

# Human Rights Due Diligence: Is It Too Risky?



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# HUMAN RIGHTS DUE DILIGENCE: IS IT TOO RISKY?

By John F. Sherman, III and Amy K. Lehr<sup>1</sup>

Due diligence is a familiar business tool, designed to enable companies to manage risk and reduce liability. It requires companies to ask tough questions about the risks of major transactions, projects, and ongoing operations. The answers may reveal unwelcome facts, requiring the company to take action to avoid or mitigate risks previously unappreciated. Since few people like bad news, companies must often overcome a reluctance to ask questions, the answers to which they may not like, in order to perform the process effectively.

Due diligence can and should now be used to assess and reduce a business risk that was only explicitly recognized as a risk quite recently—corporate involvement in human rights abuse. This is the conclusion of a 2008 report to the UN Human Rights Council by Harvard Kennedy School Professor John Ruggie, the Special Representative of the UN Secretary-General for Business and Human Rights (SRSG).<sup>2</sup> The report, entitled “Protect Respect, Remedy,” articulates an interdependent, three part framework that notes: (1) states have a duty to protect human rights, (2) business has a responsibility to respect human rights, and (3) there is a need for greater access to remedy for human rights violations.

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<sup>1</sup> The views expressed in this memo are solely those of the authors, and do not necessarily reflect the views of the Kennedy School, National Grid, Foley Hoag, BLIHR, or the SRSG.

<sup>2</sup> Protect, Respect, and Remedy: A Framework for Business and Human Rights, A/HRC/8/5 (April 2008), <http://tinyurl.com/4snzhm>.

Under this framework, the business responsibility to respect human rights requires companies to conduct human rights due diligence. This means adopting a human rights policy, conducting human rights impact assessments, integrating the policy into the company's operations and culture, and tracking and monitoring performance. The SRSG's Framework has enjoyed significant uptake by business, civil society, and governments, including most recently, the strong endorsement of the Presidency of the European Union.<sup>3</sup>

In his subsequent 2009 report, the SRSG identified the concern, raised by some corporate counsel, that rather than reduce risks for companies, human rights due diligence could actually increase a company's risks of liability.<sup>4</sup> This concern may reflect a natural reluctance to ask questions about previously unappreciated risks, exacerbated by the relatively new appearance of human rights risk on the business agenda. The short and sufficient answer is that human rights due diligence enables a company to identify potential human rights risks and address them before they occur, which should reduce the company's exposure to litigation of all kinds, and help the company defend against human rights claims that might be filed.

### **1) Due Diligence and Risk Management**

Human rights due diligence is designed to enable a company to lower its business and legal risks relating to human rights. The due diligence process described by the SRSG has much in common with other due diligence processes, such as the U.S.

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<sup>3</sup> Protect, Respect, Remedy – Making the European Union take a lead in promoting Corporate Social Responsibility, <http://bit.ly/3dVgVn>.

<sup>4</sup> Business and human rights: Towards operationalizing the “protect, respect, and remedy framework”, A/HRC/11/13 (April 2009), <http://tinyurl.com/cqz384>.

Sentencing Guidelines for Organizational Defendants, the internal controls derived from COSO (the Committee of Sponsoring Organizations of the Treadway Commission), as embodied in Section 404 of the Sarbanes Oxley Act,<sup>5</sup> and the enterprise wide risk management processes set forth in the UK Turnbull Report.<sup>6</sup> Each of these processes requires a company to identify, analyze, and mitigate risk, which requires turning over rocks and looking for problems.

Conducting due diligence provides corporate boards with strong protection against mismanagement claims by shareholders, usually in the form of derivative lawsuits, as the Chancery Court of Delaware (home to most major U.S. companies) determined in its 1996 *Caremark* decision.<sup>7</sup> Just as due diligence can help a company manage and reduce the business and legal risks of criminal wrongdoing, a human rights due diligence process helps a company to reduce its business and legal risks of and from human rights abuses. Compared to a company that does not seriously attempt to manage its human rights risks, a company that conducts human rights due diligence is better able to resist a claim by shareholders that it incurred loss by mismanaging human rights issues.

## 2) **Alien Tort Statute Claims.**

One potential source of concern about conducting human rights due diligence might be the discovery of facts that might increase the company's exposure to tort liability claims by victims against companies for redress for alleged human rights abuses.

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<sup>5</sup> 17 U.S.C. §762.

<sup>6</sup> U.S. Sentencing Guidelines, <http://tinyurl.com/19orqe>; COSO internal control framework, [www.coso.org](http://www.coso.org); Turnbull Guidance, <http://tinyurl.com/lc7ttn>.

<sup>7</sup> *In re Caremark Int'l, Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996).

Although the U.S. is not the only country to incorporate international human rights principles into domestic law and apply them to companies,<sup>8</sup> the U.S. Alien Tort Statute (“ATS”), 28 USC §1350—which grants aliens the right to sue in U.S. federal courts for violation of the law of nations—represents so far the largest body of domestic law on the subject. Although ATS claims have been filed against companies in recent years, leading to a number of settlements, that body of law is embryonic. It is based on a Jeffersonian-era statute that has no legislative history and began to be used only in recent years as the basis for human rights claims against companies. So far the statute has resulted in only three jury trials, which resulted in two verdicts in favor of the defendants and one for the plaintiffs.<sup>9</sup>

In his 2008 Report, the SRSG stated that “the corporate responsibility to respect human rights includes avoiding complicity,” which “refers to indirect involvement by companies in human rights abuses—where the actual harm is committed by another party, including governments and non-State actors. Due diligence can help a company avoid complicity.”<sup>10</sup> ATS claims often are often based on complicity theories, such as aiding and abetting. Although the case law so far is limited, for aiding and abetting claims under ATS, courts have required: (1) assistance by an act or omission with a

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<sup>8</sup> Ramastry and Thompson, Commerce, Crime and Conflict: Legal Remedies for Private Sector Liability for Grave Breaches of International Law: A Survey of Sixteen Countries, Fafo Report 536 (2006), available at <http://tinyurl.com/mef97k>.

<sup>9</sup> These jury trials involved claims against Chevron arising from its use of security forces to protect its oil platforms in Nigeria (<http://bit.ly/i77K8>), against Drummond Coal Company arising from killings at its mines in Columbia (<http://bit.ly/145Hr>), and against a Bangladeshi company for its role in the arrest and torture of a business rival by a paramilitary (<http://tiny.cc/DGpbu>).

<sup>10</sup> SRSG April 2008 Report, *supra*, p. 20.

substantial effect on the commission of an international crime by a third party (*actus rea*); and (2) depending on the legal standard applied, knowledge or intent (*mens rea*).

As to the *actus rea* requirement of assistance, the claimant need only show that its assistance facilitated the crime, not that it caused the crime. In an ATS case arising out of alleged corporate support for South African Apartheid, the District Court required a close causal link between the assistance and the commission of the international crime, distinguishing between products that were specially tailored to help support various aspects of apartheid, and others that were fungible commodities.<sup>11</sup> If this standard is applied in future cases, plaintiffs could likely prove that the company provided such specifically tailored assistance whether or not the company discovers these facts in due diligence. There is no reason for the company to stay in the dark, since the linkage will be proven afterwards in any event.

The major uncertainty is the second requirement, regarding the state of mind, or the *mens rea*. The question is whether the test is knowledge or intent. The Supreme Court has not ruled on this point, and the lower court decisions are in disagreement.<sup>12</sup> Whether the standard is intent or knowledge, however, conducting human rights due diligence is a highly prudent decision.

Under the intent test, proof that a company exercised due diligence to prevent human rights crimes can be used to counter an allegation of wrongful intent. For

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<sup>11</sup> *In re South African Apartheid Litigation*, 617 F.Supp. 2d 228, 262 (S.D. NY 2009).

<sup>12</sup> Compare *Presbyterian Church of Sudan v. Talisman*, 582 F.3d 244 (2d Cir. 2009) (intent standard) with *Doe I v Unocal*, 395 F.3<sup>rd</sup> 932, 947 (9<sup>th</sup> Cir. 2002) (knowing assistance standard). The *Unocal* opinion was withdrawn following the grant of an en banc petition for review and settlement by the parties. Cook, *Tentative Settlement of ATCA Human Rights Suit Against Unocal*, *American Journal of International Law* (April 2005), pp. 497-498.

example, in *Talisman v. Presbyterian Church*, the District Court followed an intent-based standard in an ATS claim against an oil and gas company arising out of human rights crimes committed by the Sudanese government; in granting summary judgment to the defendants, the court noted that the company had advocated unsuccessfully several times for the government to adopt better human rights practices and to stop using the company's air strips.<sup>13</sup>

A knowledge standard should be relatively easy for plaintiffs to demonstrate in ATS cases, which typically involve crimes affecting large numbers of people and information that is in the public arena anyway. The District Court in the Apartheid litigation concluded that knowledgeable employees need not be managers or more senior executives in the corporate structure.<sup>14</sup> If future courts follow this approach, then senior managers have every incentive to understand what is going on at all levels of the company with respect to human rights, since the company will be charged with the knowledge of all employees.

Moreover, knowledge need not be actual; it can be constructive. Thus, the company need only know sufficient facts to make a reasonable person conclude that such a crime likely has been or will be committed. For instance, in the *Unocal* case, which involved allegations of corporate complicity in international crimes against Burmese villagers by the Burmese military, the record showed that Unocal could be charged with knowledge of such crimes from numerous sources.<sup>15</sup> In cases involving such widespread

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<sup>13</sup> *Presbyterian Church of Sudan v. Talisman Energy, Inc.*, 453 F. Supp.2d. 633, 657 (S.D.N.Y. 2006), affirmed 582 F.3d 244 (2d Cir. 2009).

<sup>14</sup> *In re South African Apartheid Litigation*, *supra*, 617 F.Supp.2d at 262 n. 184.

<sup>15</sup> *Doe I v. Unocal*, 110 F.Supp.2d 1294 (C.D. Cal., 2000), reversed by, in part, affirmed by, in part, and remanded, 395 F.3<sup>rd</sup> 932 (9<sup>th</sup> Cir. 2002) (opinion withdrawn following



abuses, it is unlikely that due diligence will discover evidence of company knowledge that is not already available through other sources.

In addition to aiding and abetting claims, plaintiffs may also bring agency law claims under the ATS. For example, in *Bowoto v. ChevronTexaco*, plaintiffs alleged that Nigerian government security forces, which committed various international crimes in responding to a protest on one of Chevron's offshore oil platform in that country, were acting as agents of Chevron's Nigerian subsidiary, which in turn was acting as agent of two of Chevron's U.S. companies.<sup>16</sup> Although plaintiffs ultimately lost the jury trial, their claims survived motions to dismiss and for summary judgment.

To date, most of the courts that have interpreted agency claims under ATS have applied the U.S. federal common law of agency,<sup>17</sup> which requires proof that the principal asked the agent to act on the principal's behalf, that the agent agreed to so act, and that the principal retained the right to control the activities of the agent. Such a relationship can be inferred by the parties' conduct, and its existence is highly fact-specific.<sup>18</sup> In addition, the injury inflicted by the agent must be within the scope of the agent's authority in order for the principal to be liable.<sup>19</sup>

Conduct is within an agent's scope of authority if it is reasonably related to the tasks that the agent was required to perform or reasonably foreseeable in the light of the

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settlement and prior to *en banc* ruling). This withdrawn opinion is not precedential, but nevertheless provides guidance regarding how courts will approach aiding and abetting liability.

<sup>16</sup> *Bowoto v Chevron Texaco*, 2007 WL 2349536 (N.D. Cal. 2007), pp. 15-16 ("Bowoto 2007").

<sup>17</sup> *In re South African Apartheid Litigation*, *supra*, 617 F.Supp.2d at 271.

<sup>18</sup> *Bowoto 2004*, *supra*, 312 F.Supp.2d at 1239.

<sup>19</sup> *Bowoto 2004*, *supra*, 312 F.Supp.2d at 1239-1240.

principal's business or the agent's job responsibilities. Even misconduct that violates a company policy, or doesn't benefit the company, may still be within the agent's scope of authority if the action was committed in the course of a series of acts authorized by the principal, or the conduct arose from an inherent risk created by the work. Furthermore, even if the misconduct was outside the scope of the agent's authority, the principal can ratify it afterwards if it knows, or should have known, of material facts relating to the conduct and then ratifies, adopts, or approves it. Thus, a company can ratify, and become liable for, the actions of an entity that was not its agent at the time that the event took place. Finally, the failure to take adequate steps to investigate or remedy the misconduct can constitute ratification.<sup>20</sup> It is not fanciful to predict that in a future case, human rights due diligence, as described in the SRSG's framework, will be cited as the standard for such a response.

In short, whether an ATS claim is filed against a company on an agency or an aiding and abetting basis, knowledge of human rights risks is a company's friend, not its enemy.

### 3) **Negligence Claims**

In addition to bringing an ATS claim, plaintiffs can also assert a company's indirect liability under common law claims, such as negligence, on the grounds that it failed to use reasonable care to protect another from foreseeable harm, resulting in

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<sup>20</sup> *Bowoto v Chevron Texaco*, Instructions to Jury, Case 3:99-civ-0506-SI, Doc. 2252, November 28, 2005 ("Bowoto Jury Instructions"), pp. 29-33, 37-39. See also, Restatement (Third) of the Law of Agency, sec 4.06 (Ratification), comment d.

injury.<sup>21</sup> Commonly accepted social standards such as industry custom, administrative regulation, or legislative statute can serve as the standard. There is no need to demonstrate the breach of an international criminal law, as there is in an ATS case. The test is not knowledge or intent, but whether the company “should have known” that it was breaching its duty of care to the plaintiff.<sup>22</sup>

For example, Exxon Mobil and its Indonesian subsidiary were sued under various tort theories arising out of killings and torture committed by Indonesian public security forces that the company had hired to protect its facilities. The court found sufficient evidence to entitle plaintiffs to a jury trial on whether the defendants were directly liable for negligently hiring, retaining, and supervising the security forces.<sup>23</sup> Similarly, in *Bowoto v. Chevron Texaco*, Chevron’s Nigerian subsidiary was sued for negligence under California law on the grounds that it failed to train and supervise the Nigerian security forces and local police it called in to suppress protests against Chevron, resulting in injury to the plaintiffs.<sup>24</sup>

Human rights due diligence is relevant to the standard of care owed by a company to victims, and has received recognition as an international standard of conduct for handling disputes involving multinational companies. For example, in 2008, the U.K. National Contact Point (NCP)—responsible for determining the adherence of U.K.

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<sup>21</sup> *Bowoto Jury Instructions*, p. 20; Prosser and Keeton, *The Law of Torts*, sec. 30 (5<sup>th</sup> Ed., 1984).

<sup>22</sup> Ruggie, *Clarifying the Concepts of “Sphere of influence” and “Complicity”*, A/HRC/8/16 (May 15, 2008), p. 6.

<sup>23</sup> *John Doe, et al v. Exxon Mobil Corp., et al*, 573 F.Supp. 2d 16 (D.D.C. 2008) (federal statutory claims against Exxon, including ATS claims, were earlier dismissed), dismissed under a seldom-used doctrine denying standing for non-citizens, 2009 U.S. Dist. LEXIS 90237 (D.D.C. 2009). Plaintiffs have appealed the case.

<sup>24</sup> *Bowoto 2007, supra* pp. 23-24.

companies to the OECD Guidelines for Multinational Entities—determined that a U.K. importer of minerals mined in the Democratic Republic of the Congo, “did not apply sufficient due diligence to the supply chain and failed to take adequate steps to contribute to the abolition of child and forced labor in the mines or to take steps to influence the conditions of the mines.”<sup>25</sup> Similarly, in 2009, the U.K. NCP noted that Vedanta Resources had failed to exercise adequate human rights due diligence in its operations in India.<sup>26</sup> Although these NCP decisions were not binding legal determinations, they evidence growing high level acceptance of human rights due diligence as a standard of care owed by companies to those impacted by its business.<sup>27</sup> At some point, therefore, it is not inconceivable that human rights due diligence may be cited by a court as a standard of care in a negligence case.

#### 4) **Misrepresentation Claims**

Another possible concern with due diligence relates to misrepresentation claims. This arises from the requirement to harmonize public statements about the company’s human rights conduct with what the company knows already, or learns from due diligence. The failure by publicly traded companies to harmonize such statements could be costly, resulting in misrepresentation claims by shareholders. This is not so much a

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<sup>25</sup> Final Statement by the U.K. Nat’l Contact Point for the OECD Guidelines for Multinational Enterprises: Afrimex (UK) Ltd., P 58-62 (Aug. 28, 2008), [www.berr.gov.uk/files/file47555.doc](http://www.berr.gov.uk/files/file47555.doc).

<sup>26</sup> Final Statement by the UK National Contact Point for the OECD Guidelines for Multinational Enterprises: Vedanta Resources plc (Sept 25, 2009), [www.berr.gov.uk/files/file53117.doc](http://www.berr.gov.uk/files/file53117.doc).

<sup>27</sup> Backer, Rights and Accountability in Development (‘RAID’) v DAS AIR and Global Witness v Afrimex: Small Steps Towards an Autonomous Transactional Legal System for the Regulation of Multinational Corporations, 2009 Melbourne Journal of International Law, Vol. 10 (awaiting publication, available at <http://ssrn.com/abstract=1427883>).

risk of due diligence as an argument in its favor, however, since prompt discovery and full disclosure of risks protects investors, and thus the company. Indeed, in the United States, under the Private Securities Litigation Reform Act of 1995, listed companies that accompany forward-looking statements (*e.g.*, predictions of future growth and earnings) with meaningful cautionary language identifying factors that qualify the forward-looking statement (*e.g.*, human rights risks), are immunized from suit for such statements, should their predictions turn out to be inaccurate.<sup>28</sup>

Customers also rely upon a company's public statements about human rights, and have the right to expect that those statements are correct. For example, a retail company may have advertised that it doesn't use child labor, but subsequent due diligence may show that this that statement isn't fully true for all of its suppliers. One well-known claim was brought against Nike for exaggerating its success in ending labor abuses in its supply chain under the California consumer protection statute, resulting in a \$1.5 million settlement.<sup>29</sup> Despite the threat of such litigation (or perhaps because of it), the courts have not been flooded with a huge volume of such litigation based on human rights issues. Furthermore, companies are able to limit the risk of such suits by making accurate and demonstrable statements regarding their human rights and labor practices.

In any event, reviewing marketing material for possible misrepresentation is a process that companies must undertake every day. If a company wishes to promote its

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<sup>28</sup> Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109, Stat. 737 (codified as amended in scattered sections of 15 U.S.C. (2000)); Sommer, The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena with a Screening Panel Approach, 44 Washburn Law Journal 413 (2005).

<sup>29</sup> Brown, No Good Deed Goes Unpunished: Is There a Need for a Safe Harbor for Aspirational Corporate Codes of Conduct?, 26 Yale L. & Policy Rev 367, 391-393 (2008) ("Brown").

human rights due diligence process in order to gain the goodwill of customers, then it needs to make sure that its public statements about its human rights performance are accurate. There is nothing remarkable or burdensome about this.

## **5) Confidentiality Concerns.**

Although conducting human rights due diligence reduces risk, companies still need a confidential space in which to investigate and evaluate the information it discovers in private. Complete transparency may chill the willingness of companies to investigate difficult problems and evaluate them candidly and realistically, and communicate internally in order to fix the problems.

The courts do recognize, however, the need to keep corporate investigations into potential legal liability confidential under legal privilege and the work product rule.<sup>30</sup> Legal privilege protects communications between the attorney and the client from discovery and use at trial, unless the client waives the privilege. The privilege applies only to the confidential communication itself, but not to the underlying facts. Thus, plaintiffs could, for instance, rely on NGO reports to demonstrate that human rights abuses occurred, even if those abuses were also discussed in privileged company communications with legal counsel. The work product rule provides more limited protection to investigative reports conducted by or for lawyers, and can be overcome by a showing of need by adversaries, such as their inability to get the information in any other reasonable way. These protections are not, however, boundless. They cannot be abused

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<sup>30</sup> See *Upjohn v. United States*, 449 U.S. 383 (1981).

to “allow a corporation to funnel its papers and documents into the hands of its lawyers for custodial purposes and thereby avoid disclosure.”<sup>31</sup>

Although the responsibility to respect human rights is not hard law, its principles have significant potential legal impact. As the reflection of a global social consensus on how business should behave, it is part of a dynamic matrix of “international soft and hard law, national law, and transnational custom and customary frameworks (institutionalized or not)”<sup>32</sup> that converge into an emerging “*lex mercatoria*” or “law merchant of human rights.”<sup>33</sup> This hybrid legal and normative system guides and drives business behavior in the absence of a central global command and control governance structure.

Given the potential risks of legal liability for failing to engage in human rights due diligence—e.g., shareholder mismanagement claims, tort suits, claims under the ATS, etc.—it would be highly prudent for companies to assemble a legal team to investigate the underlying facts where allegations of company involvement in human rights abuses have occurred, or likely will occur. In such a case, appropriate assertion of legal privilege and work product would not be incompatible with human rights due diligence, since those protections do not apply to underlying facts communicated, and even investigations conducted under attorney work product may be disclosed upon an appropriate showing of need. In fact, legal privilege and attorney work product protections provide an important space in which clients and counsel can have candid

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<sup>31</sup> *Radiant Burners, Inc. v. American Gas Association*, 320 F.2d 314, 324 (7th Cir., 1963)

<sup>32</sup> Backer, *supra*, p. 36.

<sup>33</sup> Steinhardt, *The New Lex Mercatoria* in Alston (ed.), Non-State Actors and Human Rights (Oxford University Press, 2005), pp. 221-6; see also, Kerr, Janda and Pitts (ed.), Corporate Social Responsibility: A Legal Analysis (LexisNexis 2009), pp. XX.

discussions regarding human rights problems and how they can be addressed that otherwise might not occur.

Communication to legal counsel about human rights risks, or their discovery by legal counsel during investigations, therefore, does not relieve the company of the need to address the risk, and where appropriate, disclose information about the risk publicly. Even where assertion of the privilege is justified, a reflexive resort by companies to invoke legal protection wherever possible may be in tension with the need to head off or reduce problems by building relationships with external stakeholders based on mutual trust. This requires being candid and open about problems and taking responsibility when things go wrong.<sup>34</sup> In the end, the decision to assert legal privilege should not be reduced to a simple on or off switch. Deciding whether to assert the privilege with respect to human rights due diligence investigations or waive it requires sound judgment, but that is no different for human rights due diligence than it is for other due diligence investigations that companies undertake every day.

Another potential protection is the so-called “self evaluation privilege” which, like the attorney client privilege and work product rule, restricts the discovery and evidentiary use of information, but is aimed at voluntary self-analysis intended to fix problems. A number of U.S. courts have recognized such a privilege under the common law in a variety of contexts,<sup>35</sup> but there is considerable disagreement about whether such a privilege exists and, if so, when it applies.

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<sup>34</sup> Susskind and Field, Dealing with an Angry Public: The Mutual Gains Approach to Resolving Disputes (Free Press, 1996), pp. 160-177.

<sup>35</sup> Brown, *supra*, at p. 381.



Courts that recognize the self-evaluative privilege require the company to show that the prospect of discovery and use of a confidential self-audit would stifle a critical self-evaluation that would otherwise serve the public interest. Thus, where the company is conducting the self-analysis to determine whether it complying with its legal obligations, some courts will deny the privilege on the ground that the sanctions for legal misconduct provide a strong enough incentive to conduct the audits anyway.<sup>36</sup>

It has been suggested that adoption of a special self-evaluative privilege could protect efforts by a company to determine whether it is in compliance with voluntary human rights and other policies.<sup>37</sup> The stated need for such a privilege is premised on the view that aspirational codes of conduct are voluntary, meaning that legal privilege and work product protection would not apply. As we discussed earlier, however, the hybrid legal and normative impetus behind the responsibility to respect human rights, and the potential for legal liability for not conducting human rights due diligence, ought to prompt companies to obtain legal advice as matter of prudence, and do so in confidence. Thus, a significant part of a due diligence investigation would be covered by existing legal privilege and work product doctrines, enabling companies to shield confidential communications—but not underlying facts—from discovery.

## 6) Immunities

It has been suggested that due diligence should immunize companies from liability, in order to encourage them to conduct due diligence robustly, and overcome the

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<sup>36</sup> *Id.*, at p. 383.

<sup>37</sup> Brown, *supra*, at pp. 401-413.

reluctance—whether or not justified—to ask tough questions that reveal unpleasant facts about the company’s human rights risks, and to take actions to mitigate them.

One commentator has suggested that the courts should recognize a business judgment rule type of immunity for companies that would bar suits by victims under the ATS, as long as the companies conduct human rights due diligence in good faith.<sup>38</sup> Analogizing to the business judgment rule in shareholder mismanagement cases, it is argued that as long as companies follow the SRSG’s human rights due diligence process, they should automatically be immunized from suit even if they make the wrong decision.<sup>39</sup>

This proposal is problematic, however, since the ATS involves claims that are very different from claims made by investors that the company mismanaged the business, resulting in financial loss. A mismanagement claim alleges that management abused its extremely broad discretion to run the business of the company without being second-guessed by shareholders. A claim by victims under the ATS is markedly different. It is about whether the company’s behavior fell below the most basic norms established by international law and global society, resulting directly or indirectly in a violation of human rights that is so severe and universally condemned that it is a violation of the laws of nations. Compared to investors, the victims of human rights abuses are far more vulnerable, and the harm is more permanent and shocking to the conscience. Indeed, the SRSG’s third pillar of the framework – increased need for access to remedy—is premised on this very point. When human rights are at issue, a company should not be entitled to

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<sup>38</sup> Dhooge, Due Diligence as a Defense to Corporate Liability Pursuant to the Alien Tort Statute, 22 Emory Int’l L. Rev. 455 (2008).

<sup>39</sup> *Id.*, pp. 476 *et seq.*

the same broad degree of protection that the business judgment rule grants to directors in financially managing a company.

Outside the human rights context, a number of commentators have argued for a “due diligence” defense in criminal prosecutions of corporations, which would avoid the stiff consequences imposed by the rule of *respondeat superior*—an agency doctrine that makes an employer responsible for the criminal acts of any employee committed in the scope of their employment, even where the employee acts contrary to corporate policy and a robust compliance program.<sup>40</sup>

The District Court in the *In re South African Apartheid Litigation* acknowledged and approved the *respondeat superior* doctrine in the ATS context, concluding that knowledge by employees of substantial assistance in committing human rights crimes should be imputed to the employer if the employees acted in the scope of their authority, even where the company prohibited the conduct.<sup>41</sup> Recent Supreme Court cases, however, have allowed companies to prove their good faith as an affirmative defense in order to avoid punitive damages in civil cases, opening a potential path to asserting a good faith defense.<sup>42</sup>

The need for a good faith defense for human rights due diligence is not entirely clear, since, as we have shown, human rights due diligence reduces many more risks than it generates. But since the issue of a good faith defense for due diligence—human rights or otherwise—is already a subject of public debate, we offer three suggestions on how

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<sup>40</sup> Weissman, *supra*, p. 3-4.

<sup>41</sup> *In re South African Apartheid Litigation*, *supra*, 617 F.Supp.2d at 262 n. 184; *United States v. Twentieth Century Fox Film Corp.*, 882 F.2d 656 (2d Cir. 1989).

<sup>42</sup> Weissman, *supra*, pp. 7-10; *Burlingham Industries v Ellerth*, 524 U.S. 742, 765 (1998).

such a defense, if implemented, could be shaped to minimize adverse impacts on human rights.

First, a good faith defense should only be applied to claims for noncompensatory damages. Using this defense as a shield against claims for compensatory damages would run counter to the need for greater access to remedy by those harmed by business-related human rights abuse—the third pillar of the Protect, Respect, Remedy framework. The purpose of noncompensatory damages, however, is to punish the defendant and deter future misconduct, not to compensate the victim. Using evidence of due diligence to reduce noncompensatory damages would be similar to the acknowledgement in the U.S. Sentencing Guidelines for Organizational Defendants that a company’s due diligence to prevent criminal misconduct is a reason to reduce the severity of criminal sanctions against the company. It potentially creates a positive incentive for companies to conduct due diligence and avoid misconduct in the first place.

Second, the defense should be available only to avoid company responsibility for the actions of lower-level employees acting contrary to enforced company policy on human rights. Where the actions of higher-level company officers are at issue, the defense should not apply. This aligns with how commentators have proposed that the good faith defense should apply outside the human rights litigation context.

Finally, the good faith defense must not lead to a tick-the-box approach, which elevates form over substance, which awards processes that do not result in better human rights outcomes.<sup>43</sup> This concern might be mitigated if the protection is conditioned

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<sup>43</sup> Huff, Note: The Role of Corporate Compliance Programs in Determining Corporate Criminal Liability: A Suggested Approach, 96 Colum. L. Rev. 1252, 1275-1276 (1996).

upon independent third party certification as to the effectiveness of the process, in much the same way that Section 404(a) of the U.S. Sarbanes Oxley Act requires qualified and independent third party auditors to verify the effectiveness of a company's internal financial controls.

As noted earlier, the human rights due diligence process has much in common with other due diligence processes used by companies to manage financial and other risks. For example, Section 404(a) of the Sarbanes Oxley Act—which the U.S. Congress passed in 2002—requires publicly-traded companies to self-assess, and independent third party auditors to report on, the effectiveness of the company's internal control structure and procedures.<sup>44</sup> In making such assessments, most U.S. companies and their external auditors have used the internal controls framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO).<sup>45</sup>

Such certification might be based upon a number of mechanisms, including an ISO standard or a multistakeholder auditing umbrella organization that oversees the auditors' practices and helps develop standards for them. It would be critical that civil society, governments, and business see the certification process to be legitimate and rigorous. To gain such legitimacy, the standards should be developed through a transparent multistakeholder process.

## **Conclusion**

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<sup>44</sup> 17 U.S.C. §762(a).

<sup>45</sup> The COSO principles are available at [www.coso.org](http://www.coso.org). See also, Sarbanes-Oxley 404: A Guide for Management by Internal Controls Practitioners, The Institute of Internal Auditors, 2d ed. (January 2008), p. 10, [www.theaia.org](http://www.theaia.org).

In the end, due diligence is about preventing and limiting risk. This article asks: is human rights due diligence too risky? The analysis boils down to one answer: not conducting due diligence is too risky, for both business and society.