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Perspectives on topical foreign direct investment issues

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Mandatory human rights due diligence: what does it mean for foreign investors and why should it be in IIAs?

by

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Worldwide, human rights due diligence (HRDD) laws are gaining momentum. Various countries have adopted HRDD standards derived from the [OECD Guidelines for Multinational Enterprises on Responsible Business Conduct](#) and the [United Nations Guiding Principles](#) that require companies to identify, prevent and mitigate human rights and environmental risks. The EU is currently in the process of adopting the [EU's Corporate Sustainability Due Diligence Directive \(CSDD\)](#) and the [EU Corporate Sustainability Reporting Directive](#); they will harmonize the HRDD and sustainability reporting requirements for EU and non-EU companies. These developments will have a significant impact on foreign investments. This *Perspective* argues that it is imperative to align international investment agreements (IIAs) with the mandatory HRDD requirements for MNEs to ensure a harmonized approach to fostering responsible business conduct.

[In March 2024](#), a compromise draft text for the CSDD was agreed upon. Upon its entry into force, the Directive will compel large EU companies and some non-EU companies¹ producing goods and services for the EU market, to conduct human rights and environmental due diligence throughout their supply chains. Currently, [more than 35%](#) of total EU assets belong to foreign-owned companies. Under the CSDD, some of these foreign enterprises investing in the European market, as well as EU companies investing in third countries, will be required to engage in a continuous process that integrates due diligence into their policy. That includes prevention, mitigation, the establishment of a grievance procedure, monitoring the effectiveness of due diligence measures, and reporting about it.

CSDD will also impact medium and small enterprises (SMEs) that are part of a supply chain: MNEs subject to the CSDD will need to ensure their supply-chain partners (including SMEs),

e.g., suppliers and distributors, have conducted human rights due diligence. Supervisory authorities at the member-state level can impose sanctions for failure to comply with the CSDD. Further, MNEs can be sued for damages under national law under the civil liability mechanism of the CSDD. Companies will also be required to seek contractual assurances from a business partner with whom they have a direct business relationship, to guarantee compliance with human rights obligations.

In international investment law, the concept of investor due diligence is not new. It has become a [significant factor](#) in determining whether the [legitimate expectations of an investor give rise to protection under the fair-and-equitable-treatment \(FET\) standard](#). Further, with the rise in importance of corporate social responsibility (CSR) requirements for foreign investors, the reference to human rights and environmental due diligence has also appeared in a few IIAs, e.g., the [2019 Dutch Model BIT](#) and [the Sustainable Investment Facilitation Agreement between the EU and Angola](#). However, references to HRDD are rare in IIAs.

There are a number of advantages to including a provision on HRDD in IIAs. First, a careful drafting of due diligence steps may benefit states and investors for early mitigation and the prevention of investment disputes, as the timely consideration of human rights standards in a host state by an investor may effectively reduce the state's interference, such as license cancellation. The latter approach might be more efficient than the insertion of broadly formulated CSR clauses that are difficult to enforce. Second, the CSDD has an extraterritorial effect and, with the implementation of new mandatory standards in the EU, the lack of a globally harmonized approach to HRDD will undermine a level playing field among enterprises in terms of responsible business conduct compliance. To this end, policymakers may consider referring to mandatory HRDD in formulating new IIAs by:

- Inserting the requirement to conduct HRDD by foreign investors by referencing the [OECD Due Diligence Guidance for Responsible Business Conduct](#) that includes six steps of the due diligence process. The OECD's definition of HRDD is widely adopted in HRDD laws and has already been applied by many companies on a voluntary basis.
- Ensuring the compliance with the HRDD provision. One option is to include requirements that arbitrators consider the failure of an investor to undertake the HRDD at the merits stage while deciding on the violation of substantive IIA provisions, such as FET or indirect expropriation. [Several tribunals](#) assessing FET standard have adopted a similar approach toward general investors' due diligence. Another possibility is to consider investors' failure to undertake HRDD at the stage of determining the amount of compensation.

Inserting HRDD provisions into IIAs may help states and investors mitigate and avert investment disputes and level the playing field for companies operating across different jurisdictions.

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¹ Non-EU companies falling under the Directive include foreign companies with a net turnover of more than EUR 450 million generated in the EU.

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