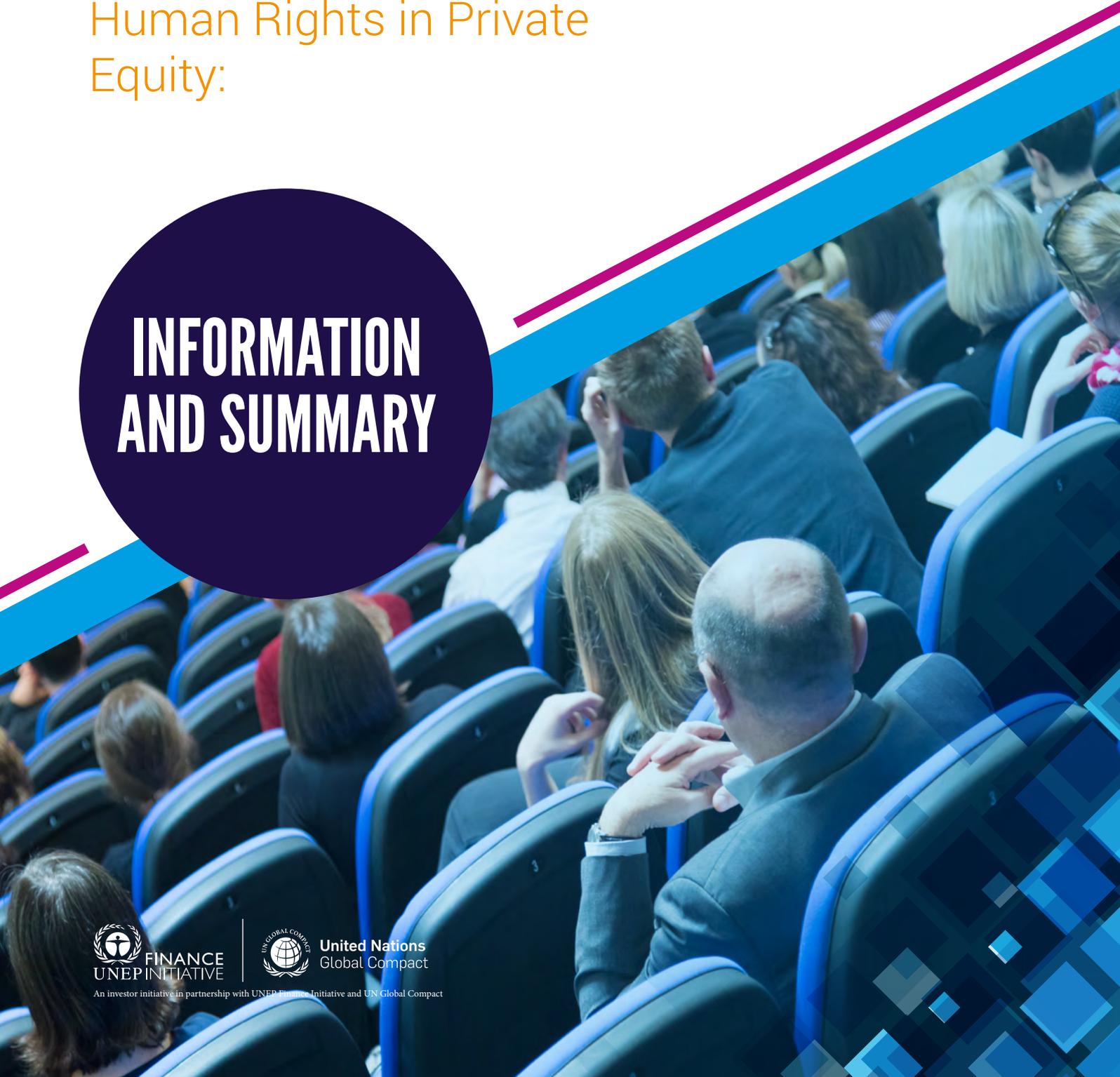


BIICL and PRI Workshop on Human Rights in Private Equity:

INFORMATION AND SUMMARY



I. Introduction

It is increasingly expected that human rights due diligence (HRDD) is undertaken by businesses, as per the UN Guiding Principles on Business and Human Rights (UNGPs),¹ OECD Guidelines for multinational enterprises,² emerging laws such as the UK Modern Slavery Act³ and the French duty of vigilance law,⁴ and other proposed legislative reforms⁵. Failure to identify, prevent and address adverse human rights impacts may lead to reputational, operational, financial and legal risk.

This paper summarises discussions from a workshop convened by the British Institute of International and Comparative Law (BIICL) and the Principles for Responsible Investment (PRI) on 14 June 2017, and attended by representatives from Actis, AP2, Collier Capital, Development Partners International, ERM, Hg Capital, as well as the OECD, the Institute for Human Rights and Business and Shift. The aim of the workshop was to explore implications of expectations (if any) for HRDD by investors, private equity (PE) firms and/or their portfolio companies, and to discuss what guidance and direction is needed.

This paper includes a summary of the background relating to HRDD and presents some key issues for the PE industry with a view of developing possible further research and guidance.

What is HRDD?

The concept of HRDD was introduced by the UNGPs in 2011 after being unanimously endorsed by the United Nations Human Rights Council.⁶ The UNGPs expect all business enterprises to carry out HRDD to identify, prevent, mitigate and account for how they address adverse human rights impacts associated with their business practices.

HRDD has several distinct features, including that it should be ongoing, it should include all relevant internationally-recognised human rights⁷, and it should focus on the risks faced by rights-holders rather than the risks faced by the business.⁸ HRDD should cover both the business actual and potential impacts on people as well as those linked to its operations, products and services by third parties with whom it has business

1 The UN Human Rights Council is the inter-governmental body responsible for promoting and protecting human rights around the world whose 47 seats are filled by member states elected for three-year terms.

2 Available at http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

3 The UK Modern Slavery Act 2015 requires all companies, including financial institutions, carrying out business in the UK with a turnover of £36 million or over to report on the steps they are taking to eradicate slavery and human trafficking in their own operations and supply chains.

4 Art. L. 225-102 of the French Commercial Code, which requires all companies of a certain size to undertake HRDD and publish annual vigilance plans. Similar legislation requiring mandatory due diligence or a duty to prevent have been proposed in other jurisdictions, including Switzerland and the Netherlands, as well as by a UK Parliamentary Committee. See European Coalition for Corporate Justice "France adopts corporate duty of vigilance law: a first historic step towards better human rights and environmental protection" (21 February 2017) available at <http://corporatejustice.org/news/393-france-adopts-corporate-duty-of-vigilance-law-a-first-historic-step-towards-better-human-rights-and-environmental-protection>, and UK Parliament Joint Committee on Human Rights: Business and Human Rights 2017: Promoting Responsibility and Ensuring Accountability, available at <https://www.publications.parliament.uk/pa/jt201617/jtselect/jtrights/443/443.pdf>.

5 Similar legislation requiring mandatory due diligence or a duty to prevent have been proposed in other jurisdictions, including Switzerland and the Netherlands, as well as by a UK Parliamentary Committee. See European Coalition for Corporate Justice "France adopts corporate duty of vigilance law: a first historic step towards better human rights and environmental protection" (21 February 2017) available at <http://corporatejustice.org/news/393-france-adopts-corporate-duty-of-vigilance-law-a-first-historic-step-towards-better-human-rights-and-environmental-protection>, and UK Parliament Joint Committee on Human Rights: Business and Human Rights 2017: Promoting Responsibility and Ensuring Accountability, available at <https://www.publications.parliament.uk/pa/jt201617/jtselect/jtrights/443/443.pdf>.

6 The UN Human Rights Council is the inter-governmental body responsible for promoting and protecting human rights around the world whose 47 seats are filled by member states elected for three-year terms.

7 These instruments are mentioned in Guiding Principle 12.

8 Commentary to Guiding Principle 17.

relationships.⁹ Where adverse human rights impacts are caused by a third party, the business enterprise should exercise leverage to influence, prevent or mitigate the adverse impact, and seek to improve leverage if leverage is limited.¹⁰

The scope and complexity of HRDD that is expected of a business will depend on the circumstances, including factors such as the type and size of the business, its location, the likelihood of severe human rights impacts, and the nature and context of operations. The UNGPs recognise that business enterprises may prioritise certain risks over others depending on the severity of their impacts in the specific context.¹¹

Although the UNGPs are not legally binding, the concept of HRDD is being incorporated into national and regional laws,¹² as well as legal claims,¹³ industry standards, contracts and other mechanisms, guidelines and tools, and civil society reports and expectations of business and their owners. HRDD is also infiltrating into business practice across sectors, and processes are increasingly being developed and refined. While it is still early days, expectations around HRDD are increasingly factoring into corporate risk management, as demonstrated by the launch of the Corporate Human Rights Benchmark in late 2016.¹⁴

Framing human rights impacts

The UNGPs expect HRDD to cover human rights impacts which may not be included under existing business policies. For example, policies around health and safety or labour processes may not cover rights relating to indigenous land, freedom of expression or privacy rights.

It is noted that there is often a correlation between red flags for human rights impacts and certain other adverse impacts, such as corruption or product quality. Human rights risks and impacts are not a separate class of E&S risks or impacts, distinct from the more familiar types of E&S impacts that fund managers already include in their due diligence. Rather, E&S impacts are also human rights impacts when their impact on individuals or groups negatively affects the ability of those individuals or groups to enjoy their basic human rights, as defined by internationally-accepted standards. Furthermore, effective HRDD should help to identify and prevent potential human rights impacts before they occur, or influence remediation of those that already existed.

Accordingly, a PE firm with a robust ESG due diligence process in place will in theory be well positioned to identify and address most human rights risks and impacts in many transactions¹⁵ (although they may not be framed in human rights language). This is applicable to PE firms that have experience conducting such due diligence in line with the IFC Performance Standards and where such due diligence is performed robustly. However, it cannot be assumed that all PE firms have ESG due diligence processes in place that are adequate for identifying and addressing the full range of possible human rights impacts referred to in the UNGPs.¹⁶ As a result, there is a need to refine and expand existing ESG processes by adding an HRDD lens. In either case, the HRDD lens will add value through its additional emphasis on contextual risks and risks connected to the business relationships.

HRDD should not necessarily be viewed as an additional process. ESG processes could be evolved, deepened and reframed to include human rights language and to comprehensively cover all internationally-recognised human rights and HRDD expectations.

9 Guiding Principle 17(a).

10 Commentary to Guiding Principle 19.

11 Guiding Principle 24.

12 For example, the UK Modern Slavery Act, the French law on vigilance and other legislative developments listed above in fn 3 and 4.

13 For example, in December 2016, an international investment tribunal confirmed that private companies have human rights obligations in terms of international law, which can be enforced in bilateral investment treaty claims: *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v the Argentine Republic*, ICSID Case No. ARB/07/26, 8 Dec 2016.

14 <https://www.corporatebenchmark.org/>

15 For example, see CDC ESG Toolkit for Fund Managers, available at <http://toolkit.cdccgroup.com/e-and-s-briefing-notes/human-rights>.

16 Casey O'Connor and Sarah Labowitz "Putting the "S" in ESG: Measuring Human Rights Performance for Investors" NYU Stern (9 March 2017), available at <http://bhr.stern.nyu.edu/statement/2017/3/8/report-reveals-gaps-in-social-performance-metrics-needed-by-investors-to-identify-leading-companies>.

II. Private Equity and HRDD

What is the responsibility of PE investors for human rights impacts?

According to the UNGPs, all business enterprises regardless of sector have a responsibility to respect human rights, and to carry out necessary HRDD. This also applies to PE investors.

Governments adhering to the OECD Guidelines (which have incorporated the UNGPs into sectoral guidance and general guidance for Responsible Business Conduct) are required to set up a National Contact Point (NCP). The main role of the NCP is to reinforce the Guidelines by undertaking promotional activities, handling enquiries and helping to resolve issues that may arise from the alleged non-observance of the guidelines in specific instances by providing a mediation and conciliation platform. The Office of the High Commissioner for Human Rights has elaborated on the HRDD responsibility of financial institutions,¹⁷ and the Norwegian NCP for the OECD Guidelines on Multinational Enterprises has discussed the HRDD responsibility of a pension fund.¹⁸ However, questions related to the implications for PE General Partners (GPs) and Limited Partners (LPs) have not been clarified. Our workshop highlighted a few questions around the application of HRDD in PE investments which would be useful to explore in further research.

The UNGPs expect that businesses identify potential human rights issues across their own operations and value chain, prioritise according to severity and likelihood, and then seek to understand how the business is connected to the human rights issues (through causing, contributing or being linked to). This analysis will then determine whether leverage, direct action or a combination of both is required. Where impacts are outside of the business enterprise's control, the UNGPs require it to exercise leverage, or seek to improve leverage where leverage is limited, including through collaboration if appropriate.

In a PE context, the responsibility of the LP, which has limited influence over the PE fund, would be to seek to exercise leverage when engaging with the fund manager. In contrast, the level of influence a GP has over a company may at times be of such a significant nature that it no longer qualifies as leverage, but instead constitutes control. In such a case, the GP may be deemed responsible for ceasing or preventing the action causing the harm, rather than exercising its leverage with the third party.

Case law on corporate accountability for human rights shows an emerging control or test, whereby courts look at factors such as the level of control, knowledge, proximity or the foreseeability a defendant company had over the activity in question, even when it was undertaken by a legally separate entity such as a subsidiary.¹⁹ This also reflects the growing expectation that businesses will seek to undertake due diligence on, and exert influence over, human rights conditions.

17 OHCHR Response to the Request from the Chair of the OECD Working Party on Responsible Business Conduct, 27 November 2013, available at <http://www.ohchr.org/Documents/Issues/Business/LetterOECD.pdf>.

18 The Norwegian National Contact Point for the OECD Guidelines for Multinational Enterprises, *Complaint from Lok Shakti Abhiyan, Korean Transnational Corporations Watch, Fair Green and Global Alliance and Forum For Environment And Development vs. Posco (South Korea), Abp/Apg (Netherlands) And Nbim (Norway), Final Statement*, 27 May 2013 at 6.

19 See for example *Choc v Hudbay Inc.*, (2013) ONSC 1414, para 27.

Another important consideration for PE investors is that the UNGPs require HRDD to consider risks emanating from specific operating contexts. As PE is a regular source of capital for businesses in developing countries with a higher likelihood of salient human rights risks (or industries in developed markets such as agriculture and warehousing with recently-reported high rates of modern slavery), these investments may require higher levels of HRDD.

Further questions for clarification in a PE context include the practical application of the concepts of severity, salience (used by the UN Guiding Principles Reporting Framework of Shift and Mazars),²⁰ and how these relate to the concepts of materiality and fiduciary duty which have traditionally provided a strong foundation for responsible investment in PE. As described above, HRDD is concerned with the risks to rights-holders, rather than material risks to the business. Whilst a robust ESG due diligence process will consider risks to business stakeholders, it does not guarantee that all risks to rights-holders will be identified. The purpose of a risks-to-rights-holders lens is that it requires prioritisation based on severity of harm rather than the level of control or feasibility of addressing the impact. This distinction is important and often brings challenges in translating and applying these concepts, although both concepts may result in operational and reputational risks.

What is the value of HRDD for PE?

HRDD is identified by the UNGPs as an ongoing process that should be embedded into a business enterprise's practices. A robust approach to HRDD by a PE firm would go from pre-acquisition due diligence to ensuring that the portfolio companies themselves embed HRDD into their own operating systems. A portfolio company with an effective HRDD process in place protects itself, investors and the relevant rights-holders, by being able to identify, prevent and address human rights impacts even before they arise.

It was pointed out in the workshop that PE is uniquely positioned to deal with human rights issues, as PE firms can "price in risk", influence improvements and share HRDD best practice approaches across fund portfolios. A PE firm capable of, and with a reputation for, embedding strong HRDD processes into formerly high-risk portfolio companies should benefit financially by protecting value through risk reduction, cost reduction (such as reducing workforce turnover), or creating value by enhancing the company brand.

Exit considerations are another driver for PE firms to adopt responsible investment programmes. One example of this highlighted at the workshop was of a portfolio company sold to a buyer with a reputation for high human rights and ESG standards. The buyer placed significant weight on its reputation and its own ESG rankings. Since the target already complied with all the buyer's ESG standards, the buyer would not need to incur costs to bring it up to its expected level. As a result, the buyer was happy to pay a premium and expressly indicated that this was due to the embedded ESG standards.

Further research could be done on the potential for human rights impacts to affect the exit process. The reputational risk implications of human rights impacts for PE firms are particularly important when considering that they rely on the strength of their reputation and track record for repeat investment and strong investor relationships. Reputation is such an important consideration for PE investors that workshop participants agreed that reputational risks are currently a stronger driver for PE firms to adopt HRDD than compliance risk.

²⁰ Available at <http://www.ungpreporting.org/>.

III. The considerations, constraints and potential for HRDD in private equity

Characteristics of private equity

Workshop participants identified various characteristics of PE that made HRDD particularly challenging or effective, raising discussion points on the application of the UNGPs that merit further research. The discussions highlighted several questions that call for further consideration regarding HRDD in a PE context.

i. The holding period

There are time constraints around what private equity firms can do.

PE investments are typically held for up to seven years. The UNGPs indicate that HRDD “should be initiated as early as possible in the development of a new activity or relationship, given that human rights risks can be increased or mitigated already at the stage of structuring contracts or other agreements, and may be inherited through mergers or acquisitions.”²¹ Workshop participants highlighted that some portfolio companies are “so far behind” that it may be a challenge to establish effective human rights policies and practices within the investment period.

Workshop participants indicated that, where possible, PE firms should meet with the target company’s management to determine what their strategies, track record and values are with respect to HRDD.

If a PE firm is able to highlight the importance of human rights impacts during due diligence and at the point of acquisition, and collaborate with the company management on how to address these, they will be in the best position to identify and mitigate human rights impacts through ongoing HRDD. The PE firm should discuss with management their understanding of human rights risks, encourage training where necessary, and support development or improvement of strategies, implementation and tracking. Ongoing HRDD should also apply to any bolt-on acquisitions made during the investment.

It was highlighted that, in situations where it was not possible to conduct thorough due diligence or where the company management shows a complete disregard for human rights, PE investors are maybe able to replace management with people who have the requisite experience to embed processes for avoiding and mitigating human rights risks.

²¹ Commentary to Guiding Principle 18.

ii. Leverage and influence

PE firms enjoy significant leverage which they may be required to use to address human rights issues.

When human rights impacts are linked to a business enterprise through the activities of third-party business partners, over which the business enterprise does not have full control, the UNGPs expect the business enterprise to exercise leverage over that third party. The UNGPs indicate that leverage exists “where the enterprise has the ability to effect change in the wrongful practices of an entity that causes a harm.” If the business enterprise lacks leverage, it should seek to increase it, through capacity-building or collaboration with other actors, for example.²²

As mentioned above, PE firms will typically be able to exercise the rights of ownership of its underlying funds, in this case the third-party business partner. Accordingly, the PE firm would be viewed as capable of exercising leverage or even control to effect change, as increasingly many PE firms do as part of their ESG efforts. Depending on the investment strategy of the PE fund, and the typical investment stake taken in the company, a PE firm may have a controlling stake which creates the expectation to cease or prevent any harm caused. Even minority stakeholders would still be seen as having a high level of influence, particularly as PE firms usually have a seat on the portfolio company board.

By contrast, the LP has a lower level of leverage insofar as they make blind pool investments and are unable to influence the investment decisions of the fund manager due to their limited liability status (although they put parameters around how their capital is invested using exclusions or opt-out rights in the fund terms). From the LP’s perspective, they could seek to use their leverage by making their expectations on HRDD clear when in dialogue with the manager during fundraising. When committing to the fund, the LP may consider how to incorporate their HRDD requirements into the fund terms. This practice would need further research. Once committed to the fund, the LP could seek to leverage their status as a (repeat) investor and an important relationship to the PE firm by engaging them in dialogue, should they have any concerns about human rights impacts in the underlying portfolio.

iii. Is termination an option?

The nature of PE means that divestment is difficult and inadvisable.

The UNGPs indicate that where a business enterprise lacks leverage over a third party linking it to human rights impacts, and is unable to increase leverage, the business enterprise may wish to end its relationship with the third party. However, before ending the relationship, the human rights impacts of the termination should be considered. The UNGPs further state that “for as long as the abuse continues and the enterprise remains in the relationship, [the enterprise] should be able to demonstrate its own ongoing efforts to mitigate the impact and be prepared to accept any consequences – reputational, financial or legal – of the continuing connection.”²³

From the LP’s perspective, whilst it is possible to put provisions in place to excuse their capital from a single investment in a fund, it is not possible to divest from a single investment in a PE fund once it is made (unless the LP is provided with the rights to force a sale in the event of serious breach). As per above, the LP could seek to engage the PE firm in dialogue about an investment. In instances where the PE firm shows complete disregard for the human rights impacts of their investments, the LP could divest from the whole fund as a last resort, although the difficulties associated with this should not be downplayed.

Workshop participants highlighted that from the PE firm’s perspective, it is often the worst time to sell when a human rights impact has been raised publicly, and the PE firm needs to ensure that the issue is fixed before it even considers exit. This mirrors NGO criticism that firms should not “cut and run” from human rights abuses; rather, once informed, they should seek to use their leverage to influence remediation for rights holders and improve company practices. If a negative human rights impact occurs, an embedded HRDD process enables a resilient investor response which can enhance future value of the asset. This confirms the importance of a robust HRDD process to identify and prevent potential human rights impacts before they take place, and to address and mitigate those impacts which do occur.

²² Commentary to Guiding Principle 19.

²³ Commentary to Guiding Principle 19.

iv. Policies, contractual arrangements and codes of conduct

There are existing mechanisms to formalise HRDD commitments, but they are not effective without capacity and monitoring.

Whilst believed to be rare at this stage, it was discussed that LPs may seek to ensure a PE firm's commitment to HRDD by requesting specific reference to HRDD and the UNGPs in the Limited Partnership Agreement (LPA) or through a side letter.²⁴ The PE firm may use the investment agreement process to define expectations on HRDD with the portfolio company. A first step towards embedding HRDD into portfolio company operations may be to require the company to create a standalone human rights policy or incorporate human rights language into policies and codes of conducts that are sent to suppliers.

BIICL's research on HRDD has shown that a commitment to monitor compliance should be included when human rights are incorporated into contracts, and that steps towards enforcement should be taken where necessary. Enforcement of contractual human rights provisions is still relatively rare across all sectors.²⁵ Fund documents, LPAs and side letters are often heavily negotiated at the outset and may refer to various instruments including the UNGPs. There is currently little understanding of how to monitor and enforce these provisions in practice. Questions around enforcement in a PE context provide an area for further exploration and guidance.

It may be worth considering whether some aspects of HRDD could be included as safeguards and others as more aspirational targets. BIICL's research has shown that clear and detailed contractual provisions may help to clarify exactly what is expected of the contracting party. Workshop participants discussed how robust ESG acquisition due diligence can uncover exposure to particularly acute ESG risks. As a result, the action plan associated with the investment agreement may include a de-risking process. This helps focus the minds of management and formalises the ESG process. The same approach could incorporate findings from HRDD if it they are not incorporated already.

Incorporation of human rights provisions into policies, contractual arrangements, codes of conduct and risk assessments constitute practical steps through which a PE firm can start to effectively integrate HRDD into its processes and demonstrate action. The challenge is that though these documents may address environmental, safety and labour law compliance for company operations, clarity is needed around concepts such as supply chain labour conditions and modern slavery risk. More research is needed on how to elicit clearer company commitment to improve respect for human rights in practice.

Integration of HRDD into PE processes

i. Human rights impact assessments

PE portfolio companies often cover a diverse range of industries, operational contexts, jurisdictions and value chains. It is therefore advisable to undertake human rights impact assessments (HRIAs) to identify the human rights impacts most at risk within the operations and supply chain of each acquisition target. Workshop participants pointed out that HRIAs are currently not standard practice in PE due diligence. However, HRIAs do not need to be standalone, and good environmental and social impact assessments (ESIAs) should comprehensively cover human rights impacts.

ii. Prioritisation

The UNGPs allow for prioritisation of certain human rights risks where they are most severe, "whether due to certain suppliers' or clients' operating context, the particular operations, products or services involved, or other relevant considerations". The UNGPs define severity of a human rights impact as being determined by scale, scope and irremediable character.²⁶

²⁴ See PRI Incorporating Responsible Investment Requirements Into Private Equity Fund Terms (2017)

²⁵ BIICL and NRF "Exploring Human Rights Due Diligence" (2017) available at <http://human-rights-due-diligence.nortonrosefulbright.online/>; McCorquodale, Smit, Neely and Brooks "Human Rights Due Diligence in Law and Practice: Good Practices and Challenges for Business Enterprises" *Business and Human Rights Journal* 2 (2017) 195.

²⁶ Commentary to Guiding Principle 14.

Workshop participants agreed that it is difficult to understand the extent of these concepts in practice, particularly when deciding how to apply limited resources to effective implementation of HRDD. One workshop participant highlighted that prioritisation is key to driving HRDD internally, in that it helps if one can explain why certain issues are prioritised and outline the potential commercial consequences to gain support from their deal team and the portfolio company management.

iii. Dedicated HRDD processes and human rights language

BIICL's research involving over 150 companies worldwide has shown that companies with a human rights focus are significantly more likely to identify adverse human rights impacts than those using existing processes that are not framed in human rights language. For example, processes focused only on health and safety or labour rights may miss other human rights such as those related to land, freedom of expression or privacy.²⁷ In addition, legal claims and public criticism often use human rights language (rather than ESG language) and, accordingly, it helps if the company can respond on the same terms.

Depending on their strategy, PE financing structures that operate in developing markets usually target growth companies which typically do not have the capacity to undertake standalone human rights processes to the same extent as larger businesses. The UNGPs acknowledge that smaller businesses may have less capacity and as a result more informal processes and management structures than larger businesses. However, the UNGPs also highlight that smaller businesses can have severe human rights impacts and should therefore have measures in place regardless of their size.²⁸ HRDD does not need to be a standalone process; it can be integrated into other processes as long as all human rights are taken into account before certain human rights risks are prioritised over others.

iv. Multitude of ESG/sustainability measures

Myriad concepts are currently used in this area besides the UNGPs. This proliferation presents a challenge for the teams responsible for ESG/sustainability and may be perceived as burdensome (due to reporting requirements, associated costs, capacity constraint in consultancy market and timing of additional due diligence/impact assessments).

Workshop participants confirmed that implementing HRDD should not be about repackaging ESG or sustainability concepts, nor should it be seen as adding yet another issue" for deal teams to consider. Instead, HRDD should be integrated as part of the ESG framework through deepening and adding a human rights lens to existing measures. It is essential that existing ESG mechanisms are updated and enhanced to incorporate more robust and dedicated HRDD questions, as some are doing.

Where the comprehensive HRDD described in the UNGPs is incorporated into ESG systems, this should also prepare the business enterprise to report on and comply with most current and forthcoming regulatory requirements which use the terminology and requirements of the UNGPs. This would streamline reporting activities, as the same reports could be used in response to the various similar and/or overlapping reporting requirements.

One example highlighted at the workshop was from a PE firm which, when the UK Modern Slavery Act came into force, had 10 portfolio companies that needed to comply with the Act. The PE firm looked at what those companies were doing regarding compliance with the Act, highlighted some best practice and applied it more widely across its portfolio to other companies not covered by the Act.

²⁷ BIICL and NRF "Exploring Human Rights Due Diligence" (2017) available at <http://human-rights-due-diligence.nortonrosefulbright.online/>;
McCorquodale, Smit, Neely and Brooks "Human Rights Due Diligence in Law and Practice: Good Practices and Challenges for Business Enterprises" *Business and Human Rights Journal* 2 (2017) 195.

²⁸ Commentary to Guiding Principle 14.

HRDD challenges in general

Some of the challenges highlighted by workshop participants are not unique to the PE financing structure, but apply to HRDD in general as relevant to all sectors.

i. Limited resources

Across sectors, it is often challenging for small companies to implement HRDD measures. HRDD processes may include sending out questionnaires to suppliers which could return a 100% compliance rate despite well-known risks in the operational context. A small company must find a realistic way to identify, prevent and address human rights risks within its limited resources. These are questions that are not unique to the PE financing structure.

ii. Company supply chains

One of the key areas of current concern for business enterprises across all sectors is how to implement HRDD in supply chains. Increasingly, regulation is requiring reporting and monitoring of human rights risks in supply chains, and more companies are starting to develop practices to address these risks.

Workshop participants identified a few of the associated challenges. For example, the question arises as to how a small portfolio company should conduct HRDD in its supply chain if its main supplier is a large multinational. Other questions include how far down the supply or value chain one is required to go with respect to exercising HRDD, and what the responsibility of the PE firm is in this respect.²⁹ This is demonstrated in the area of conflict minerals where firms have been pressured by stakeholders to assess and engage to influence an issue extremely far down their supply chains.

iii. Internal communication/translation into operational language

Workshop participants expressed a need for training or guidance on translating human rights language into operational language, and internally between teams. It was stated that it is currently difficult for support teams to know how to raise human rights issues with the deals team. For example, it was confirmed that most managers understand what is meant by "health and safety", but there is considerably less knowledge about the meaning and content of the array of internationally-recognised human rights. It was highlighted that HRDD should not be a specialist issue but integrated into corporate culture.

Workshop participants indicated that case studies may be useful to assist with communicating the human rights issues applicable within the specific business context. It was also highlighted that successful internal communication is enhanced by speaking in pragmatic terms, operationalising human rights language, highlighting ways in which HRDD can add value, and by playing a part in resolving any major crises that may arise. It would also be helpful to analyse how HRDD adds value over and above existing approaches, disentangling where it identifies the same ultimate impact, although framed in a different way, and where it can provide the perspective to identify previously undiscovered impacts.

One example of translating human rights into operational language highlighted at the workshop was where a human rights issue arose through the outsourcing process of a company. The ESG team informed the deal team that it was not possible to quantify the risk, but that if the risk materialised the anticipated IPO may be cancelled. When human rights impacts are incorporated into business language, it is easier to bring about action.³⁰

29 See PRI's guidance [Managing ESG risk in the supply chains of private companies and assets](#) (2017) which aims to empower private equity, infrastructure and real estate investors to improve the risk profile of their portfolios and maximise their returns by promoting effective management of ESG risks in the supply chains of their portfolio companies.

30 However, whereas this was an example of translating the risks that adverse human rights impacts may pose to a specific business, it should be emphasised that adverse human rights risks cannot always be linked to negative operational or financial consequences, and the UNGPs emphasise that HRDD should look at the risks to rights-holders, regardless of any corresponding risks for the business enterprise itself.

iv. Monitoring and grievance mechanisms

As part of HRDD, the UNGPs expect business enterprises to monitor the effectiveness of actions taken to address actual or potential adverse human rights impacts. The UNGPs also refer to the use of operational-level grievance mechanisms to identify and address adverse human rights impacts.

Questions arise across all sectors as to how effective monitoring can take place in practice. The limitations of commoditised, non-collaborative auditing processes are well-documented, and more companies are participating in industry collaborative human rights-focused audits whereby rights-trained auditors can be better funded to spend sufficient time being appropriately investigative. There is a need to develop a better understanding of what effective HRDD monitoring and grievance mechanisms could look like in a PE context.

IV. Key takeaways

HRDD is a new area where the landscape and practice is still evolving. Some key questions arise on the implementation of HRDD in PE investment specifically. Workshop participants agreed that it would be useful for further research to consider what a HRDD process may look like in a PE context.

The following takeaways from the workshop point to areas where further research could be helpful:

- i. HRDD entails having a **comprehensive process** in place to identify and prevent any potential adverse human rights impacts (risks) before they occur, as well as addressing and mitigating those impacts which have already occurred.
- ii. Certain features of PE investment may necessitate a higher level of HRDD than other types of investment or financial activity. For example, **holding periods**, the **size of the investment stake**, the nature of the markets in which they invest, and the limited options for termination all contribute to the level of HRDD which may be expected. With that said, the leverage of PE firms puts them in an excellent place to influence faster action by portfolio companies on HRDD and to track results and effective practices.
- iii. Even robust ESG due diligence processes may not capture all human rights risks. Questions arise as to how UNGP-compliant HRDD **could enhance existing ESG processes**.
- iv. Several practical questions arise around implementation. For example, how can a GP or LP respectively exercise **leverage**? How can **contracts, side letters and codes of conduct** be improved to facilitate HRDD? How can **human rights impact assessments (HRIAs)** and **prioritisation of severe impacts** be incorporated into current processes?
- v. It is acknowledged that **internal communication** could be improved. Human rights language should be used and operationalised to ensure that all team members understand potential human rights impacts and risks.
- vi. Human rights considerations may be of utmost importance at the exit stage. Further research on the role of HRDD in the **exit process** would be welcomed.

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- Bettina Reinboth, Senior Manager Social Issues at PRI
- Olivia Watson, Head of Social Issues at PRI

Further reading

Business and Human Rights Resource Centre:

<https://business-humanrights.org/>

Search by sector, country or region, issue or by Principles (such as ILO, UNGPs, PRI)

BIICL Business and Human Rights research: <https://www.biicl.org/pilresearch>

And Human Rights Due Diligence research: <https://www.biicl.org/duediligence>

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