The Columbia FDI Perspectives are a forum for public debate. The views expressed by the authors do not reflect the opinions of CCSI or our partners and supporters.

No. 381  April 15, 2024

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

by

Yulia Levashova

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 companies 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.
Yulia Levashova (j.levashova@nyenrode.nl) is an Associate Professor, Nyenrode Business University, The Netherlands. The author wishes to thank Loukas Mistelis, Alessandra Mistura and an anonymous peer reviewer for their helpful peer reviews.

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

The material in this Perspective may be reprinted if accompanied by the following acknowledgment: “Yulia Levashova, ‘Mandatory human rights due diligence: what does it mean for foreign investors and why should it be in IIAs?’ Columbia FDI Perspectives, No. 381, April 15, 2024. Reprinted with permission from the Columbia Center on Sustainable Investment (http://ccsi.columbia.edu).” A copy should kindly be sent to the Columbia Center on Sustainable Investment at ccsi@law.columbia.edu.

For further information, including information regarding submission to the Perspectives, please contact: Columbia Center on Sustainable Investment, Chioma Menankiti, at clm2249@columbia.edu.

The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and Columbia Climate School at Columbia University, is a leading applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. Our mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools. For more information, visit us at http://ccsi.columbia.edu.

Most recent Columbia FDI Perspectives

- No. 380, John Gaffney, ‘Helping ensure respect for the SDGs under bilateral investment treaties: the case of human rights,’ Columbia FDI Perspectives, April 1, 2024
- No. 379, Joshua Paine and Elizabeth Sheargold, ‘Facilitating climate friendly FDI: the importance of ongoing cooperation,’ Columbia FDI Perspectives, March 18, 2024
- No. 378, Rob Van Tulder, ‘Strategy changes, principles remain: why policy makers should stay focused on the SDGs,’ March 4, 2024
- No. 377, Diora Ziyaeva and Cody Antony, ‘Deep Seabed Mining in International Waters,’ Columbia FDI Perspectives, February 19, 2024
- No. 376, Kraijakr Thiratayakinant, ‘Investors’ obligations under IIAs: toward a practical solution,’ Columbia FDI Perspectives, February 5, 2024

All previous FDI Perspectives are available at https://ccsi.columbia.edu/content/columbia-fdi-perspectives.