

# Proactive contracting principles - How to facilitate companies' human rights due diligence work in global supply chains?

April 23, 2024

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### Ingress:

The evolving landscape of corporate sustainability necessitates innovative approaches to human rights due diligence (HRDD) and contracting. Recently, we published an open access article on how *proactive contract theory* could be used to translate the ambitious objectives of the upcoming EU's Directive on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (later CSDDD) into actual business practices within complex value chains and networks. In the article, we propose four avenues for sustainable contracting practices via proactive contracting. In this blogpost, we summarize these proposals and discuss their relation to the forthcoming HRDD legislation and the principles of responsible contracting.

### The EU CSDDD

The EU CSDDD represents a significant regulatory effort to align companies' due diligence requirements with the United Nations Guiding Principles on Business and Human Rights. Despite the latest political compromises in early 2024, the final compromise text of the CSDD dated March 2024 incorporates the due diligence process outlined by the UNGPs. It underscores the necessity for companies to integrate sustainability into their policies and management systems, encompassing the identification, prevention, and mitigation of adverse human rights and environmental impacts. Proactive contract theory plays a crucial role in translating these abstract obligations into specific contracting practices, fostering shared responsibility and collaboration in supply chains.

## Proactive Contract Theory – A Paradigm Shift in Contracting

Proactive contract theory, developed through collaboration between Nordic academics and practitioners at the turn of the millennium, regards contracts as legal, economic, managerial, and social tools designed to prevent undesirable outcomes and promote favorable ones. It aligns well with recent developments in corporate sustainability legislation, such as Responsible Contracting Project (RCP), as it underscores the need for collaboration, trust, and achieving a balanced relationship between contracting parties. In contrast to RCP and responsible contracting principles, proactive contract theory promotes multi-professional collaboration and the application of information design principles, including user-centricity and design-based methods – such as experimentation, prototyping, and user-testing – in the contract design process. Therefore, proactive contract theory can enhance responsible contracting principles, aiding in the practical application of sustainable contracting practices within complex value chains.

## Implementing Proactive Contracting in Supply Chains

In the article, we introduce four ways to promote corporate sustainability due diligence in supply contracts through proactive contracting:

- Shifting from one-sided safeguarding to shared responsibility and collaboration: This entails moving from risk-shifting contracts that are one-sided to contracts that are more balanced and fairer, fostering collaboration by including guiding principles and processes to sustain and develop collaboration. This aligns with the first principle of responsible contracting, which concerns the responsible allocation of risks and responsibilities.
- Incentivizing responsible and sustainable business practices with promotive contract clauses: We advocate for promotive contract framing, wherein goals are presented as opportunities and safeguards are expressed as rewards, rather than using typical purchasing contracts that unilaterally emphasize the supplier's responsibilities and penalties for non-compliance. Parties, for instance, could be motivated to undertake more ambitious sustainability tasks under a contract that permits either party to unilaterally renew the agreement if it successfully meets its corporate sustainability obligations. Another example is pricing schemes with bonus systems that take effect when the parties surpass their sustainability objectives, illustrating a promotively framed sustainability clause.
- Engaging end users in the contract design process: We recommend that companies design their purchase contracts and supplier codes of conduct at least with their first-tier suppliers and ideally involve other stakeholders, such as upstream workers' representatives. This could translate to industry-wide initiatives (see e.g. Home – STTIcom), which the EU CSDDD also cites as an appropriate tool to aid in fulfilling company obligations. Furthermore, the collaborative contract design process should incorporate insights from information design research, considering factors such as literacy proficiencies, memory, information processing and overload, and comprehension. Research related to these topics is relevant and timely, because the language used in these contracts should not obscure the parties' commitments (see the Research Project Jargonfree)
- Preventing disputes: While acknowledging EU CSDDD Article 22 on civil liability, we propose that conscientious contract design can forestall disputes. A design process that includes contracting parties and relevant stakeholders allows for a proactive discussion of needs, the anticipation and addressing of potential issues before they arise. If issues do occur, programs that facilitate the review and enhancement of collaboration, as well as learning from past experiences, provide a framework to examine the fundamental reasons for these issues. Once identified and deliberated, companies can formulate and execute a remediation plan, adjusting processes and contract clauses to avert similar future conflicts.

Although our article discusses the four proposals in the context of the EU CSDDD, they can be adapted to other HRDD legislation, such as the German Supply Chain Due Diligence Act

(GSCDDA). As highlighted in a recent blog post by Michaela Streibelt and Daniel Schönfelder, the GSCDDA mandates that German companies conduct HRDD, underscoring shared responsibility and collaboration in supply chains. It emphasizes the necessity for equitable burden-sharing and responsible contracting, which are in harmony with the tenets of proactive contract theory.

### **Future Directions and Global Implications**

The principles of proactive contract theory, combined with regulatory frameworks like the EU CSDDD or GSCDDA, pave the way for a new era in corporate sustainability. This approach necessitates a fundamental shift in the mindset of businesses, from mere compliance to active responsibility. The future is likely to witness a burgeoning adoption of corporate sustainability-related model clauses rooted in the principles of responsible contracting and proactive contract theory, as companies endeavor to fulfill new obligations and maintain the essence of sustainability and human rights due diligence globally.

**Suggested citation:** J. Saloranta and A. Hurmerinta-Haanpää, 'Proactive contracting principles – How to facilitate companies' human rights due diligence work in global supply chains?', Nova Centre on Business, Human Rights and the Environment Blog, 23rd April 2024