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Business and human rights – emerging issues for financial institutions

The UK, the Netherlands, Denmark and Italy have all recently published "national action plans" on implementation of the UN's Guiding Principles on Business and Human Rights, with other governments expected to follow in 2014. These government policies emphasise the expectation that all companies respect human rights in their activities. As financial institutions increasingly commit to policy statements on human rights, here Clifford Chance experts explore some of the emerging legal issues that accompany these trends.

In September 2013, the UK government became the first in the world to publish its policy on implementing the UN's Guiding Principles on Business and Human Rights, including its expectations of corporations. The Guiding Principles, endorsed by the international community in 2011, are the global standard that sets out what businesses should do to respect human rights. In brief, this involves using due diligence to identify and address adverse human rights impacts with which they may be involved. The principles are now subsumed within other international standards such as the OECD Guidelines for Multinational Enterprises and the UN Global Compact, and are reflected in market standards applied by the financial sector, such as the IFC Performance Standards and the Equator Principles.

The Guiding Principles have acted as a catalyst for financial institutions to introduce or to expand policies and procedures around human rights due diligence although the sector is at an early stage of examining the full implications. As the understanding of the practical application of the Guiding Principles unfolds, the way in which these non-binding principles may translate into hard law contractual obligations tends, by and large, to be overlooked.

Rae Lindsay, the co-head of Clifford Chance's Public International Law practice, says: "If an institution is publicly committing to these principles, at some point it has to think about incorporating those commitments into its relationships, and that will typically be via contracts and the negotiation process. At the moment, in many cases this responsibility to respect human rights is not reflected in contracts at all, but where it is, it might not have been thought through with sufficient rigour."

The responsibility to respect

Historically financial institutions have tended to focus on human rights issues only in certain lines of business that tend to pose a more obvious potential impact on such rights, particularly project finance. In the last 12 months, however, there has been an increasing focus on what the Guiding Principles mean for other products

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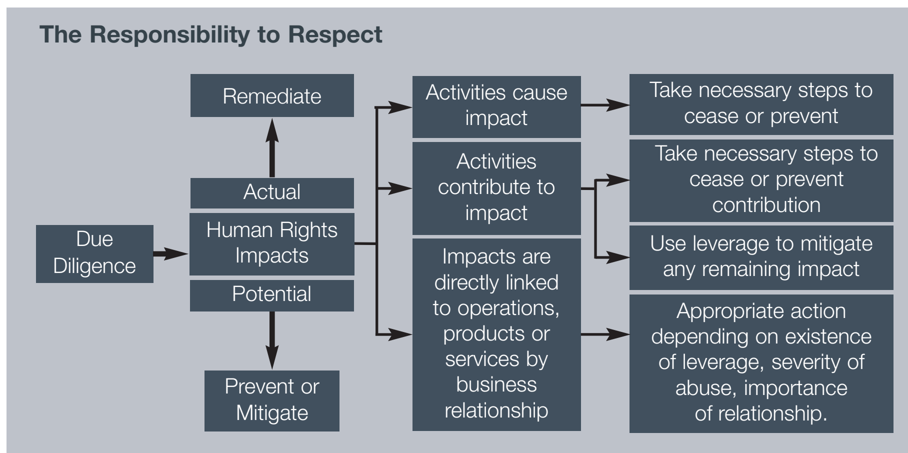

and services, and how they should be implemented in areas such as corporate finance, asset management and others.

The Principles set out what the responsibility to protect human rights actually means in practice: due diligence should be conducted in relation to transactions and relationships in a way that assesses actual and potential human rights impacts. Institutions need to think about whether they are causing or contributing to an adverse impact or whether they are directly linked to an adverse impact through their business relationships, and take necessary steps to remediate, prevent or mitigate those impacts as appropriate.

A key issue is that businesses are considered to have the potential to use "leverage" to influence the behaviour of other entities that cause or contribute to harm. Where the responsibility of the institution is engaged, it may be appropriate for it to use its leverage or to consider how it might increase its leverage to effect change.

One of the biggest challenges for financial institutions is determining the way in which the responsibility to respect arises with and how it should be discharged across the business; covering relationships with employees, clients, investee companies and project partners, and across retail, corporate and investment banking as well as asset management, capital markets and project finance. The risk of being linked to adverse human rights impacts is higher for some activities involving certain sectors, for example, the financing of natural resource extraction or defence.

Institutions need to be aware of, and consider carefully the potential hardening of their non-binding commitments into contractual obligations. Identifying a responsibility to mitigate an adverse human rights impact, or to use leverage within a relationship may mean using negotiations to reflect issues raised during due diligence in eventual contract terms. Depending on the context, this could, for example, take the form of asking for representations and warranties, imposing conditions precedent before funds are advanced, or maybe keeping open the option to exert leverage through monitoring processes or conditions subsequent to further funding.

The position is likely to be particularly challenging and complex where multiple parties are involved, such as in syndications. Thought also needs to be given to enforcement mechanisms, such as whether failures to discharge human rights related obligations inserted into a contract should amount to events of default.

Rae says: "There is greater familiarity with these concepts around project finance, for example, where contractual arrangements dealing with environmental and social issues have been commonplace for some time, and practice relating specifically to human rights is emerging. But trying to apply this across sectors, businesses, products and geographies is not necessarily straightforward and requires a lot more thought."

From guidance to obligation

There has been significant activity around incorporating human rights considerations into contractual agreements in the asset management sector.

The UN-supported six Principles for Responsible Investment initiative currently has 1,244 signatories, including asset owners, investment managers and professional services firms. These signatories committed to incorporating environmental, social and corporate governance issues into investment analysis and decision-making processes; to being active owners and incorporating ESG (environmental, social and governance) issues into ownership policies and practices; and to seeking appropriate disclosure on ESG issues by the entities in which they invest, among other things.

In many instances, these principles have since become embedded in contracts, with some private equity fund documentation committing to investors that the fund will only invest in businesses that respect the human rights of workers and respect "the health, safety and wellbeing of those adversely affected by their business activities". In turn, companies in which private equity funds invest are asked to commit to take account of their impact on their local community; to ensure harmful

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effects are properly addressed; and to implement social and environmental management systems.

It seems unlikely that the developments discussed have yet led to circumstances in which institutions could be directly legally liable to the victims of abuse, because this would require piercing the corporate veil or proving a direct duty of care in negligence. There is, however, potentially increased scope for investors to seek to hold asset managers liable where investee companies have abused human rights on the basis that breaches of the investment mandate, of the contractual duty of care, and of fiduciary duty, have occurred.

Roger Leese, a partner specialising in banking and financial services disputes, says: "If the contract places an obligation on the asset manager to address human rights issues, or perhaps even if there is nothing in the contract, but the manager has signed up to the UN Global Compact, then an investor could argue that they understood the manager would be doing appropriate due diligence on the companies in which it invested. If one of those companies suffers a decrease in value as a result of involvement in human rights abuses, then there is the beginning of an argument about breach of contract and breach of fiduciary duty."

So far these issues have yet to be tested in litigation, but there seems a realistic possibility that investors could claim for losses in investment value or for damaging effects on their business. When the liabilities of directors introduced by the Companies Act 2006 are also taken into account – that they must act in a way that has regard for the impact of the company on its community and environment, for example – and the fact that derivative actions can be brought by single shareholders, the legal risks that are involved become apparent.

The US perspective

For the past 25 years the United States has provided a case study on the impact of enforceable hard-law human rights standards, with the Alien Tort Statute (ATS). In the 1980s this statute, which is more than 200 years old, began to be used by plaintiffs as a means of getting foreign defendants into court to answer allegations of human rights abuses abroad. Soon corporations and multinationals with a US presence came within its reaches for the alleged violations of others through theories of aiding and abetting liability – for example, for hiring a security force that committed abuses, or even by participating in the South African economy during the period of Apartheid.

> "Know the risks of the projects you are involved in, and know the implications of the clauses and policies that have been put in place."
> Steve Nickelsburg, Clifford Chance, Washington DC

For 20 years the scope of potential liability expanded dramatically, with the US increasingly being seen as the forum to police the world's businesses on human rights. These cases were difficult and expensive to defend, and carried high reputational risk. Faced with uncertain outcomes in US trial courts, companies frequently settled for significant sums, notwithstanding differences in view over whether corporations could engage liability under the ATS at all. In 2004, the tide shifted when the Supreme Court ruled that only a narrow class of cases could be brought under ATS, and called for vigilant door keeping by the lower courts. Then in 2013 the Supreme Court applied a presumption against extraterritoriality in a case involving allegations of abuses by the Nigerian security forces defending the platforms of a multinational oil company against protestors.

Steve Nickelsburg, a litigation partner in Clifford Chance's Washington DC office, says: "The good news for potential corporate defendants is that this particular hard law regime has been substantially softened." Not only did the Court bar cases involving purely non-US parties and conduct, it also said that simply having an affiliate in the US would no longer expose a multinational to US jurisdiction. Nevertheless, numerous cases are still pending and the exact limits of corporate exposure under the ATS remain uncertain.

The ATS, in its pared down domain, does not represent the only threat from the US plaintiffs bar. Other US laws and regulations including federal criminal statutes, the Foreign Corrupt Practices Act and Dodd-Frank, while not providing private causes of action, provide fertile ground for driving general corporate responsibility. Developments with the ATS may signify a shift of focus for bringing claims raising human rights issues from the US federal courts to other venues seen as more hospitable, such as US state courts or courts in Europe.

The lesson learnt from the ATS experience is that victims will make use of any legal process available to attempt to hold businesses to account for human rights violations. Steve says: "This area of law is inevitably going to continue to develop. The way to deal with it is to know the risks of the projects you are involved in, and to know the implications of the clauses and policies that have been put in place in your business. That way you can not only demonstrate your efforts to discharge the responsibility to respect human rights but also assess and fairly deal with risks to the business that increasing expectations around corporate behaviour may bring."

Conclusion

As institutions across the spectrum of the financial services sector subscribe to human rights initiatives and put policies in place to give effect to them, practical steps will be needed to live up to those commitments. Often this will translate into contractual terms. When undertaken with appropriate care, institutions should be able to achieve the right balance between respecting human rights consistently with the Guiding Principles, and a clear appreciation of the impact such contractual commitments may have on legal risks assumed by the business.

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