

The New Draft Treaty on Business and Human Rights: How Best to Optimize the Incentives?

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The third revised draft of the proposed UN treaty on business and human rights, released August 17, retains the diplomatic progress and concessions made to date. It focuses on business activities with at least some transnational element, recognizes the contributions of the UN *Guiding Principles on Business and Human Rights*, directly regulates States and not business, and improves the technical drafting.

Even so, the heart and soul of the treaty – preventing human rights abuses and providing remedies for victims of abuses – needs fundamental revisiting.

Optimizing Incentives to Prevent Harm:

To prevent human rights harm, what is needed is a set of carrots and sticks that incentivize companies to do serious and effective – but not impossible -- human rights due diligence. They should have incentives to get right both key aspects of due diligence – serious risk assessment, and effective preventive action. This means rewarding companies who do both aspects responsibly, by not penalizing them or holding them liable for risks they could not reasonably have foreseen. In contrast, costs should be raised for companies which fail to assess risks responsibly or which fail to act reasonably on the identified risks. Those companies should be penalized and held legally liable for resulting harm (including through reparations to victims).

In short, a combination of positive incentives for companies who do right, and negative incentives for companies who do not, is most likely to optimize the treaty's contribution to preventing significant human rights abuses.

An alternative approach would simply hold companies liable for all adverse human rights impacts of their business activities, regardless of due diligence or fault. The preventive rationale is that companies would then be forced to detect and prevent abuses, in order to minimize the risk of future liability.

The normative justification of this approach focuses, not on fault, but on allocation of risk. If unforeseeable harm results from a business activity, someone will have to bear the resulting cost: either the victims, the public (through the State), or business. Allocating the cost to business gives companies maximum incentives to prevent harm in the first place.

However, there are real world downsides to such an approach. One is economic welfare. Business generates not only adverse but also positive impacts. As recognized in the preamble to the draft, business has “the capacity to foster sustainable development through an increased productivity, inclusive economic growth and job creation ...” If costs are imposed on business regardless of fault, many companies may respond by simply avoiding investment in high risk,

developing countries – precisely the countries that most need the economic benefits business can provide.

Another downside is diplomatic. Enticing States to adopt a treaty on business and human rights is no easy task, even if companies are penalized only when they are at fault. If companies are to be held legally liable regardless of fault, the chances of diplomatic acceptance of the treaty will greatly diminish.

For both economic and diplomatic reasons, then, a fault-based approach is most likely to optimize prevention of human rights harm, without adversely affecting economic development or State acceptance. Companies that get due diligence right should be rewarded. Those that get it wrong should pay a price.

By this standard, the current draft of the treaty misses the mark.

Human Rights Due Diligence:

The main means to prevent harm is to carry out effective human rights due diligence. With respect to the first key aspect of due diligence – risk assessment -- the draft requires companies to identify, assess and publish “any” actual or potential human rights abuses that may arise from their business activities or relationships. (Article 6.3.a.)

However, identifying “any” actual abuse, let alone any potential abuse, is too demanding a task for even the most ambitious (and expensive) program of due diligence. Requiring a company to identify “any” abuse, no matter how minor, is neither realistic nor efficient; no company could ever comply. Due diligence should focus on “significant” abuses (those which pose a risk of significant harm) which are “salient” (most likely or frequent) for a particular industry or company.

With respect to the second key aspect of due diligence – preventive action -- the draft requires appropriate measures to “avoid, prevent and mitigate effectively” the identified abuses which a company causes or contributes to through its own activities, or through entities or activities it controls or manages. (Article 6.3.b.) Combined with the prior obligation to identify “any” abuse, this appears to mean that companies must also prevent any “identified” abuse – no matter how minor. This, too, is mission impossible. The duty to take preventive action should focus on “significant” abuses which are “salient” for a particular industry or company.

Unrealistic due diligence requirements are all the more objectionable, because States must penalize companies that fail to meet them. (Article 6.7.) Instead of being rewarded for getting due diligence right, companies are to be penalized for failing to do the impossible.

Granted, these concerns may be partially eased by other provisions of the draft. States may allow companies to engage in due diligence “proportionate” to their “risk of human rights abuse” (among other factors) (Article 6.3.). State compliance procedures may consider the “severity of associated risks” (among other factors). (Article 6.6.) But these qualifiers are vague. They fall short of assuring companies that, if they carry out appropriate due diligence, they will not be penalized or held legally liable – and vice versa.

Degrees of Due Diligence:

In principle the treaty applies to “all” business activities. (Article 3.1.) However, its due diligence requirement is subject to a potentially enormous limitation. States “may establish in their law, a non-discriminatory basis to differentiate how business enterprises discharge these [prevention] obligations commensurate with their size, sector, operational context or the severity of impacts on human rights.” (Article 3.2.)

This provision has salutary aspects. It gives States much-needed flexibility, for example, to allow mom-and-pop retailers to engage in far less (and less expensive) due diligence than, say, a global oil company.

On the other hand, the vague wording leaves the incentives unclear. Until national implementing legislation is adopted, companies will not know what degree of human rights due diligence they must carry out. National laws will no doubt be the subject of aggressive lobbying. It will be a near miracle if the resulting incentives, guided by nothing more than this vague treaty language, are well aligned with the treaty goal to optimize prevention of human rights abuses.

The vague language could also open the door to abuse. For example, the treaty covers State-owned enterprises. (Articles 1.3 and 1.5.) However, the authorization to “differentiate” due diligence obligations based on “sector” or “operational context” might tempt States to allow SOE’s to engage in less due diligence than private corporations, and thereby also face a lesser risk of liability for failing to carry out due diligence.

The provision on “differentiated” responsibility for prevention, then, deserves further thought. Clearly small businesses need relief; they cannot be expected to carry out the sophisticated due diligence one should require of large companies. But it is not clear that other differentiations need to be expressly authorized by the treaty. In any event, the provision should make clear that it is not an excuse to reduce the due diligence required of SOE’s.

Legal Liability:

The draft’s provisions on legal liability add further to the conflicting incentives. States Parties must impose liability on companies (and individuals) for “failure to prevent another legal or natural person with whom they have had a business relationship, from causing or contributing to human rights abuses, when the former controls, manages or supervises such person or the relevant activity that caused or contributed to the human rights abuse, or should have foreseen risks of human rights abuses in the conduct of their business activities, ... , or in their business relationships, but failed to take adequate measures to prevent the abuse.” (Article 8.6.)

This convoluted provision is not easy to interpret. However, it appears to impose liability in some situations where companies could not reasonably have foreseen or prevented an abuse.

A plausible reading is that the provision imposes liability in two situations: (1) where a company failed to prevent abuses by entities under its control, management or supervision, or (2) where a company should have foreseen risks of abuses, including in its business relationships, but failed to take “adequate measures” to prevent them.

In the first situation, the draft appears to impose liability for failing to prevent abuses by controlled or managed entities, even when the abuses were not reasonably foreseeable and could not have been anticipated by due diligence. If so, the draft makes companies (and individuals) absolutely liable, without regard to fault. For the reasons stated earlier, this is not an optimal incentive.

The second situation does require foreseeability. However, it also requires “adequate measures to prevent” the abuse. It is not clear whether this is an obligation of means or of result. Is a measure “adequate,” so long as it is reasonable, even if it does not in fact prevent the abuse? If so, this would incentivize companies to adopt reasonable preventive measures.

But what if a company does what it reasonably can, but the other party in a business relationship refuses to act? Is the company then liable for the other party’s abuse? That would not give the company a constructive incentive.

The ambiguities should be clarified. Companies which adopt adequate measures should not be penalized or held liable, merely because their measures fail to achieve the desired result.

A further ambiguity is whether companies are to be liable for harms caused by their contractors. The draft defines “business relationships” to include “any relationship between natural or legal persons, ..., to conduct business activities, including ... through affiliates, subsidiaries, agents, suppliers, partnerships, joint venture, beneficial proprietorship, or any other structure or relationship as provided under the domestic law of the State, ...” (Article 1.5.)

This definition omits the prior draft’s explicit reference to relationships by “contract.” Possibly, then, “business relationships” in the new draft do not include contractual relationships. On the other hand, a contractual relationship might implicitly be included in “any other” relationship under domestic law. Especially because this ambiguity affects whether companies can be held liable for abuses by their contractors, it should be clarified as well.

Due Diligence Defense:

If a company engages in serious and robust human rights due diligence, it should not later be held liable for adverse impacts that were unforeseeable, i.e., impacts that could not have been foreseen through genuine and reasonable due diligence.

The draft does not meet this standard. It indirectly contemplates, but does not define, a due diligence defense. Human rights due diligence “shall not automatically absolve a legal or natural person conducting business activities from liability for causing or contributing to human rights abuses or failing to prevent such abuses.” A court or other competent authority will decide on liability “after an examination of compliance with applicable human rights due diligence standards.” (Article 8.7.)

If due diligence does not “automatically” absolve companies from legal liability, then implicitly it absolves them at least sometimes. But when? Under the draft, courts are to decide after examining compliance with “applicable human rights due diligence standards.” Suppose, then, that the court finds that a company’s due diligence met applicable standards. Is the due diligence

then a defense? If that is the intention, it should be made clear. It should also be specified that a company whose risk assessment program does not meet international standards is not entitled to a due diligence defense. Likewise, a company which engages in world-class risk assessment, but then fails to take reasonable action to avoid the risks, should not be entitled to the defense. But a company which responsibly undertakes both risk assessment and preventive action should have a defense. Otherwise, it would be penalized for harm that was not reasonably foreseeable and was not due to fault on the part of the company.

The current draft, however, leaves both companies and courts in a state of uncertainty. Not only does it fail to optimize incentives, its vague language arguably violates the principle of legality.

Conclusion

Many aspects of the new draft deserve comment. Most important is to get right its central core – the provisions on human rights due diligence and on legal liability. To optimize the incentives to prevent harm, companies should be rewarded for carrying out serious and effective human rights due diligence. They should be penalized and exposed to risks of legal liability if they do not. The current draft should be reviewed with these objectives in mind.