

What new standards on Responsible Business Conduct tell us about Contracting

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New standards on Responsible Business Conduct agreed at the OECD provide insights into how governments expect business to contribute to sustainable development as well as future regulatory trends.

The revised OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (the OECD Guidelines), published on 08 June 2023, set out recommendations provided by governments to multinational enterprises on how business should contribute to sustainable development and address adverse environmental and social impacts of their operations and in their supply chains.

Agreed by 51 States and developed in consultation with trade unions, business associations and civil society, the OECD Guidelines constitute multilaterally agreed standards that governments have committed to promoting globally.^[1] For companies seeking to adapt to shifting and complex social and environmental challenges, whilst aligning practices with new sustainability legislation, the Guidelines and associated due diligence guidance provide a blueprint for managing impacts on society and the environment across international value chains.

The OECD Guidelines provide the basis for various legislative initiatives and regulations,^[2] including new rules on human rights and environmental due diligence (HREDD) and sustainability reporting. The EU Corporate Sustainability Reporting Directive (CSRD) for instance, in force since January 2023, refers to the UN Guiding Principles on Business and Human Rights (UNGPs) and OECD Guidelines as the expected standard of business conduct. The proposed EU Corporate Sustainability Due Diligence Directive (CSDDD), currently being negotiated, references the OECD Guidelines as the expected approach to due diligence. Standards for responsible business conduct (RBC) set out in the OECD Guidelines are also being reflected in corporate governance standards, sustainable finance regulations and securities law.^[3] Through integration in both domestic and international policy frameworks, the OECD Guidelines both reinforce and shape both public and private

sector contributions to sustainable development.

Endorsed by the U.S., Japan, Brazil, Germany and the UK, the Guidelines reflect what key capital markets expect from business and provide insight into emerging regulatory trends. Whilst the form and speed of integration into policy frameworks may differ, reflecting contextual differences across jurisdictions, RBC is increasingly seen by policy makers as a keystone of strategies to promote green and equitable economic growth. The Guidelines are also being used by businesses, investors, benchmarking initiatives, and ESG rating and data providers to inform, assess and shape business strategy, investor stewardship and advocacy approaches.

Contracts sits at the core of modern business practices and create legal link across value chains. They are both operational and legal documents that tell parties what to do and can be enforced in court or by arbitration. Within this context, what can we infer from the revised Guidelines on where contracting sits within broader due diligence expectations?

Risk-shifting through contracts

The OECD Guidelines recommend that enterprises undertake risk-based due diligence to identify, prevent, mitigate, and account for how they address adverse social and environmental impacts. The concept of shared responsibility sits at the heart of effective HREDD. Each enterprise in a business relationship has its own responsibility to identify and address adverse impacts, and the lead firm, often the buyer of goods or services, plays a key role in promoting respect for human rights across its supply chains. The Guidelines are clear; effective HREDD does not shift responsibilities down the value chain.

Rather, companies should seek to establish the most effective means, through contracting and other interactions, to prevent and address adverse impacts. Contracts should incentivise open communication and understanding of RBC risks and include mutually beneficial responsibilities and governance structures to keep parties' expectations and interests aligned over the long term.

Traditional supply chain contracts tend to place much of the responsibility for human rights and environmental performance on suppliers. Alongside codes of conduct, contracts are the most widely used tool by companies for managing supply chain risks but are often mis-used when designed to manage company, rather than human rights risks.

A conventional contract will usually comprise a set of representations and warranties that the buyer presents to the supplier, setting out duties, responsibilities, and penalties. Contracts often state that the supplier will remain in compliance with the buyer's human rights standards and is responsible for human rights outcomes in its facilities and supply chain. This may include a commitment to prevent excessive working hours for instance. Such representations are often static, passive commitments that may not reflect the operating context, and may be very difficult or even impossible to adhere to.

Supplier-only responsibility clauses often don't reflect or price in the conduct of buyers, who may contribute positively or negatively to social and environmental outcomes through their purchasing practices. Suppliers are often asked to manage human rights under extreme commercial pressures which can result in negative human rights outcomes. Buyers may drive prices down, change order size or requirements, make last-minute design adaptations, or not communicate expectations clearly enough, which can causes delays that the supplier may then be penalised for through contract terms, and which may then impact on payment of workers' wages.

Firms that have made ambitious public commitments or developed human rights policies and supplier codes of conduct may not have contracts that support their own corporate objectives. Risk-shifting through traditional contracting practices undermines HREDD efforts, may conflict with the companies' disclosures on sustainability performance, and

undermine enterprise-wide sustainability goals. Put simply, traditional contracts that pass on human rights responsibilities to suppliers are incompatible with the UNGPs and OECD Guidelines.

The disconnect between policy and practice has been framed as a coherence gap.[4] This may not reflect the sincerity of often well-intentioned corporate commitments. The business may have developed stakeholder-orientated human rights targets and KPIs, and yet simultaneously be deploying contracting clauses that undermine their own efforts to meet such goals. Responsible contracting is therefore central to aligning commercial practices with human rights-related commitments and targets.

Responsibility for upholding human rights in supply chains is a shared responsibility. Robust risk management requires agreements and allocation of responsibilities that are supported, rather than extracting unrealistic commitments on compliance from business partners that foster a false sense of security, and disincentivises honest dialogue on challenges.

New expectations on tech and the environment

The *revised* OECD Guidelines clarify expectations on risk based due diligence, provide new guidance on environmental due diligence, and on mitigating risks resulting from the use of technology, amongst other issues. The Guidelines recommend for instance that risk-based due diligence addresses the development, financing, sale, licensing, trade and use of technology, including the gathering and use of data, where necessary. They encourage the adoption of responsible data governance practices, digital security risk management, and state that due diligence should take into account *known or reasonably foreseeable* circumstances related to the use of digital products or services. Contracts covering data stewardship, or the development or use of AI or other technologies, may require complimentary and supportive due diligence measures if business partners handle personal or sensitive data or are developing new technology for instance.

Arguably the most important new concepts in the revised Guidelines are those relating to environmental due diligence, and how responsible business conduct can help align business models with a just transition.[5] The Guidelines confirm the expectation that enterprises should use risk-based due diligence to assess and address adverse environmental impacts, and provide a new (and non-exhaustive) list of potential impacts, including a) climate change; b) biodiversity loss; c) degradation of land, marine and freshwater ecosystems; d) deforestation; e) air, water and soil pollution; and f) mismanagement of waste, including hazardous substances. This update aligns the Guidelines with the environmental objectives enshrined in the EU Taxonomy regulation.[6]

Expectations include the implementation of transition plans, as well as the adoption of short, medium and long-term science-based mitigation targets.[7] Businesses seeking to address environmental risks or health and safety impacts in value chains need to factor in the *capacity* of supply chain partners to meet these expectations, and not resort to simply delegating responsibilities through contractual provisions. Meeting ambitious new environmental targets may require a fundamental shift in business practices along with the provision of technical support and investment. The OECD Guidelines incentivise supply chain collaboration and stakeholder informed action on supply chain decarbonisation. Contracts which adopt 'cut-and-run' strategies to reduce scope 3 exposure, without actually contributing to real-economy decarbonisation, are inconsistent with this approach and may undermine HREDD efforts.

Contractual clauses can support the mitigation of adverse environmental and health and safety impacts by promoting transparency in supply chains, sharing of data, incentivising collaboration and building trust between companies and other stakeholders. This is particularly pertinent when an adverse impact is identified or reported. Remedies in

traditional contracts typically flow from the breaching party, which tend to be the supplier, to the non-breaching party, often the buyer, and not the victims of human rights-related breaches.

Such contractual terms may therefore fail to account for harm to stakeholders beyond the contracting parties, and yet may allow the buyer to suspend payment, terminate the contract, or sue the supplier for breach of contract, without giving the supplier an opportunity to fix the issue, even if the buyer contributed to the impact through its own purchasing practices. These traditional remedies ignore the need to address the grievances of those who are harmed by the breach.

Under the UNGPs and OECD Guidelines, both parties have a responsibility to identify serious human rights violations and ensure remediation is provided to victims. The Guidelines explicitly cover adverse impacts where a business has caused or contributed to the impact or where they are linked (e.g. through business practices, products or services). Business relationships include relationships beyond contractual, 'first tier' or immediate relationships. Furthermore, its relationship to adverse impacts is not static in that it will likely change depending on the context.[8] To align with the OECD Guidelines, contracts should therefore reflect a commitment by brands and buyers to collaborate in providing remedy, particularly if it contributed to the adverse impact through, for example, its own purchasing practices.

HRDD-aligned contracting

The revised Guidelines specifically recommend building expectations around responsible business conduct and due diligence specifically into commercial contracts.[9] The Responsible Contracting Project Toolkit supports integration of the UNGPs and the OECD Guidance into each stage of a contract. Designed by the Working Group of the American Bar Association Business Law Section, the toolkit supports businesses in protecting human rights through supply contracts. The Model Contract Clauses 2.0 (MCCs 2.0) and the Supplier Model Contract Clauses provide practical, free to access contractual templates, intended to help operationalize the shared-responsibility approach set out in the UNGPs and OECD Guidelines, and thereby close the coherence gap between corporate sustainability commitments and contracting practices. Businesses may introduce relevant aspects of the clauses into their international supply contracts in order to improve the performance of such contracts, and by extension, their own human rights performance and impacts.

Responsible contracting practices establish a stable and fair distribution of the costs of due diligence across the supply chain. They do not shift cost and responsibility towards suppliers or incentivise cut-and-run approaches. Responsible contracting is central to aligning business practices with the OECD Guidelines and UNGPs, new legislation on HREDD as well as evolving investor expectations on sustainability. Businesses who wish to demonstrate corporate leadership and increase supply chain resilience should adopt responsible contracting practices that situate shared responsibilities at the heart of their approach.

[1] The OECD Guidelines, as part of the OECD Declaration on International Investment and Multinational Enterprises, are open to adherence by non-OECD Members. As of 8 June 2023, 51 countries have adhered to the Declaration. All OECD Members are Adherents, as well as Argentina, Brazil, Bulgaria, Croatia, Egypt, Jordan, Kazakhstan, Morocco, Peru, Romania, Tunisia, Ukraine and Uruguay.

[2] OECD (2022), Stocktaking Report on the OECD Guidelines for Multinational Enterprises,

<https://mneguidelines.oecd.org/stocktaking-exercise-on-the-oecd-guidelines-for-multinational-enterprises.htm>

[3] See for instance Section 1502 of the US Dodd-Frank Act which provides that companies must report on whether they source certain minerals from conflict areas. The EU Sustainable Finance Disclosure Regulation (SFDR) introduces transparency rules for financial institutions on the integration of sustainability risks and impacts in their processes and financial products, including reporting on adherence to internationally recognized standards for due diligence, specifically that of the OECD. The EU Taxonomy Regulation and South Africa Green Finance Taxonomy both establish a list of environmentally sustainable economic activities and mandate compliance with the MNE Guidelines as minimum social safeguards. See also the G20/OECD Principles of Corporate Governance, 2023: <https://www.oecd.org/corporate/principles-corporate-governance/>

[4] Sharing Responsibility for Human Rights in Contracts. Bloomberg Law. Olivia Windham Stewart and Sarah Dadush. September 2021. <https://www.bloomberglaw.com/external/document/X8VLBTRO000000/commercial-professional-perspective-sharing-responsibility-for-h>

[5] OECD (2021), The role of OECD instruments on responsible business conduct in progressing environmental objectives. <https://mneguidelines.oecd.org/The-role-of-OECD-instruments-on-responsible-business-conduct-in-progressing-environmental-objectives.pdf>

[6] The Taxonomy Regulation establishes six climate and environmental objectives: i) Climate change mitigation, ii) Climate change adaptation; iii) The sustainable use and protection of water and marine resources; iv) The transition to a circular economy; v) Pollution prevention and control; vi) The protection and restoration of biodiversity and ecosystems. See Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (Text with EEA relevance). <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852>

[7] OECD Guidelines for MNEs on Responsible Business Contract. 2023. Commentary on Chapter VI: Environment, 77.

[8] OECD Guidelines for MNEs on Responsible Business Contract. 2023. Commentary on Chapter II: General Policies, 16, 17.

[9] OECD Guidelines for MNEs on Responsible Business Contract. 2023. Commentary on Chapter II: General Policies, 23.

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