

A large, stylized blue hand graphic is positioned in the background, with fingers spread. It is semi-transparent, allowing the text to be seen through it. The hand is oriented with the palm facing upwards and slightly to the right.

# INVESTOR GUIDANCE ON RESPONSIBLE CONTRACTING

---

# ACKNOWLEDGEMENTS

The Investor Guidance is the product of a collaboration between the ICCR and the Responsible Contracting Project and nothing contained herein, including the clauses to be considered for adoption, is intended, nor should it be considered, as the rendering of legal advice for specific cases or particular situations. Readers are responsible for obtaining such advice from their own legal counsel. The Investor Guidance is intended for educational and informational purposes only.

Designed by Molly Conley

## **Reproduction Note/Copyright:**

©2024 by ICCR. All rights reserved. Material in this report (including text and any charts/illustrations) may not be copied or duplicated in whole or part by any means without express prior agreement in writing. Some photographs or documents contained in this publication may be the copyrighted property of others; acknowledgment of those copyrights is herein given. All such material is used with the permission of the owner.

Readers shall not use, redistribute or transfer content contained in the publication for any commercial purpose, including but not limited to the republication or sale of information, services, or resources contained therein.

MARCH 2024

## **Photo credits:**

Cover vector graphic: KreativKolors/Shutterstock.com;  
Page 5: Petr Magera unsplash; Page 6: OECD; Page 7: Pinar Alver/Shutterstock.com; Page 8: Valentina Gurney; Page 9: Responsible Contracting Project; Page 10: Valentina Gurney; Page 12: humphery/shutterstock.com.

Interfaith Center on Corporate Responsibility  
475 Riverside Drive, Suite 1842  
New York, NY 10115

Visit us online at [www.iccr.org](http://www.iccr.org)

## **About the Interfaith Center on Corporate Responsibility (ICCR):**

The Interfaith Center on Corporate Responsibility (ICCR) is a broad coalition of more than 300 institutional investors collectively representing over \$4 trillion in invested capital. ICCR members, a cross-section of faith-based investors, asset managers, pension funds, foundations, and other long-term institutional investors, have over 50 years of experience engaging with companies on environmental, social, and governance (“ESG”) issues that are critical to long-term value creation. ICCR members engage hundreds of corporations annually to foster greater corporate accountability. Visit our website [www.iccr.org](http://www.iccr.org).

## **About Responsible Contracting Project:**

The Responsible Contracting Project (RCP) works to improve human rights in global supply chains by developing and disseminating practical tools to implement human rights and environmental due diligence (HREDD) in commercial contracts. Our international team of legal and business and human rights experts collaborates with companies, investors, and public and private standard setters to achieve uptake and implementation of the core RCP Principles, which operationalize the shared-responsibility approach to HREDD enshrined in the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, and the OECD Due Diligence Guidance for Responsible Business Conduct.

# TABLE OF CONTENTS

<b>4</b>	<b>INTRODUCTION</b>
<b>6</b>	<b>PART 1: BACKGROUND ON THE WHY AND THE WHAT OF RESPONSIBLE CONTRACTING</b>
6	What is human rights and environmental due diligence (HREDD)?
6	Why are contracts important for promoting human rights in global supply chains?
8	What are responsible contracts?
9	How is contracting relevant to HREDD?
10	Why should investors care about contracts?
11	Why is HREDD-alignment so important? The turn toward mandatory HREDD legislation.
<b>13</b>	<b>PART 2: INVESTOR TOOLS: ENGAGEMENT QUESTIONS AND ENGAGEMENT LETTERS</b>
13	Questions to pose to companies to assess integration of responsible contracting principles
15	Template corporate engagement letter
17	Template shareholder proposal on responsible contracting
19	Questions to anticipate in corporate dialogues



# INTRODUCTION

In recent years, we have witnessed a major shift in how corporate stakeholders—investors, shareholders, employees, consumers, communities—understand the content of responsible business conduct. For investors, this shift is manifesting in new approaches to company engagement, first because of ethical concerns, then because of ESG concerns, and now, increasingly, because of legal concerns. The legal landscape is rapidly evolving with the adoption of new hard law like the French [Duty of Vigilance](#) law, the German [Supply Chain Due Diligence Act](#) (LkSG), the [Norwegian Transparency Act](#), and perhaps eventually the [European Union \(EU\) Corporate Sustainability Due Diligence Directive](#) (CS3D),<sup>1</sup> all of which require large businesses to conduct ongoing, risk-based, human rights and environmental due diligence (HREDD) throughout their supply chains. In the United States and Europe, trade sanctions regimes such as the [US Tariff Act of 1930](#), the [Uyghur Forced Labor Prevention Act](#) (UFLPA), and the proposed [regulation on prohibiting goods made with forced labour on the Union market](#) (proposed EU Import Ban) are also pushing companies to carry out more and better due diligence in their supply chains to ensure that the goods they want to bring into and sell in the US and EU are not made with forced labor.

From the investor perspective, determining the magnitude of the risk of operational disruptions, reputational damage, regulatory fines, litigation, and trade sanctions related to a target company's or existing portfolio company's human rights and environmental (HRE) performance is key for making investment and divestment or sale decisions. With HRE performance becoming an increasingly important component of companies' financial performance, investors are understandably interested in learning more about how to engage with portfolio companies to achieve better HRE outcomes.

This Investor Guidance aims to explain the critical role that contracts play in supporting more robust HREDD processes. Contracts make the commitment to HREDD between buyers and suppliers across the supply chain legally binding. They also facilitate the flow of information between the contracting parties

and across the supply chain. That information can be used for multiple purposes, including to better equip portfolio companies to conduct comprehensive HREDD and prevent adverse HRE impacts, address inquiries from regulators, such as the U.S. Customs and Border Protection (CBP) agency, report on non-

**For HREDD to be effective, companies should move away from the traditional one-sided, strict compliance model of contracting toward a due diligence-aligned model that is dynamic, responsive, cooperation-based, and supported by responsible purchasing practices**

financial performance in accordance with the EU [Corporate Sustainability Reporting Directive](#) (CSRD), and to provide more effective and speedy HRE remediation, when/as needed.

This Investor Guidance recommends that investors engage with their portfolio companies to ensure that they are using their supply contracts to support—not undermine—effective HREDD processes. For HREDD to be effective, companies should move away from the traditional one-sided, strict compliance model of contracting toward a due diligence-aligned model that is dynamic, responsive, cooperation-based, and supported by responsible purchasing practices. This Investor Guidance equips investors with the conceptual and practical tools for carrying out such engagement.

To serve as effective components of HREDD processes and a robust risk-management regime, this Guidance recommends that companies align their contracts with the [United Nations Guiding Principles for Business and Human Rights](#) (UNGPs), the Organisation for Economic Cooperation and Development's (OECD) [Guidelines for Multinational Enterprises on Responsible Business Conduct](#), and the [Due Diligence Guidance for](#)

<sup>1</sup> For a comparison of the proposals put forth by the Commission, Parliament, and Council, see <https://drive.google.com/file/d/1Akl0Hr2obZMZrTDV5DmGflivKugnGRcn/view>

[Responsible Business Conduct](#), and other sector-specific OECD guidance (together, the OECD Guidance). Engaging with portfolio companies as recommended in this Guidance would equip institutional investors to better adhere to the [Principles for Responsible Investment](#) and to the recommendations set out in the OECD report on [Responsible Business Conduct for Institutional Investors](#).

This Investor Guidance, which was prepared by the [Interfaith Center on Corporate Responsibility](#) (ICCR) and the [Responsible Contracting Project](#) (RCP), draws heavily on RCP's [core principles](#) of responsible contracting and on the RCP [Toolkit](#), which take the UNGPs and the OECD Guidance as their starting point. The Toolkit offers practical, immediately usable, and versatile tools to assist companies, the internal and external counsel that advise them, and their stakeholders to operationalize a due-diligence-aligned, shared-responsibility approach to contracting.

ICCR and its Members have long challenged companies to be responsible corporate actors, using a varied set of tools including investor statements, corporate engagement letters, and

shareholder resolutions. This Investor Guidance is intended to help investors introduce responsible contracting principles into their corporate engagements. ICCR and its Members support the focus on prevention embodied in RCP's core principles and believe that the RCP Toolkit is a vital tool for promoting prevention and remediation, as well as compliance with regulatory and legal obligations.

Below in [Part I](#), you will find some background on responsible contracting, how it fits into HREDD, and why investors should pay attention to contracts. In [Part II](#), you will find some investor tools for company engagement, including (i) questions investors may want to ask their portfolio companies concerning their contracts, (ii) a template corporate engagement letter and a template shareholder resolution, as well as (iii) responses to anticipated pushback investors may receive from companies during corporate dialogues – we refer to these as Frequent Pushbacks or FPBs.



# 1 BACKGROUND ON THE WHY AND THE WHAT OF RESPONSIBLE CONTRACTING

## What is human rights and environmental due diligence (HREDD)?

HREDD is a dynamic, ongoing process whereby companies must identify, prevent, mitigate, account for and, where appropriate, remediate any potential or actual adverse human rights impacts (Adverse Impacts) in their supply chain. The concept of HREDD is enshrined in the UNGPs and the OECD Guidance ([see links on page 4](#)). For more information on the due diligence process and supporting measures, please consult these instruments.

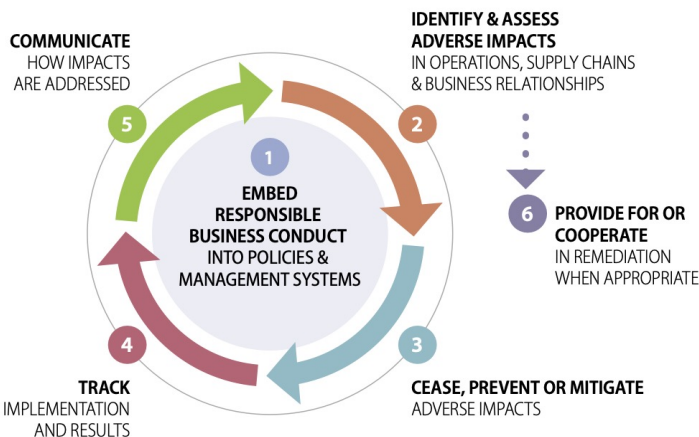


Fig. 1 The Due Diligence Process and Supporting Measures, OECD Due Diligence Guidance for Responsible Business Conduct, Pg. 21

What is critical to understand about HREDD is that its overriding objective is to **prevent** adverse impacts from occurring. While HREDD certainly contemplates and emphasizes the importance of providing remedy to adversely impacted stakeholders/rights-holders if an actual adverse impact occurs, the emphasis is on taking proactive measures to prevent adverse impact from occurring in the first place.

As such, HREDD is first and foremost a forward-looking, risk management regime. It does not expect perfection, it expects continuous improvement and best efforts to prevent harm and provide remedy if a harm occurs. To be effective at preventing adverse HRE impacts, HREDD processes and measures must be

designed to proactively and responsively **manage** HRE risk to prevent such risks from escalating into actual adverse impacts. In sum, with HREDD, the inquiry does not stop at the question, “Are there any human rights risks in your supply chain?” because there almost always are such risks.<sup>2</sup> Rather, HREDD goes on to ask: “What are the companies involved doing, in an on-going, dynamic fashion, to mitigate identified risks to prevent them from graduating into harm?” And, if prevention is unsuccessful and/or something bad happens, HREDD asks: “What are the companies involved doing to remedy the situation to ensure the adverse impact stops and that the victim(s) are restored to the position they were in prior to the impact?”

## Why are contracts important for promoting human rights in global supply chains?

Along with supplier codes of conduct, contracts are the most widely used tool for managing supply chain risks, including HRE risks. Contracts take a company’s policies, which, on their own, are unenforceable, non-binding documents, and make them binding. Otherwise put, when HRE policies are incorporated in contracts, they become legally binding and enforceable. Contracts therefore make soft policies hard and make it possible for these policies to “go global” by binding parties operating in different parts and legal jurisdictions of the world.

Unfortunately, although contracts are widely used to manage supply chain risks, they are typically *misused* for purposes of managing HRE risks. All too often, companies use their contracts to shift HRE risks and responsibilities onto their contract counterparties and other actors in their supply chains.

<sup>2</sup> See also, Managing Human Rights Risks: What Data Do Investors Need? December 2022, <https://www.unpri.org/download?ac=17543>

Unfortunately, although contracts are widely used to manage supply chain risks, they are typically misused for purposes of managing HRE risks. All too often, companies use their contracts to shift HRE risks and responsibilities onto their contract counterparties and other actors in their supply chains.

The responsibility for mitigating HRE risks is typically placed on the shoulders of the less powerful party (usually the producer-country supplier) by the more powerful party (usually the consumer-facing buyer / brand / retailer), with little acknowledgement that HRE risk may be caused in whole or in part by the acts (e.g., purchasing practices) and omissions (e.g., lack of assistance) of the more powerful party. To formalize this type of risk-shifting, suppliers are frequently required to make a contractual promise (by way of a representation or a warranty) that there are no HRE violations anywhere in the supply chain and that all is perfect. Such promises are unrealistic because there is no such thing as a perfectly clean supply chain, but they are also dangerous because they incentivize suppliers to hide infractions out of fear of losing the contract and to push infractions further out of the buyer's view, where they are even less likely to be addressed.

In addition to bearing the bulk of the contractual risk, suppliers are often expected to assume the costs associated with upholding HRE standards, usually without support, financial or otherwise, from their buyers. Moreover, suppliers often contend with prices that do not cover the costs of production, let alone the costs associated with responsible business conduct, and other poor purchasing practices.<sup>3</sup> These dynamics combine to create serious commercial pressures on suppliers, which are passed on to workers and their communities.<sup>4</sup>

While risk-shifting may be effective for some aspects of supply chain risk management, it is ineffective, and even dangerous, for purposes of managing HRE risks. A key take-away from this Investor Guidance is that, when it comes to preventing adverse HRE impacts, **risk-shifting is not the same thing as**

**The most effective way to manage HRE risks is to proactively mitigate them to prevent their escalation into harm or actual adverse impacts. And this is what HREDD is all about—prevention.**



<sup>3</sup> Examples of poor purchasing practices include: imposing prices that are too low to cover production costs (including labor costs); making last-minute changes to orders; requiring suppliers to assume HRE-related costs without providing additional—technical or financial—assistance; making unfair retroactive modifications to payment terms (e.g., asking for steep discounts after the order has been completed or shipped); inaccurate forecasting of how much of suppliers' production capacity should be reserved and not paying for unused reserved capacity; short turnaround on delivery of goods, accompanied by steep penalties for delays; and irresponsible exit.

<sup>4</sup> For example, in the face of COVID-related lockdowns, many buyers unilaterally invoked force majeure clauses in their contracts to get out of their contractual obligations to purchase from suppliers without considering the human rights impacts of their decisions. Suppliers, in turn, reduced their labor forces, passing on the economic impact to workers (and their families and communities). The order cancellations also generated a serious wage theft epidemic, whereby millions of dollars of wages – for completed work – were never paid to workers. For example, Ramatex, a Nike supplier, closed a factory during the pandemic and failed to make required severance payments to over 1,500 workers. Neither Ramatex nor Nike have compensated the workers to date, despite public reporting on the issue, and repeated investor inquiries.

**risk management.** Risk-shifting contracts tend to aggravate HRE risks, not mitigate them. Investors should understand that when their investees use their supply chain contracts to shift HRE risks onto their business partners and suppliers, this is unlikely to support effective HRE risk management or better HRE outcomes.

The most effective way to manage HRE risks is to proactively mitigate them to prevent their escalation into harm or actual adverse impacts. And this is what HREDD is all about—**prevention.** As explained below, moving toward responsible contracting is not only more effective for preventing and remedying adverse impacts, but also for achieving compliance with rapidly-evolving legal requirements, including the new HREDD laws, sustainability reporting laws, and trade sanctions laws.

To serve as effective components of HREDD processes, supply chain contracts should move toward a responsible contracting model whereby both parties commit to cooperate in carrying out ongoing, risk-based HREDD, to share responsibility for upholding HRE standards, and to cooperate to provide remedy to victims in the event of an actual adverse impact. The shared-responsibility

approach supports more balanced buyer-supplier relations and more effective implementation of human rights policies and risk-management processes that can in turn support better HRE outcomes in global supply chains. It also enables better legal compliance.

## What are responsible contracts?

The RCP Toolkit contains several tools that can be employed to support better contracting practices that in turn support better HRE outcomes and better legal compliance. It is comprised of:

- the [Model Contract Clauses 2.0](#) (MCCs 2.0);<sup>5</sup>
- the [Responsible Purchaser Code of Conduct](#) (Buyer Code);
- the [Supplier Model Contract Clauses](#) (SMCs 1.0);<sup>6</sup> and
- the [European Model Clauses](#) (EMCs) (forthcoming as a Zero Draft for public consultation in Spring 2024).<sup>7</sup>

The MCCs 2.0, the SMCs, and the EMCs (together, the Clauses) are template contractual provisions designed to help buyers and suppliers [better respect human rights in their supply chains](#). The Clauses are designed to give the parties and their counsel a starting point to contractually codify HREDD processes for purposes of improving HRE outcomes in their supply chains. They achieve this by translating the shared-responsibility principles enshrined in the UNGPs and the OECD Guidance into contractual obligations.

The Clauses are modular, meaning they are designed to be selected, edited, and adapted by adopting companies. As such, the Clauses are not a one size fits all, and simple copying and pasting should be avoided. Rather, the Clauses should be selected and tailored by internal and external counsel according to the specific needs of the contracting parties as part of the companies’ due diligence processes.



Retained worker passports, Thailand. Courtesy, Valentina Gurney

<sup>5</sup> The MCCs 2.0 and the Buyer Code were developed by a working group formed under the auspices of the American Bar Association’s (ABA) Business Law Section and published in 2021.

<sup>6</sup> The SMCs 1.0 were developed by RCP in collaboration with the German development agency, GIZ, and the Sustainable Terms of Trade Initiative specifically to respond to a request from apparel manufacturers and suppliers for contractual tools to bring into negotiations with brands. The SMCs 1.0 were published in September 2023. A simplified version of the SMCs is forthcoming in 2024, along with a SMC Drafting Guide.

<sup>7</sup> The EMCs adapt the MCCs 2.0 for the more capacious and demanding European legal context. The EMCs are being developed by the European Working Group, an independent working group composed of legal practitioners and academics representing France, Germany, Italy, the Netherlands, Poland, Portugal, and Spain, as well as legal experts from the UK and the US.



The Clauses reflect the three [core principles](#) of responsible contracting or the 3 “Rs” of responsible contracting:

1. **Responsible allocation of risks and responsibilities:** First, the parties should abandon static, one-sided, supplier-only promises (“representations & warranties”) of perfect HRE compliance that are both unrealistic and dangerous. In their place, buyers and suppliers should make a joint commitment to cooperate in conducting ongoing, risk-based, HREDD.
2. **Responsible purchasing practices:** Second, buyers should agree to support their suppliers’ HRE performance and, by extension, the HREDD process, by engaging in responsible purchasing practices.
3. **Remediation first and responsible exit:** Third, if an adverse impact occurs, the parties should prioritize victim-centered human rights remediation over traditional contract remedies, such as suspending payments, canceling orders, or terminating the contract. Measures should be taken to ensure the harm stops and does not reoccur. Exit should be pursued only as a last resort, after remediation efforts have failed or it becomes clear that staying engaged will further aggravate HRE risks. Regardless of the reason for exit (e.g., changed market conditions, a force majeure event like a

pandemic or a war, a Zero Tolerance HRE violation, or an unremediable adverse impact), the party wanting to exit should do so responsibly, by taking measures to mitigate related adverse HRE impacts.

## How is contracting relevant to HREDD?

Contracts are a mechanism for allocating risks, rights, and obligations between the parties—the buyer (and/or its representatives) and the supplier. How supply contracts are negotiated, the terms they contain, and their performance—how buyers and suppliers play out their contractual relationship— affects how well the human rights of workers are protected and how environmentally safe their communities will be. Used properly, contracts can function as a key component of HREDD.

Most traditional contracts rely on unrealistic promises of perfection and often place the supplier in breach of contract on day 1; these are out of sync with the HREDD approach. In addition, traditional contracts are generally focused on mitigating company risk, which is distinct from HRE risk. Furthermore, traditional contracting overlooks the buyer’s responsibility to manage its own actions and behaviors in such a way that supports—rather than undermines—positive HRE outcomes, while HREDD recognizes that a buyer’s own behavior, including

Conventional Contracts	HREDD–Aligned Contracts
<p><b>Static, Supplier-only</b> promises of perfect compliance (Reps &amp; Warranties)</p> <p><b>Supplier is solely</b> responsible for human rights:</p> <ul style="list-style-type: none"> <li>● Only Supplier can be in “social breach”</li> <li>● Supplier has no right to cure</li> <li>● Buyer can terminate immediately</li> </ul> <p><b>Remedies</b> for social breach flow from Supplier to Buyer + neither party has obligation to provide remedy to victims</p>	<p><b>Joint</b> obligation to carry out ongoing, risk-based HREDD</p> <p><b>Shared</b> responsibility for human rights:</p> <ul style="list-style-type: none"> <li>● Buyer commits to responsible purchasing practices as part of its HREDD, including: <ul style="list-style-type: none"> <li>○ Responsible pricing</li> <li>○ Providing reasonable assistance to supplier</li> <li>○ Responsible change orders &amp; modifications</li> <li>○ Responsible exit (COVID)</li> </ul> </li> </ul> <p><b>HRE remediation</b> <i>before or in conjunction with</i> traditional contract remedies -- provided <u>jointly</u> if Buyer contributed to the adverse impact</p>

its purchasing practices, can significantly contribute to adverse impacts. Finally, traditional contracts prioritize contract remedies that flow between the parties—not to victims—such as suspension of performance or payments, rejection of goods, immediate termination, and money damages, while HREDD requires that the parties (buyer and supplier) provide for, or cooperate in providing, remediation to the adversely impacted stakeholders. For these reasons, traditional contracts are often used to allow buyers to contract out of their HRE-related responsibilities instead of discharging them.

When it comes to managing HRE risks, then, HREDD places cooperation, prevention, and remediation far ahead of termination—precisely the opposite of what is achieved through traditional contracts. And since, as discussed below, HREDD, and more specifically, effective HREDD, is now becoming a legal requirement for many companies through new legislation, the inconsistency between traditional contracts and responsible, due diligence-aligned contracts should matter to investors.

## Why should investors care about contracts?

Investors should care about responsible contracting for several reasons related to their corporate engagements, as well as to their own obligations as responsible investors.

On company compliance: First, as discussed above, companies that adopt (and adapt) the responsible contracting tools effectively could achieve alignment with the UNGPs and the OECD Guidelines, as well as better legal and regulatory compliance.

Second, responsible procurement or purchasing is a key element of responsible business conduct, as well as prudent long-term, risk-sensitive business governance. [Know the Chain](#) (KTC) benchmarks companies across the food and beverage, footwear and apparel, and information and communications technology sectors and reviews purchasing practices as part of its evaluation process. In 2020, the average score on purchasing practices was 23 out of 100 across all three sectors, making [purchasing practices](#) one of the lowest scoring factors in the benchmark. This means that companies across all three of these sectors are either engaging in unethical recruitment practices or have yet to integrate human rights obligations into their relationships with their suppliers. This can lead to material risk in the short and long term. Supply chain instability may result in negative performance in the short term, while investments in a cooperative relationship

**Most traditional contracts rely on unrealistic promises of perfection and often place the supplier in breach of contract on day 1; these are out of sync with the HREDD approach.**



Worker paystub indicating unsanctioned deductions by employers, Thailand. Courtesy Valentina Gurney

between buyer and supplier that avoids such disruption can decrease turnover, increase resilience, and foster a healthier and more productive workforce. In addition, there is a growing body of research indicating that companies that are stronger on ESG metrics tend to perform better over time and present less investment risk (e.g., less litigation risk, less reputational risk, greater sustainability). Long-term risk analysis is particularly essential for pensions and index investors required to maintain their investments in a company for as long as the company is in the index, which could be decades.

With the RCP Toolkit, investors have a tool to use with companies to improve their financial, as well as HRE performance. Contractual provisions, such as those contained in the RCP Toolkit, are a valuable tool for investors to clarify expectations with portfolio companies regarding ESG-related performance, validation, and data reporting. Indeed, large institutional investors are leading the call for decision-useful information on a company's performance on ESG factors. The most significant ESG disclosure drivers for companies are the evolving legislative and regulatory requirements, such as the CSRD; the continuing integration by mainstream investors of ESG factors into investment decisions, ongoing portfolio monitoring, and

engagement; and the proliferation of impact funds, or funds that are formed with the intent of achieving a specific ESG-related impact alongside risk-adjusted financial returns.

*On investor compliance:* Finally, while neither the UNGPs nor the OECD Guidelines explicitly outline a role for investors in supporting HRE outcomes, the obligation to avoid causing or contributing (and preventing and mitigating) adverse impacts applies to all business sectors. The OECD's report, [Responsible Business Conduct for Institutional Investors: Key Considerations for Due Diligence under the OECD Guidelines for Multinational Enterprises](#), makes clear that institutional investors have an obligation to conduct due diligence across their investment portfolios to assess the HRE risk associated with particular investments. Specifically, they should: 1) adopt HREDD-aligned policies and management systems for investors; 2) identify actual and potential adverse impacts within (potential) investment portfolios; 3) use their leverage to influence investee companies causing an adverse impact to prevent or mitigate that impact and; 4) document, track, and communicate about the manner in which adverse impacts are addressed by the portfolio company and the investor; and 5) provide remediation where the investor has caused or contributed to an adverse impact.

Investors should shoulder their responsibility under the UNGPs and the OECD Guidelines, as well as watch legal developments closely and equip themselves to engage with companies on how they are integrating HRE matters and, when applicable, HREDD requirements, into their processes, including their supply contracts.<sup>8</sup> They should use their leverage to promote a different, due diligence-aligned approach to contracting (supported by responsible purchasing practices) referred to here as responsible contracting.

## Why is HREDD-alignment so important? The turn toward mandatory HREDD legislation.

HREDD, as set out in the UNGPs and OECD Guidance, is the foremost standard for managing human rights impacts in supply chains. Although these international instruments remain 'soft law' in most jurisdictions, an increasing number of national and supranational laws are either in force or coming into existence

requiring in-scope companies to conduct HREDD in their own operations and supply chains in line with the UNGPs and OECD Guidance.

Examples of mandatory human rights and environmental due diligence (HREDD) laws and sustainability disclosure laws already enacted include:

- The German Supply Chain Due Diligence Act (LkSG), in force since January 2023
- The Corporate Sustainability Reporting Directive, in force since January 2023
- The Norwegian Supply Chain Transparency Act, in force since July 2022
- The French Duty of Vigilance Law, in force since March 2017

As concerns compliance with the LkSG, which is already in force in Germany, the German Helpdesk on Business and Human Rights (a governmental entity), in collaboration with the BAFA, the regulatory authority that is in charge of enforcing the German Supply Chain Act, recently published guidance clarifying that contracts cannot be used to shift responsibility and that contracts are a type of preventive measure that must be designed in an effective fashion to be compliant with the law (see [here](#) for an English-language opinion on this). The guidance uses the term "shared responsibility" throughout the text, emphasizing the no-shift point. Thus traditional contracts, which tend to focus on risk-shifting techniques for governing human rights risks and are ineffective with respect to mitigating these risks, let alone remedying actual adverse impacts, are likely to be viewed as non-compliant with the German law.

Another law of interest to investors and that is already in force in the EU is the CSRD, which requires large companies to make sustainability related disclosures based on a "double materiality" standard. Under that standard, companies must report on: (1) the impacts of their activities on people and the environment, and (2) how they are being affected and expect to be affected by sustainability matters. The contents of these reports could affect portfolio companies' share prices, but also serve as a kind of HREDD alarm system in that, if a company's reports reveal many or significant HRE issues, that could indicate that there will be

<sup>8</sup> Investors were included in an earlier draft of the CS3D. Article 8a required institutional investors and asset managers "to engage with the investee company and exercise voting rights . . . in order to induce the management body of an investee company to bring the actual [adverse impact] to an end or minimize its extent." While inclusion of the financial sector in due diligence obligations was reserved for a future date (and the future of the CS3D is uncertain), investors may, in future, need to get ready to meet new legal requirements.



other compliance problems down the line under the HREDD laws (especially if the CS3D is eventually adopted in the EU).

Yet another significant development is the EU Taxonomy Regulation. A cornerstone of the EU's sustainable finance framework, the [EU Taxonomy Regulation](#) helps direct investments to the economic activities most needed for a just transition in line with the European Green Deal objectives. The Taxonomy is designed to ensure that investments or activities labeled as "Taxonomy-aligned" meet certain minimum governance standards and do not violate social norms, including human rights and labour rights. The Regulation specifies that one of the three criteria for economic activities to be considered sustainable is that they are "carried out in compliance with the minimum safeguards."<sup>9</sup> This includes an assessment as to whether or not the company has established an adequate HREDD process as outlined in the UNGPs and OECD Guidance. Contracting practices form a critical component of broader HREDD practices and should be considered in the evaluations of UNGP-alignment.

The EU is also in the process of negotiating the final text of the CS3D under which companies that generate above a certain threshold of revenue within the EU—regardless of whether they are EU companies—will be required to conduct HREDD within their own operations and supply chains. At this time, the latest consensus text for the CS3D clearly articulates that contracts should not be used to transfer HREDD-related responsibilities

from in-scope companies to other companies (e.g., suppliers) in their supply chains. Additionally, responsible purchasing practices (e.g., fair pricing that covers a living wage or a minimum wage, whichever is higher, and providing assistance to business partners to uphold HRE standards) are discussed in the text as an important component of effective HREDD.

As such, rather than pursuing the traditional, risk-shifting contracting approach, in-scope companies would be better off proactively aligning their contracts with due diligence principles, as proposed in the SMCs, the MCCs 2.0, the EMCs, and the broader, still-expanding RCP Toolkit, which will soon include Responsible Investor Model Clauses (RIMCs). All of the Clauses in the RCP Toolkit are drafted to align with both best practice and existing and emerging legislation.

In addition, the due diligence processes that underlie a commitment to responsible contracting will also better position companies to avoid importing goods made with forced labor into the United States, risking enforcement under the Tariff Act of 1930 or the UFLPA. In the event that a Withhold Release Order (WRO) is issued and goods are stopped at the border under suspicion of being made with forced labor, the due diligence collected will help the company either contest the WRO and have the goods released or to remediate and have the WRO lifted.

The investor questions and template engagement letters offered below can serve as the basis for this engagement.

<sup>9</sup> See also Final Report on Minimum Safeguards. Platform On Sustainable Finance. Oct 2022. [https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-minimum-safeguards\\_en.pdf](https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-minimum-safeguards_en.pdf)



# INVESTOR TOOLS: ENGAGEMENT QUESTIONS AND ENGAGEMENT LETTERS

## Questions to Pose to Companies to Assess Integration of Responsible Contracting

- 1. Do you have a human rights and environmental (HREDD) process and associated implementation program in place in your supply chain to identify, assess, prevent, mitigate, bring to an end, and remedy negative impacts in your supply chain?**
  - a. To what degree does your HREDD process and implementation program align with the UNGPs, the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, the OECD Due Diligence Guidance for Responsible Business Conduct, and the OECD's sector specific guidance?
  - b. In carrying out HREDD, do you meaningfully engage stakeholders such as workers, local communities, and other individuals or groups potentially or actually affected by adverse impacts?
  
- 2. What role do your contracts play in your HREDD regime?**
  
- 3. If human rights and environmental (HRE) issues are reflected in your contracts, how do you go about doing that?**
  - a. Incorporate your policies by reference into the contract and make them binding that way?
  - b. Require suppliers to make one-sided representations & warranties about compliance with your policies / codes of conduct? Do such representations extend to other suppliers and sub-suppliers in your supply chain?
  - c. Commit to cooperate in carrying out HREDD with your supplier / contractual counterparty?
  - d. Commit to engaging in responsible purchasing practices to support your supplier's HRE performance, e.g.,
    - i. imposing fair, reasonable, and non-discriminatory terms on business partners, especially Small and Medium Sized Enterprises (SMEs)?
    - ii. providing reasonable assistance (financial and technical) to the supplier to implement HREDD?
    - iii. collaborating with suppliers to agree on a price that accommodates the costs associated with implementing HREDD?
    - iv. exiting responsibly if you decide that disengagement is called for by considering the potential adverse impacts of your exit and employing proportionate and reasonable efforts to mitigate those impacts, providing reasonable notice of intent to terminate, and paying costs accrued prior to the date of termination?

**4. What do your contracts say about how you will react if an actual adverse HRE impact occurs in relation to your contract?**

- a. Do you immediately terminate the contract?
  - i. Do you have a list of ‘zero tolerance’ adverse impacts that are met with immediate termination?
- b. Does your counterparty have a right to cure the breach?
- c. Do you commit to remediating the adverse impacts?

**5. What documentation do you request of your supplier(s) to ensure HREDD is working, e.g.,**

- a. a list of their suppliers and subcontractors / a regularly updated supply chain map;
- b. copies of their policies or codes of conduct that they apply to their own business partners;
- c. evidence that they are including HREDD commitments in their contracts with their suppliers and subcontractors;
- d. records of worker complaints or grievances and reports on the use of their internal level grievance mechanism;
- e. evidence of remediation, including involvement of stakeholders in the remediation process; and
- f. timely notice of adverse impacts (potential and actual)?

**6. Do you commit to requiring disclosures from your suppliers in a way that minimizes their administrative burden and avoids overwhelming them with due diligence obligations, such as filling in questionnaires and carrying out audits, e.g., by repurposing or accepting questionnaires filled in for other buyers if they meet your standards?**

**7. Is an individual within the senior management team tasked with overseeing HRE-related risks?**

**8. Provide specific examples of how HRE-related incidents have been identified and addressed in the past.**

# Template corporate engagement letter

Company Info

Dear X,

We write to share our perspectives on the use of human rights and environmental due diligence (HREDD) as an element of Company X's responsible business conduct and, specifically, how responsible contracting practices can support Company X's approach to managing HRE risks across the supply chain. [ADD OTHER RELEVANT BESPOKE LANGUAGE].

As the framework for responsible business conduct continues to evolve, HREDD has taken center stage as a tool that allows companies to assess HRE-related risks in their supply chains, to think systematically about how to effectively prevent those risks from graduating into harm, and to provide remediation for adversely affected stakeholders, including workers and their communities. Additionally, expectations of corporate responsibility and transparency are increasing. There is significant movement in the current legal and regulatory landscape to codify the principles of the 2011 [United Nations Guiding Principles for Business and Human Rights](#) (UNGPs), the 2023 Organisation for Economic Cooperation and Development's (OECD) [Guidelines for Multinational Enterprises on Responsible Business Conduct](#), the 2018 [Due Diligence Guidance for Responsible Business Conduct](#), and other sector-specific OECD guidance (together, the OECD Guidance), and the UN Sustainable Development Goals into law, including via the French [Duty of Vigilance law](#), the German [Supply Chain Due Diligence Act](#) (LkSG), the [Norwegian Transparency Act](#), and the proposed [European Union \(EU\) Corporate Sustainability Due Diligence Directive](#) (CS3D). Companies will soon be required to demonstrate how they effectively implement HREDD to address salient HRE risks across their operations and supply chains, and these regulatory schemes will hold parent companies accountable for certain violations in their supply chains.

Responsible contracting is one essential aspect of corporate responsibility and the HREDD framework. To contract responsibly throughout supply chains, most buyers and suppliers will have to change their approach from the traditional contract model that typically places the responsibility for upholding HRE standards wholly on suppliers, to a model that creates shared responsibility and accountability. Buyers generally hold the power in traditional contracts and the instability and lack of transparency that results from this one-sided relationship exacerbates HRE risks, which then create material risks to companies and their suppliers. The effects of these one-sided relationships were particularly evident during the height of the COVID-19 pandemic when millions of dollars of wages were stolen from garment workers who were not paid for the work they had done and whose livelihoods were threatened by layoffs and reduced working hours and pay due to factory closures and the cancelation of purchase orders through force majeure clauses.<sup>10</sup>

<sup>10</sup> ILO Brief, The supply chain ripple effect: How COVID-19 is affecting garment workers and factories in Asia and the Pacific (October 2020), [https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/briefingnote/wcms\\_758626.pdf](https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/briefingnote/wcms_758626.pdf)

To align with international business and HRE standards and to comply with current and forthcoming mandatory HREDD and trade sanctions legislation, including the US Tariff Act of 1930, the UFLPA, and the proposed EU Import Ban, traditional contracts must evolve to reflect both parties' commitments to upholding HRE standards and provide a clear process for upholding such standards in cooperation.

If buyers and suppliers see their contractual process as one that can and should address HRE risks, they can better prevent HRE-related harms and generate better HRE outcomes for stakeholders and rights-holders throughout the supply chain. The Responsible Contracting Project (RCP) [Toolkit](#),<sup>11</sup> which contains open-access contractual tools, including model clauses (the Clauses) and codes of conduct, provides immediately usable, practical tools designed to give all contracting parties a starting point to codify mutual responsibility for human and environmental rights protections in their contracts.

The Toolkit takes the UNGPs and the OECD Guidance as its starting points and provides a roadmap for due diligence-aligned contracting. Rather than copying and pasting the Clauses, X Company should carefully select and strategically edit and adapt the Clauses (with help from external counsel, as needed) to effectively support the Company's HREDD process and meet the specific needs of the contracting parties.

Given X Company's stated commitments to respect human rights and uphold HRE standards, we would like to better understand how implementation of those commitments and HREDD is incorporated into your current supplier contract model. We would appreciate the opportunity to engage with you to better understand:

- Do you have a HREDD regime in place in your supply chain and is that reflected in your supply contracts? If so, how?
- What role do your contracts play in implementing your HRE policies?
- How do you address HRE-related breaches of contract?
- What evidence do you request of your supplier(s) to ensure HREDD is being implemented?

We welcome a dialogue with you to discuss your approach to embedding HREDD within your contracts and how tools like the Clauses could help Company X and its suppliers implement an effective HREDD process that can prevent adverse impacts and improve HRE outcomes across Company X's supply chain.

<sup>11</sup> RCP continues to expand its open-access Toolkit in response to demands from different stakeholders and legislative developments.



# Template Shareholder Proposal on Responsible Contracting

**RESOLVED:** Shareholders of **XXX** Company urge the Board of Directors to prepare and provide a report to shareholders, at reasonable cost and omitting proprietary information, assessing the effectiveness of current Company contracts for integrating human rights and environmental due diligence (HREDD) into the Company's processes and operations. HREDD should be designed to identify and address the salient risks that may exist or arise in the Company's supply chain, including, for example: **[TO BE TAILORED AS NEEDED:** modern slavery, forced labor, child labor, adverse environmental impacts, violence from company security forces, compromised workplace safety, violations of workers' rights, and discrimination and harassment]. HREDD-aligned contracts formalize a joint or shared responsibility for buyers and suppliers to cooperate in conducting HREDD, rather than simply transfer such responsibility from one party to the other.

**SUPPORTING STATEMENT:** Shareholders recommend that the report, at Board and management's discretion:

- Assess the appropriateness and fitness of the existing contractual approach for effectively preventing and, if needed, remediating adverse human rights and environmental impacts;
- Consider, according to the human rights and environmental risks that do or may exist in the Company's supply chain, the feasibility and appropriateness of adopting proactive solutions such as following the core [Responsible Contracting Principles](#) and making strategic use of the [Responsible Contracting Toolkit](#).
- Identify a process to revise Company contracts to support effective HREDD and avoid a mere transfer of responsibility for upholding human rights and environmental standards from one party to the other, as such transfer is unlikely to effectively prevent adverse impacts or to effectively remedy such impacts when they occur.

**WHEREAS:** **[MATERIAL BELOW TO BE USED AS APPROPRIATE TO JUSTIFY THE RESOLVED CLAUSE ABOVE. ARGUMENTS INCLUDED WILL DEPEND ON THE STATE OF THE COMPANY'S HREDD PROCESSES]**

**XXX** ("the Company") sources from approximately **XXX** vendors in over **XXX** countries (if this can't be found it could be said sources from multiple vendors in multiple countries), including locations where human rights and environmental risks are known to exist in the manufacturing chain of product categories.

In the current legal and regulatory environment, the expectations of companies' human rights and environmental performance are increasing. There is significant movement in the current legal and regulatory landscape to codify the principles of the 2011 [United Nations Guiding Principles for Business and Human Rights](#) (UNGPs), the 2023 Organisation for Economic Cooperation and Development's (OECD) [Guidelines for Multinational Enterprises on Responsible Business Conduct](#), the 2018 Due

## Template Shareholder Proposal on Responsible Contracting, continued

Diligence Guidance for Responsible Business Conduct, and other sector-specific OECD guidance (together, the OECD Guidance), and the UN Sustainable Development Goals into law, including via the French [Duty of Vigilance law](#), the German [Supply Chain Due Diligence Act](#) (LkSG), the [Norwegian Transparency Act](#), and the proposed [European Union \(EU\) Corporate Sustainability Due Diligence Directive](#) (CS3D).

Companies are becoming expected, even required, to demonstrate how effectively they implement HREDD to address salient human rights risks across their operations and supply chains. These regulatory schemes will hold parent companies accountable for certain violations in their supply chain. Responsible contracts that embed HREDD and that establish a shared responsibility for the companies involved in the supply chain to cooperate in carrying out on-going, risk-based HREDD, are therefore necessary for companies to comply with these forthcoming regulations and to meet fast-evolving expectations.

[While **XXX** Code of Conduct prohibits [forced, child, and prison labor,] it does not adequately integrate HREDD into the contractual obligations of **XXX** and its suppliers or of **XXX's** suppliers and their suppliers].

[In addition, the Company/Board is aware of several human rights benchmarks, which track corporate progress of human rights-related issues. **[INSERT RELEVANT INFORMATION ABOUT COMPANY SCORE ON HREDD/CONTRACTING ASPECTS OF BENCHMARK]** The Company is committed to implementing comprehensive HREDD mechanisms, including in its contracts, in order to continuously improve its human rights and environmental performance.]

# Questions to Anticipate in Corporate Dialogues

## 1. How do I implement responsible contracting principles with my hundreds of suppliers? What if I can't afford to implement this across my supply chain?

HREDD is a risk-based process and different business relationships carry with them varying levels of HRE risk. Those business partner relationships that carry the most risk of severe adverse impacts should be prioritized for the incorporation of the [Core Responsible Contracting Principles](#).<sup>12</sup> This will generally involve an evaluation of the scale, scope, and irremediability of various risks by country, sector, and company,<sup>13</sup> with higher risk companies the initial target for responsible contracting efforts. Lower risk business partner relationships can be integrated into a responsible contracting model over a longer timeline. In other words, the HREDD contents of the contracts should differ from relationship to relationship based on the risk levels involved.

What is critical to understand about HREDD and the laws that are making HREDD a legal requirement is that it does not expect perfection, but rather continuous improvement. In other words, you will not be expected to overhaul all of your contracts or your business processes overnight or all at once, but rather to prioritize those HREDD-related “upgrades” that will allow you to respond effectively to the most severe HRE risks present in your supply chain. Ideally, over time, you will have it set up so that all HRE risks in your supply chain(s) are identified, mitigated, addressed, and prevented, but HREDD is pragmatic and allows for prioritization.

## 2. What do the new HREDD laws say about contracts?

The proposed CS3D and the LkSG explicitly refer to contracts as a type of preventive measure—an important component of a larger HREDD process. As such, contracts (along with other preventive measures) must be **appropriate** in design and implementation to effectively address the HRE risks involved. Appropriateness can be established by considering factors such as the commercial context for the transaction, your company's proximity to a potential adverse HRE impact (you may cause, contribute, or be directly linked to an adverse impact), the severity of the HRE risks at issue, the likelihood that they will materialize into actual adverse impacts, the size of the contract, and the leverage your company has—or could have—to influence your counterparty's HREDD processes (e.g., are you a key or reputationally important client for this supplier, how much of their output do you purchase, how central is this relationship to your own operations?).

To be appropriate, contracts should be supported by and formalize responsible purchasing practices, including providing business partners with reasonable support and assistance to implement HREDD-related obligations, according to the partner's capacity and both parties' relationship to the HRE risks at issue. Additionally, as preventive measures, contracts must be regularly monitored for **effectiveness**, meaning that you will be expected to revise and adapt your contracts to better identify and address HRE risks over time, especially if risk levels change for whatever reason (e.g., in the event of a pandemic or a war).

<sup>12</sup> See also, UNGP 24: “Where it is necessary to prioritise actions to address actual and potential adverse human rights impacts, business enterprises should first seek to prevent and mitigate those that are most severe or where delayed response would make them irremediable.”

<sup>13</sup> For additional resources, see <https://www.unpri.org/human-rights/how-to-identify-human-rights-risks-a-practical-guide-in-due-diligence/11457.article>

**3. Am I responsible for ensuring that my suppliers comply with responsible contracting principles in their own contracts? What if my company implements responsible contracting with our suppliers and subcontractors, but the latter don't want to, or fail to?**

Under the responsible contracting model, HREDD-related commitments should be made and shared by both parties, meaning that each party assumes responsibility for conducting its own HREDD across its own supply chain with its own suppliers and subcontractors and for cooperating with business partners to support an effective HREDD process, including by disclosing any (actual and potential) adverse impacts. This responsibility should cascade across the supply chain, meaning that the supplier would be expected to share HREDD responsibilities with its own suppliers and subcontractors, including contractually. Note, however, that cascading does not mean transferring or shifting responsibilities from one party to the other. Rather, it means that due diligence responsibilities—and associated costs—are at all times shared by your company and the businesses that are part of your chain of activities.

**4. So am I now locked into my supplier relationships or does responsible contracting allow me to terminate a contract with a “bad” supplier?**

If, after giving them a reasonable opportunity, you realize that your business partner is unwilling to or incapable of participating in your HREDD process to address potential adverse impacts, then you may decide to switch to a different partner, depending on factors such as the severity of the HRE risks at issue, the availability of alternative partners, and the commercial significance of the relationship. In other words, termination may, depending on the circumstances, be the appropriate response. If an actual adverse impact has occurred and your business partner caused or contributed to it, and if, after giving them a reasonable opportunity and support to remedy the situation, you realize that your partner is unwilling to or incapable of providing remedy to affected stakeholders, then you may decide to terminate the relationship.

The core of responsible contracting is to formalize processes for you to cooperate with your business partners in implementing HREDD to support the effective prevention of potential adverse impacts and remediation of actual adverse impacts. Where such cooperation cannot be achieved, and where the risk of severe adverse HRE impacts is aggravated as a result, disengagement may be the responsible choice. That said, as indicated in the UNGPs, the OECD Guidance, and the new HREDD laws, exit should be pursued as a last resort, not as a first stop. Furthermore, exit must be effectuated responsibly, by considering the HRE impacts of exit, taking appropriate measures to mitigate those impacts, and, where appropriate, providing reasonable notice to the business partner, and paying any outstanding invoices incurred prior to termination.

**5. How can I maintain flexibility to change orders and suppliers when applying responsible contracting principles?**

Needs often change in the course of the supply relationship. This is to be expected and accommodated in light of HREDD obligations and commitments. When material changes or modifications are necessary, the parties should cooperate to ensure that revised obligations are agreed to and performed in line with HREDD commitments. Changes should be discussed and negotiated (not unilaterally imposed) to ensure that they do not create or aggravate risks of adverse HRE impacts. For example, if a buyer wishes to materially increase the quantity of an order, they should discuss with the supplier to make sure that such an increase will not strain workers' rights (e.g., lead to unpaid overtime or unhealthy or unsafe working conditions). If discussions reveal that the supplier needs more time to deliver the order, or a higher per-unit price to pay overtime, then the parties should negotiate to reach a HREDD-supportive compromise. Such cooperation should help prevent or mitigate adverse HRE impacts that may result from making material changes to the contract. Changing suppliers is in some ways more challenging under the responsible contracting model because one of its objectives is to foster longer-term, more stable, cooperative, and resilient relationships in the supply chain. As indicated above, however, where a decision is made to terminate a relationship, disengagement must be responsible.

## 6. What is a Responsible Purchasing Code of Conduct and why do I need one?

The [Responsible Purchasing Code of Conduct](#) establishes the buyer's commitment to uphold HRE standards and sets out the steps buyers can take to support positive HRE outcomes and effective HREDD, including through their purchasing practices. It promotes the [shared-responsibility](#) approach of the UNGPs and the OECD Guidance and can be used internally as a corporate policy document or, alternatively, it can be incorporated into the contract as a binding schedule.

## 7. My company already has a Supplier Code of Conduct. Why isn't this sufficient?

Under the traditional contracting model, the supplier is typically the only party responsible for upholding the HRE standards contained in the contract and the Supplier Code of Conduct. Indeed, traditional supply contracts tend to shift HRE responsibilities—including the costs associated with meeting those responsibilities—onto the supplier, without providing financial or technical assistance, and without considering the buyer's own role in creating or aggravating HRE impacts through its own purchasing practices (e.g., pricing, cost-shifting, providing assistance, changing orders at the last minute, changing commercial terms retroactively, canceling orders after manufacturing is complete, and exiting irresponsibly).

Traditional contracts often require suppliers to guarantee ("represent and warrant") that they have no actual or potential adverse impacts in their operations, which is unrealistic and not conducive to establishing cooperative or transparent relationships with your suppliers. Your Supplier Code of Conduct could be a great starting point, but it should be paired with a commitment by your company to behave in ways that support effective HREDD, including through your purchasing practices. This commitment could take the form of a separate Responsible Purchasing Code of Conduct (see above) or a new, joint code of conduct (e.g., [Social Accountability International's Buyer-Supplier Mutual Code of Conduct](#)) that combines both your and your suppliers' commitments to uphold HRE standards, acknowledging that the actions of both the supplier and the buyer may cause, contribute to, or be linked to adverse impacts.

## 8. What is the relationship of contracts to purchasing practices when it comes to preventing adverse HRE impacts?

Contracts are linked to purchasing practices in that contracts set the parameters for the commercial relationship, including elements such as price, deadlines, order modifications, penalties, and termination. Contracts are often drafted in ways that allow and formalize purchasing practices that actually exacerbate HRE risks and that make it harder to prevent or remediate adverse HRE impacts. Examples of such practices include prices that do not cover costs of production, including minimum or living wages, excessive penalties for delays (even when delays are caused by the company), and immediate contract termination in the event of any (potential or actual) adverse impact or imperfect adherence to a code of conduct. In setting the parameters of the commercial relationship and purchasing practices, contracts are a central aspect of due diligence. They must be designed to support effective due diligence processes, including through appropriate purchasing practices.

## 9. How do I explain to my shareholders that I am spending money on measures that are unlikely to accrue to my benefit, but rather that of my suppliers?

Responsible contracting starts with a shared commitment to cooperate in conducting HREDD to identify HRE risks and take affirmative measures to address those risks so that they don't graduate into an actual adverse impact or HRE harm. The parties should also commit to cooperate to provide remedy to adversely affected stakeholders in the event of an actual adverse impact. That is the HREDD loop: cooperate to identify, prevent, address, and remedy potential and actual adverse impacts, as appropriate. A shared-responsibility, cooperative approach to conducting HREDD should increase transparency in your supply chain, improve the effectiveness of your preventive measures, and, consequently, reduce HRE-related risks to

your company and your shareholders, especially in the longer term. This will benefit the company's long-term stability and should have a positive medium- to long-term financial impact. Finally, now that several jurisdictions are requiring companies to conduct HREDD, doing so effectively will be to your distinct advantage, both reputationally and economically.

#### **10. Are you suggesting that I just scrap all of my contracts and have my suppliers sign new ones?**

No. The [Core Responsible Contracting Principles](#) can be introduced in your contracts incrementally, according to your HRE-related risk exposure, your capacity, and your ambition for improving the HRE performance of your supply chain. The recommendation is to start by making responsible contracting and due diligence “upgrades” to your contracts with those business partners and suppliers that pose the highest HRE risks and with whom you have more influence and/or larger or more essential (difficult to replace) contracts.

#### **11. How can I be sure that additional support for suppliers is being used as intended, to improve HRE performance?**

There are several ways that companies can ensure that their support for suppliers is used for the aims intended. First, the parties can include an open book calculation in the contract to, for example, determine the wage and labor costs that will be covered by a higher price. Second, and alternatively, the buyer can require the supplier to submit documentation after the fact showing that the funds were used for the indicated purposes.

#### **12. How can I disclose supplier relationships without giving away my competitive advantage?**

If your competitors are covered by any of the current or prospective legal measures introduced to promote responsible business conduct (e.g., EU Corporate Sustainability Reporting Directive (CSRD), French Duty of Vigilance, LkSG, CS3D), supply chain mapping and disclosure of risks associated with the supply chain will be mandatory for all covered entities (including your competitors). Even if they are not, there are several benefits to a commitment to supply chain transparency. Consumers often care about the conditions under which their goods were produced and where they were made; companies like Patagonia, which is well known for its supply chain transparency, are rewarded by consumer brand loyalty. In addition, employees and investors are increasingly focused on corporate responsibility and transparency, so your disclosure could lead to lower employee turnover and greater investor satisfaction.

#### **13. What role can my contracts play in meeting disclosure requirements?**

Due diligence-aligned, responsible contracts can have major informational benefits: Because they are rooted in shared-responsibility, partnership, and cooperation—rather than in extraction, one-sidedness, and adversariality—they can serve to gain visibility into and elicit information from within the supply chain. Such information can then be used to meet legal requirements, such as those contained in the CSRD, the EU Battery Regulation, and the various Modern Slavery Acts. Such information can also be used to assess the effectiveness of various preventive measures, as required by the LkSG and potentially the CS3D, or to respond to investigations from US authorities, such as CBP under the US Tariff Act of 1930 or the UFLPA.

#### **14. How am I supposed to change things when my competitors are sourcing more from the same suppliers and not doing HREDD?**

If your competitors are covered by any of the current or potential legal measures introduced to promote responsible business conduct (e.g., the LkSG), they will be required to conduct HREDD and will eventually incur the same implementation and compliance costs as you. Outside of these jurisdictions, responsible contracting presents an opportunity for more effective implementation of your own HRE policies and standards, which increasingly matter to your investors, customers, and business partners. Responsible contracting can help to avoid adverse HRE impacts, which are costly, both reputationally and operationally and, increasingly, legally. Your company will also likely benefit from the increased stability, resilience, and reduced disruptions in the supply chain.

#### **15. I have operations in the EU and the US, but they function separately. Why should I adopt responsible contracting principles for my US operation when they are not required under any current or pending legislation?**

While the United States does not have HREDD-focused legislation, your US-based operations are still subject to the US 1930 Tariff Act and the UFLPA, both of which prohibit the import of goods made in whole or in part with forced labor. Compliance with those laws requires visibility into the supply chain that is easier when both buyer and supplier share responsibility for identifying, assessing, and addressing its risks. In addition, you will need to rely on your suppliers to obtain the documentation needed to contest a WRO under the US 1930 Tariff Act or overcome the presumption under the UFLPA, and you will be in a better position to commit to remediation efforts if you have actively cultivated cooperative, supportive relationships with your suppliers. Moreover, while your US operations may not come under the purview of the mandatory HREDD laws, it is possible that some of the companies with which you are in business will be in-scope for those laws and that they will expect you to make HREDD-related disclosures and adjustments to your own processes, including your contracts.

#### **16. How is responsible contracting different from auditing? Why do I need to do both?**

Although contracts and audits are both pieces of the HREDD toolkit, they are distinct preventive measures. Contracts underlie and accompany the whole business relationship from start to finish, while auditing is a (more or less) regular check that is carried out to assess gaps between the HRE standards, policies, and commitments enshrined in the contract and the realities on the ground. Both are components of HREDD and both are useful for ensuring that HRE standards are being adequately upheld in the supply chain; if not, these tools can highlight discrepancies that require addressing and support a corrective or remediation action plan for the parties to implement in cooperation. Responsible contracting asks buyers and suppliers to commit to sharing responsibility for HRE protection as a foundation of and throughout their relationship. It allocates responsibilities at the start of the relationship and outlines how both parties will work together. Audits are carried out periodically and often as part of a wider audit program that tests diverse elements of corporate policies and operations. In this context, an auditor might undertake two inquiries: first, how well do the HRE standards to which the parties committed actually function to prevent HRE risks? Second, how well are the parties actually sharing responsibility for HRE protection? The results of the audit and any gaps identified should be shared with management and, potentially, fed back into the contracting process through contractual amendments. Finally, note that there are a number of other tools that companies can use, in addition to contracting and auditing, to promote positive HRE outcomes, like ongoing monitoring, supply chain mapping, and employing responsible purchasing practices.

## **17. We have a long standing tradition of working with a respected NGO to review our supplier relationships.**

### **Why isn't that enough?**

Monitoring and auditing of supplier relationships are two elements of HREDD that underpin the responsible contracting system. Both in-house and external resources (e.g. NGOs) can play an important role in assessing the effectiveness of HREDD or HRE-related preventive measures. This form of (external) review, however, does little to move the contractual relationship toward the shared-responsibility model, which we believe is far more effective for preventing adverse HRE impacts than the traditional, risk-shifting, model. The move toward shared responsibility must be effectuated within the contractual relationship itself; the [Toolkit](#) was developed to help companies with this process.

## **18. Why should I be responsible for remediating harm that my company didn't directly cause?**

The UNGPs set out three distinct ways in which a business can be involved with adverse HRE impacts: causation, contribution, and direct linkage.<sup>14</sup> Businesses that cause or contribute to adverse impacts must cooperate with their suppliers and subcontractors to provide remedy to adversely affected stakeholders. Where the relationship between buyer and harm is attenuated, and a buyer is only linked to the harm caused or contributed to by a business partner, the buyer must use its leverage to try to make the business partner participate in the remediation process. The Clauses contained in the [Toolkit](#) offer template language that can be edited and adapted as needed to establish the shared responsibility of the parties to cooperate in carrying out HREDD, the duty of the supplier to disclose and report on adverse impacts, and the mutual commitment of the parties to prioritize victim-centered HRE remediation over traditional contract remedies, such as suspension of payment and termination.

## **19. For what sectors is the responsible contracting approach relevant?**

The [Core Responsible Contracting Principles](#) (joint commitment to cooperate in carrying out HREDD versus one-sided guaranties of perfection; shared responsibility for upholding HRE standards, including by engaging in responsible purchasing practices; prioritization of HRE remediation over traditional contract remedies) can be integrated into contracts for any type of transaction and any sector, but they may be particularly relevant in an upstream supply chain context and in sectors with significant power imbalances between the parties. Know the Chain, which benchmarks the implementation of HREDD concepts among companies, has tracked the uptake of responsible contracting in the apparel and footwear, food and beverage, information technology and communications sectors. The average score for companies across all sectors on “purchasing practices” is just 2 of 100, which means the vast majority of companies stand to gain a significant amount through the adoption of the Responsible Contracting Principles.

## **20. Do I have to adopt all of the model clauses?**

No. Companies are encouraged to start by considering how the overarching [Core Responsible Contracting Principles](#) could be integrated into their contracts, codes of conduct, and business relationships as part of a broader HREDD process. Once that determination has been made, companies are encouraged to strategically and diligently select and adapt, rather than adopt or copy-and-paste, the model clauses that make the most sense for them. The model clauses contained in the

<sup>14</sup> United Nations High Commissioner for Human Rights, The Corporate Responsibility to Respect Human Rights: An Interpretive Guide, p. 15, [https://www.ohchr.org/sites/default/files/Documents/publications/hr.pub.12.2\\_en.pdf](https://www.ohchr.org/sites/default/files/Documents/publications/hr.pub.12.2_en.pdf); Organization for Economic Cooperation and Development, Due Diligence Guidance for Responsible Business Conduct, <https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>



[Toolkit](#) offer ready-to-adapt examples for how to translate the Core Principles into contractual language. The clauses are modular, acknowledging that one size does not—and should not—fit all. Each element of the Toolkit can be used together or separately. The model clauses include alternative text, with extensive footnotes, that provide counsel with research and resources that might be useful in making drafting decisions (e.g., clothing brands need no standards on conflict minerals, and electronics makers are not concerned with cotton sourcing). The clauses that are ultimately incorporated into contracts should be specifically tailored to address risks identified, which will vary from supply chain to supply chain and from company to company. The Responsible Contracting Project [Team](#) can advise on the implementation of the [Toolkit](#), including by providing gap analyses between your contracts and the mandatory HREDD legislation. For additional resources, please see the Responsible Contracting Projects list of [publications, events, and media](#).

### **21. I already have a hotline for reporting grievances. Do I have to adopt a new one?**

Not necessarily. If the grievance mechanism you have in place is accessible, reliable, equitable, transparent, independent, and rights-compatible, it could be used to field concerns from workers and business partners. This mechanism should be accompanied by a robust response and remediation process, in which remediation undertaken to resolve concerns is documented in detail. The model clauses contained in the [Toolkit](#) offer some contractual language concerning internal grievance mechanisms and remediation processes.

### **22. My company has been asked to participate in so many industry initiatives. How does this differ?**

There are several different initiatives that focus on the role that responsible sourcing plays in safeguarding human rights, including [Better Buying](#), [Higg Social and Labor Module](#), [Know the Chain](#), and the [Corporate Human Rights Benchmark](#). These initiatives either rate or measure companies on their performance on different metrics, including responsible sourcing, or serve as a forum for communication and collaboration between buyers and suppliers that are committed to human rights focused outcomes. The [Responsible Contracting Project](#), the [Core Responsible Contracting Principles](#), and the Toolkit occupy a distinct, complementary space in this framework. The Toolkit is intended as a practical, immediately-usable resource for businesses and, where applicable, their internal and external counsel, to align contracts with HREDD principles and requirements. While integrating the Core Responsible Contracting Principles and the model clauses can feed into positive evaluations or ratings for your company, the Responsible Contracting Project does not rate buyers or suppliers. Furthermore, as noted above, the model clauses are designed to be diligently and strategically selected, adapted, and tailored to the specific needs of each contractual relationship, not simply “adopted” or copy-and-pasted wholesale.

### **23. Are there companies already using the Toolkit and what have been their lessons learned and/or challenges?**

You can find information about uptake of responsible contracting principles [here](#).