposed reform of directors' duties has already generated opposition by business groups.⁹⁷

B. Defence to Legal Liability

Going forward, a second corporate governance issue will be whether and the extent to which a corporation's implementation of HRDD should protect it from liability for not managing the corporation's human rights risks. The risk of liability will increase if the EU adopts mandatory human rights due diligence legislation that has teeth and is enforced robustly by regulatory authorities.

During the SRSG's UN mandate, an observer suggested that the proper exercise of HRDD ought to provide a safe harbour from legal claims arising from the involvement in human rights abuse, similar to the so-called business judgement rule under Delaware law, which immunizes a board's actions from legal liability in a *Caremark*-type claim if it the board's action is rational.⁹⁸ However, the Commentary to UNGP 17 flatly rejects safe harbour immunity. Rather, it states that evidence that a corporation took "every

⁹⁵ *Sustainable corporate justice*, supra.

⁹⁶ John G. Ruggie, *Letter to the European Commission regarding reform of directors duties* (February 2021), <https://www.business-humanrights.org/en/latest-news/john-ruggie-raises-concerns-about-adding-company-directors-duties-in-eu-mandatory-human-rights-due-diligence-legislation/>

⁹⁷ Sarah Anne Aarup, Barbara Moens, Giorgio Leali, and Hans von der Burchard, *Europe, Inc. wins as EU delays new business rules*, Politico (March 21, 2021), <https://www.politico.eu/article/europe-inc-puts-brussels-new-business-rules-on-ice/>.

⁹⁸ Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, *Business and Human Rights: Further steps toward the operationalization of the "protect, respect and remedy" framework* A/HRC/14/27 (April 9, 2010), par. 86, <https://media.business-humanrights.org/media/documents/files/reports-and-materials/Ruggie-report-2010.pdf>.

reasonable step to avoid involvement with an alleged human rights abuse” should help to defend itself from a legal claim.

As a result, in order to defend against a claim that a corporation’s failure to conduct HRDD led to its involvement in human rights abuse, a corporation should be prepared to submit evidence to point show that it took “every reasonable step” to avoid involvement in human rights harm through the exercise of HRDD. This requires more than pointing to the existence of its of its human rights policy, or listing the number of training sessions and the number of contracts with human rights provisions. These steps may be important, but they do not explain why and how a company has taken these particular steps, how those steps fit into the company’s overall HRDD efforts, and whether they are effective.

More fundamentally, the company should be prepared to defend itself by pointing to the specific HRDD policies, processes, and systems that it has integrated into its corporate governance, and to the leadership that it has exercised, in order to drive respect for human rights into the organization’s culture.⁹⁹ In other words, the effective integration of HRDD into corporate governance will become critical to the defence of a claim under mandatory HRDD laws, even though it should not provide absolute immunity.

IV. Conclusion

As I have tried to show, the increased recognition of the need to embed HRDD firmly into corporate governance has resulted from, in Professor Ruggie’s words, a process of “norm cascading” by distributed networks of independent entities, rather than from a top down, command and control enforcement process by the UN. This reflects his desire that the UNGPs “trigger an iterative process of interaction among the three global governance systems, producing cumulative change over time.”¹⁰⁰ As the UN Business and Human Rights Working Group has recently is “normative development is easy to overlook but has been an essential step for progress. Norms shape laws, policies and practices.”¹⁰¹ And vice-versa.

The evolving and dynamic relationship between corporate governance and the soft and hard law of HRDD is a prime example of this interaction. The interactive relationship is a two-way street. As I noted at the outset, the development of HRDD was shaped by dynamic interaction of the hard and soft law of internal controls, the Sentencing Guidelines, ERM, and the fiduciary duty of directors and officers under

⁹⁹ Shift, *Discussion Draft: 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), <https://shiftproject.org/resource/signals-draft1/>.

¹⁰⁰ John G. Ruggie, *The Social Construction of the UN Guiding Principles on Business and Human Rights*, 12 Jun. 2017, Harvard Kennedy School Faculty Research Working Paper Series, HKS Working Paper No. RWP17-030, <https://www.hks.harvard.edu/publications/social-construction-un-guiding-principles-business-human-rights>, at 25.

¹⁰¹ Report of the UN Working Group on the issue of human rights and transnational corporations and other business enterprises, *Guiding Principles on Business and Human Rights at 10: taking stock of the first decade*, A/HRC/47/39 (April 22, 2021), <https://documents-dds-ny.un.org/doc/UNDOC/GEN/G21/093/82/PDF/G2109382.pdf?OpenElement>.

Caremark. The dynamic interaction of HRDD with those and other mixed soft and hard law standards continues to this day.