BUSINESS, HUMAN RIGHTS AND THE ENVIRONMENT

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The legal implications of Human rights and Environmental due diligence for Financial Institutions

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About the authour: Robin Brooks is a corporate finance lawyer with nearly 40 years experience of M&A and corporate transactions with a strong focus on developing and emerging markets. A significant proportion of Robin's work has been advising boards on governance and ethical issues including on investigations and their consequences. He was an early specialist in human rights due diligence and impact assessments for business. He retired as a partner in a City and international law firm and remains a consultant. He has spent many years supporting NGOs specialising in human rights.

Background

Financing comes in many forms and the legal nature (but note not necessarily the substance) of the link between the provider of finance and environment, social and human rights impacts can differ according to the type of finance being provided. Confusingly in terms of the relationship between a provider of finance and a human rights or environmental impact the form in which the finance is provided is not definitive so there may, for example, be close similarities between an equity issue where funds are intended for a specific purpose and, for example, a project financing in terms of their link to harm.

It is not possible to briefly describe the differing structures and the potentially different analyses of the legal impacts the provision of finance can have. This talk focuses on the link between Human Rights and Environmental Due Diligence (HRDD) and providers of finance and looks at the impact of HRDD on the potential liabilities of the financier in terms of the law. Other speakers have mentioned how this issue would be approached under the UNGPs and by a National Contact Point.

In a traditional legal analysis, the structure utilised to make the finance available could and historically would have had a significant effect on the liabilities of the financial institutions involved. Similarly analysing the form of corporate groups structures could determine many legal outcomes. Even before the recent English Supreme Court cases this should never have been the whole story as can be seen from the post 2008 restructuring and

allocation of responsibilities for securitisation and similar structured finance structures. The recent English Supreme Court decisions culminating in Opkabi v Shell have shown that the UK courts will look at the underlying reality of who takes and implements what decisions for the purpose of determining potential liabilities for these acts rather more than the formal legal structures to which they have traditionally been attributed (1).

Liability for harms resulting from purposes for which financing is provided

A good starting point when considering the legal position of financiers is to consider the well-known example involving the IFC-the Jam Case (Jam v International Finance Corporation) (2). This case illustrates the link between HRDD (and also in this case supervision) as a basis for legal action and highlights the position of development banks such as IFC (3). The application of the principles of Tort law (or delict) now needs to be considered against a background of the developing laws and regulations requiring HRDD (4). (5) As regards project finance IFC's Performance Standards are given practical effect through a voluntary association of financing institutions in the Equator Principles Association. This is a voluntary "club" but includes some 108 institutions in 37 countries which are understood to be involved in more than 80% of project financings. The absence of clear standards and mechanisms to hold financial institutions to account are significant limitations but they have established the principle that HRDD as required by the UNGPs should now be conducted as part of any project financing. Legal documentation in many forms of finance will now build on the increasing practice of doing some form of HRDD and impose obligations in relation to the use of finance designed to protect the lender from responsibility for harms caused by or associated with the particular lending. In some cases, this will address the substance of avoiding harm and, if caused, impose mechanisms for redress.

This is the background against which recent legal developments need to be considered. Consideration of the position of a financial institution will now in all likelihood take place against a background where some form of HRDD may have identified the possibility or foreseeability of harm and the contractual documentation will seek to manage this risk while at the same time facilitating the purposes for which finance was sought. Provision of finance may facilitate a project or "purpose" in the clear knowledge of potential for harm caused by infringement of rights and the documentation may demonstrate a common purpose which may be sufficient to impose liability on a finance provider.

Whilst acknowledging that the development of legal principles is not necessarily consistent over time and this is shown by the contrasting attitudes of the judges in the Vedanta and pre–Supreme Court Shell cases, English law has shown a willingness to apply general principles in a number of areas to the benefit of claimants who have been harmed in situations where there would otherwise be no redress for these harms. This litigation has taken place at the pre-trial stage where the defendant has sought to strike out claims on the basis that they had no possibility of succeeding. This is significant in practice as if a case gets beyond this stage there is a strong impetus for a defendant to settle.

In these recent cases the English Supreme Court used basic Tort principles to establish that a UK parent company can be responsible for loss suffered by persons in addition to its employees for loss caused by a mine through environmental damage, pollution caused by leaks from pipelines but not yet for a failure to protect against rioting caused by elections. In addition, recently the English Court of Appeal in Begum versus Maran (2021) (6) specifically stated that contractual arrangements the implementation of which led to causing harm could be a basis for liability. In parallel to these developments there is scope for the principles of accessory torts to be applied against a provider of finance. This is an area of law where there is considerable debate, for example, should there even be a "conspiracy tort" but for all this debate it seems that assisting someone to commit a tort may give rise to a liability and there are some signs in legal commentary that the focus in this area could shift from "intent" (as in the criminal law) to the impact on rights as a basis

for imposing responsibility. It is clear that tort principles are unlikely to form the basis of redress in situations of pure omission or where state authorities such as the police engage in wrongdoing. The Court of Appeal decision in the case of Kadie Karma v African Minerals (2020) limits the situations where a company can be held liable for harms caused by third parties. Whilst decisions on financier lability will turn on the facts there are good grounds for distinguishing the issues in Kadie Karma from the analysis applicable to a financier of a project which causes harm.

It also needs to be borne in mind that the actions causing harm can arise after the finance has been provided. The acts complained of could relate to inadequate supervision but if a financial institution is drawn into taking decisions which lead to harm there is ongoing potential for liability.

Whilst there is an established practice that ESG due diligence is conducted during the establishment of a project or financing it is also clear from the UNGPs that there is a need for ongoing due diligence. Depending on the risks identified this may go beyond simply relying on monitoring and reporting clauses in documentation. If an FI exercises step in rights and proceeds to take control of a project or the assets of a borrower, the legal analysis will also change. Similarly, if a group of FIs restructure the financing or indeed sell it on then, assuming there are HR risks, further HRDD or assessment of these risks should also be made.

The more developed HRDD becomes and the more impact resulting contractual provisions have the more likely it is that the same principles as have held parent companies liable will be applied to providers of finance. These tort principles have the advantage that they focus on the underlying realities of corporate life imposing responsibility on relevant decision takers and implementers avoiding being side-tracked by complex notions of corporate control and legal personality with the related issues of corporate jurisdiction and presence. In addition, if in order to claim that particular finance is "sustainable", a finance provider holds itself out as having done proper HRDD and taken suitable steps to ensure potential harms are avoided, we have seen that holding out that you comply with certain standards is capable of affecting how a court assesses your responsibility for harm. The jurisdictional implications of tort actions against parent companies, financiers and those responsible for contractual arrangements are potentially very significant but outside the scope of this talk.

Development in regulation of anti-money laundering, terrorism and Financial Institutions generally

The last 20 or so years has seen the development of significant regulatory jurisdiction over financial instructions in relation to money laundering, sanctions and terrorist financing. The cost to FIs of accepting money from criminals has included 10-digit fines, the imposition of monitors and mandatory interference with internal governance structures. Whilst these are all serious issues the provision of finance by FIs in connection with projects which do serious harm to "rights" and the environment is no less serious and ought to lead to the development of similarly rigorous regulation of FIs. The existence of voluntary standards applicable to project finance through membership of the Equator club is positive especially given its jurisdictional diversity (especially given its recent alignment with the UNGPs) but more general mandatory provisions applying to all forms of finance now need serious consideration.

A measure of the seriousness of any attempt to regulate multinational corporations and their impacts on the human rights of others will be the difference between the measures used generally to regulate financial institutions and any regulatory regime in this area. The general financial services regime in the UK includes many devices which could be adapted should a regulatory regime governing impacts on the environment and human rights be considered. These include a senior managers regime designed to ensure that responsibility for regulatory failures can be attributed to individuals and also to ensure that key functions

within an institution are held by people of suitable experience. Whilst the complication and sophistication of financial regulatory structures exceeds what is necessary for commercial entities in relation to their HR and environmental impacts there seems to be no good reason why significant failures to avoid impacts which harm human rights and the environment should not be regulated within financial institutions in particular and separately within commercial organisations.

Conclusion-how should these experiences inform future efforts to mandate HRDD and broader sustainability due diligence

Conducting an inadequate due diligence on environmental or human rights issues or failing to follow through contractual provisions in the implementation of a financing may increasingly give rise to issues of liability. The solution is to ensure that any HRDD conducted is meaningful and properly tailored to the risks involved. FIs may also not be able to avoid responsibility to those affected by the implementation of a project which means that the requirements of the UNGPS for ongoing due diligence need to be properly implemented. Turning a "blind eye" in the hope of avoiding responsibility is not going to lessen the potential for liability and may increase it. This affects all business enterprises but given the pivotal position of those providing finance and, in many situations, the fact that they are the only "deep pockets" means that financial institutions should expect greater scrutiny of their actions in the future.

Note the views expressed in this talk do not constitute legal advice, should not be relied upon as such, are personal to Robin Brooks and should not be attributed to any organisation with which he is associated or connected.

Footnotes:

1. For an excellent study of differing finance structures and criticism of an FI in an environmental context your attention is drawn to the 2017 Greenpeace report into financings in Indonesia with an alleged consequential destruction of rain forest. The financings criticised included underwriting an equity issue by a company for the purpose of investing in palm oil through general corporate lending to a holding company and specific project financings. This report illustrates both the significance and irrelevance of different financing structures in terms of the attributing of moral and possibly legal responsibility for providing finance.
2. The facts: In 2008 a loan was provided by financiers including IFC to finance a coal power plant which polluted the nearby sea destroying the livelihood of a fishing community. A report in 2011 by IFC's internal ombudsman found that IFC had not adequately considered the potential harmful effects of the project. Legal proceedings commenced in the US and IFC claimed blanket immunity from suit. In a celebrated judgement in 2019 the US Supreme Court said that international organisations such as IFC and the World bank only enjoyed the same immunity as a Sovereign State under US law which is not blanket, importantly excluding from immunity issues arising connected with commercial or business activities. The case went back to the District Court for Columbia which decided that the "core" or gravamen" of the acts complained of was not the approval and disbursement of the loan which took place in the US but the failure to supervise the building of the power plant which took place in India. The court then upheld the IFC's immunity on the basis that the activities complained of did not constitute "commercial activities" falling within the exemption to immunity.
3. The decision to plead immunity appears "wrong" but there will be internal reasons why the staff of the IFC felt compelled to do so based on their constitution and their perceived risks in not doing so. It also illustrates how analysis of the basic components of a tort and its location can affect the result.
4. Of note the proposed EU directive on mandatory HRDD will be relevant to providers of

finance and in particular project finance if its scope includes the full value chain but would not necessarily directly impact on financial institutions as regards their lending activities if it only regulated supply chains.

5. Caution: there is some confusion in the understanding of terms. "Duty of care" due diligence" "Impact assessment" "risk assessment". It is also often assumed but is not necessarily the case that liabilities for breach of a duty to conduct mandatory HR due diligence will be same as a breach of a direct duty of care to avoid adverse impacts in a group's supply chains. This needs further consideration especially in the light of experience gained in relation to the French law of Vigilance. There is also a necessary link between duties which arise in relation to group companies or suppliers and responsibilities for one's own direct acts (note, the attribution issue in a corporate context).
6. Begum v Maran is an interesting English Court of Appeal case and it may be significant. It involved a claim against a manager of ships who had sold the ship to a purchaser knowing that that purchaser would arrange for the ship to be broken in Bangladesh in a manner that posed both severe environmental and safety risks. The plaintiff was the widow of someone who had died in these unsafe conditions. As this was pre-trial the factual basis of the claim was assumed. This note is not intending to analyse the detail of how the English law of torts applies in this situation, but the approach of English Court of Appeal is striking in the way they refused to strike out what many would have thought was a far from straightforward claim, rightly. This ingenuity extended not only to the law of tort but also incidentally, to the law of time limitations. The difference in the analysis of the two Court of appeal judges is interesting on the link between contract and proximity. The harm in the Begum case was the death of a worker breaking a ship in Bangladesh. The ship was sold out of Singapore to a middleman who then sold it for breaking to a "yard" in Bangladesh. The contract under which it was sold included mandatory contractual provisions requiring the "safe" disposal for breaking of the ship, but it was inferred that the agent concerned (treated in these respects as the owner) knew that the ship would in fact be broken in the unsafe conditions of Bangladesh and that loss of life in this process was a likely outcome.

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