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Unexpected Allies: Could International Investment Law Transform Human Rights in Supply Chains?

Laura Kaspar · Saturday, April 20th, 2024

Supply Chain Due Diligence ("SCDD") laws, such as the German *Lieferkettensorgfaltsgesetz*, the recently approved EU Corporate Sustainability Due Diligence Directive, or the U.S. Uyghur Forced Labor Prevention Act ("UFLPA"), represent a pivotal step toward fostering ethical supply chains, underscoring the shared responsibility of states and corporations in combating human rights violations. As an advocate for such laws, I recognise the urgent need to make supply chains fairer and more ethical. Simultaneously, I find it crucial to acknowledge the challenges corporations face in their efforts to implement these laws, including the concern over the potential bureaucratic burden and the impact on global competitiveness, or the difficulty of conducting effective audits, especially in regions like Xinjiang, due to restricted auditor access and regulatory opacity. Additionally, suppliers grapple with the task of navigating a myriad of (conflicting) ethical guidelines carrying a risk to the purchasing entity, and complicating risk identification and mitigation. The initiative by BMW to ethically source cobalt further serves as a pertinent example that illustrates the challenges of relying on certifications and audits. Finally, the Rana Plaza disaster tragically highlighted corporations' limited control over regulatory enforcement failures, inadequate labour laws, and local governmental corruption.

The Cost of Compliance and the Dilemma of Withdrawal

According to the British Institute of International and Comparative Law, to compensate for such shortcomings of the domestic legal system in protecting human rights, companies must "invest considerable resources in steps to undertake heightened ongoing HRDD [Human Rights Due Diligence]." A recent report by *Institut der deutschen Wirtschaft* similarly emphasised the high implementation costs companies face if they were to raise production standards to meet legal requirements instead of withdrawing from certain states with weak governance and human rights standards.

It is disputed, however, whether strategies of withdrawal or disengagement will rather harm the social and economic development in these states as such actions could result in job losses and the sale of parts of the business to less responsible companies, potentially worsening the impact on workers, communities, and the environment. Besides, disengagement might not be feasible when sourcing depends on the unique natural resources exclusive to certain regions.

Subsequently, I will present a series of potential, non-exhaustive, pathways on how multinational corporations ("MNCs") which can be defined as foreign investors, could leverage their rights under international investment treaties to address some of the challenges arising from SCDD laws. This aims to highlight both the co-responsibility of states and corporations and reassert the state as the primary obligation-holder.

Potential Avenues within International Investment Law to Address the Challenges of SCDD Laws

1. International Investment Law Perspective:

- The Fair and Equitable Treatment ("FET") Standard and Legitimate Expectations:
  - Actions by the Host State/State-Led Human Rights Violations (e.g. the violations against Uyghurs in Xinjiang): Could it be posited that a host state undermines the legitimate expectations of foreign investors and engenders an unpredictable and opaque investment climate by committing human rights violations, despite having established labour laws and even acceding to international treaties like International Labour Organization conventions or the International Covenant on Economic, Social and Cultural Rights? In other words, does this discrepancy between the state's legislative standards and its actual practices not lead to a breach of investors' legitimate expectations, thereby contributing to an environment of uncertainty, unpredictability, and lack of transparency?
  - Omissions by the Host State/Supplier-led Human Rights Violations:
    - Is it possible to argue that a host state's negligence in enforcing its own labour laws when suppliers of foreign investors are committing human rights abuses similarly frustrates the legitimate expectations of foreign investors possibly leading to an investment environment that is unpredictable and unstable? Can a foreign investor not legitimately expect that its host state enforces its own laws?
    - Could such an argument also be made when the host state both failed to align its domestic legislative framework with its international obligations in the first place and to enforce it accordingly in order to ensure that foreign investors' suppliers will not be committing human rights violations?
  - Most Favoured Nation ("MFN") or National Treatment Clauses:
    - Could it be argued that foreign investors from home states with SCDD laws receive disparate treatment compared to national businesses or those from other nations without SCDD laws? Could we interpret MFN or national treatment clauses in a way that suggests that any differential, disadvantageous treatment stems, in the first place, from the host state's human rights violations (actions) or its failure to enforce human rights laws (omissions), leading to operational disadvantages for these foreign investors? In this context, the disadvantage faced by foreign investors, motivated either by SCDD laws in their home states or their own commitment to ethical business practices, is not directly attributed to SCDD laws themselves but to the actions or omissions of the host state. In other words, such investors face disadvantages in host states not because of SCDD laws but due to the host state's failure to prevent human rights abuses or properly enforce labour laws. Such investors inadvertently experience an uneven investment environment, as their commitment to human rights standards – whether legally motivated or otherwise – necessitates compensating for the host state's shortcomings or misconduct, placing

them at a competitive disadvantage compared to other businesses, national or foreign, not concerned with human rights.

- Investor Due Diligence and State Defences: this strategy is, of course, dependent on the specific context, considerations such as the timeline of the investment and the human rights violations, the investor's due diligence efforts prior to investing, and potential defences by the state.

2. SCDD Laws Perspective:

- Could bringing such claims under investment treaties be regarded as a form of risk management or (long-term) remedial action in the context of an applicable SCDD law? Would this be sufficient to, at least partially, satisfy "best effort" obligations, for example under the German Lieferkettensorgfaltsgesetz?
- Could judgements of such investment claims be used as part of the reporting requirements, again, such as required under the German Lieferkettensorgfaltsgesetz?
- Extraterritorial effects of host state actions: Could investment treaty provisions even be interpreted to cover adverse extraterritorial effects of host state actions on foreign investors? For instance, are protections provided in scenarios where a foreign investor's goods are banned in any third state due to the host state's actions such as conducting human rights violations (state-led) or failing to prevent supplier-led human rights violations (e.g. goods banned from importation under the UFLPA but the harm on the business is essentially caused by and stems from China's human rights violations in Xinjiang)?

Final Thoughts and Considerations

This approach could offer a pathway for businesses to seek compensation for state-led human rights violations that affect their operations as well as for any deficiencies in the host state's domestic legal system, failing to shield foreign investors from getting embroiled in supplier-led human rights violations beyond their control, and thereby imposing undue (extraterritorial) economic and legal burdens.

To clarify, I am not suggesting pursuing human rights claims within investment cases. Instead, I propose framing human rights violations as matters of business interest within an investment context. Although unexplored to date, I argue that this is not due to the strategy's legal infeasibility, but because MNCs have only recently begun to face unprecedented legal and non-legal pressures in terms of their responsibility in human rights protection. Thus, what is essential, in addition to corporations' interest and willingness, is a reinterpretation of investment provisions. I believe that such a reinterpretation is legally not impossible, especially considering the inherent vagueness of certain investment provisions, such as the FET standard. While this vagueness and broad interpretative scope have often been criticised, it is precisely this characteristic that offers a unique opportunity for positive change. Instead of inducing regulatory chills, they could promote a "regulatory push" towards alignment with international human rights standards, while aiding corporations in fulfilling their SCDD commitments and remaining competitive on the global stage – the overarching aim being for every business operating in that host state to adhere to an elevated standard of human rights protection.

Please note that this is not about imposing “Western” human rights standards on other states but is contingent on established national and possibly international human rights commitments agreed upon by the states themselves.

While this legal route might not address immediate human rights concerns, it aims for long-term systemic changes and could help define the boundaries of responsibility and liability for human rights violations in a more nuanced manner.

In the short term, successful investment claims could provide companies with financial resources to, ideally, enhance SCDD compliance processes, or funding initiatives (such as Nestlé’s plan to directly payout African cocoa farmers to combat child labour) and publicly bolster their legal and ethical stance, showcasing their commitment to proactively addressing human rights violations in their supply chains. As rightly stated by the authors of a previous blog post, “ISDS and ESG: Friends or Foes?”, “[f]oreign investment, particularly in developing countries, is urgently needed for a sustainable future.”

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