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Inherited Human Rights Risk

The Importance of Human Rights Due Diligence in M&A
Transactions

LAGF03 Essay in Legal Science

Bachelor Thesis, Master of Laws programme
15 higher education credits

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Term: Autumn term 2018

Contents

SUMMARY	1
SAMMANFATTNING	2
ABBREVIATIONS	3
1 INTRODUCTION	4
1.1 Background	4
1.2 Purpose	5
1.3 Research Questions	5
1.4 Previous Research and Delimitations	6
1.5 Methodology and Material	6
1.6 Structure	7
2 MERGERS AND ACQUISITIONS	8
2.1 Definition of M&A	8
2.2 Private Target M&A Transactions	8
2.2.1 <i>Share Purchase or Asset Purchase</i>	8
2.2.2 <i>Agreements</i>	10
2.3 Public M&A Transactions	10
2.4 Due Diligence	11
3 LEGAL FRAMEWORK FOR BUSINESS AND HUMAN RIGHTS	13
3.1 UN Guiding Principles on Business and Human Rights	13
3.1.1 <i>Corporate Responsibility to Protect</i>	14
3.1.2 <i>Human Rights Due Diligence</i>	15

4	LEGAL AND REGULATORY DEVELOPMENTS IN REGARD TO HUMAN RIGHTS	16
	4.1 International Developments	16
	4.2 Case-law Developments	17
5	ANALYSIS	18
6	CONCLUSIONS	21
	BIBLIOGRAPHY	23
	TABLE OF CASES	29

Summary

To date, there is no international ‘hard law’ instrument creating legally binding obligations for corporations. Instead, corporate activity is regulated by domestic law and ‘soft law’ standards on corporate responsibility and human rights. Increased pressure from various stakeholders combined with new regulatory developments illustrate that this might however, be changing. As increasing trends of globalization allow companies to operate transnationally, the concept of human rights risk has started to gain traction. New case-law in several jurisdictions has illustrated that the shield of limited liability that traditionally has served as a safety net for parent companies may no longer be as efficient, and that parent companies may in fact soon be facing responsibility for the human rights impacts of their foreign subsidiaries. It is therefore vital that companies seeking to undertake a merger or an acquisition integrate human rights aspects in their initial due diligence to avoid assuming human rights issues that might be embedded in the target company’s operations.

Although the purchaser in M&A transactions can seek contractual protection against risk through incorporating warranties and indemnities, these are often limited to financial and legal risks, and may not always prove sufficient in the case of human rights complications. As reflected in the United Nations Guiding Principles on Business and Human Rights (UNGPs) companies should therefore conduct a thorough human rights due diligence to avoid becoming accountable for unwarranted liabilities. This will allow the purchaser to identify potential risks connected to human rights impacts that may expose the purchaser to severe financial, legal, commercial and reputational damage.

Sammanfattning

I dagsläget saknas bindande internationell eller mellanstatlig lagstiftning för företag motsvarande "hard law". Regelverk för företag har istället utvecklats genom nationell lagstiftning och "soft law" i form av icke-bindande principer och normer för mänskliga rättigheter och företagsansvar. Genom påtryckningar från olika intressenter samt genom utvecklingen av ny reglering, kan detta dock komma att ändras. Växande globalisering gör att företag idag kan verka över hela världen, vilket även har resulterat i ett ökat fokus på företagsansvar och mänskliga rättigheter. Ny rättspraxis på området i flera olika länder belyser även att det begränsade ansvar som tidigare skyddat moderbolag i förhållande till deras dotterbolag, kanske inte längre har samma effekt, och att moderbolag inom snar framtid kan komma att bli ansvariga för ett dotterbolags påverkan på mänskliga rättigheter. Det är därför av stor vikt att ett företag som planerar att genomföra ett företagsförvärv integrerar frågor om mänskliga rättigheter i sin företagsbesiktning (en så kallad "due diligence") innan de förvärvar målföretaget.

Även om köparen i viss mån genom avtal kan skydda sig i form av garantier och skadeslöshetsvillkor, gäller dessa oftast uteslutande finansiella och legala risker, och ger inte alltid ett adekvat skydd mot problem förknippade med mänskliga rättigheter. Företag bör därför i enlighet med FN:s vägledande principer om företag och mänskliga rättigheter genomföra en "human rights due diligence" för att undvika oönskat ansvar. Detta gör att köparen kan identifiera potentiella risker förknippade med mänskliga rättigheter, som i sin tur kan medföra finansiella, juridiska och kommersiella risker för det köpande företaget, samt påverka företagets rykte.

Abbreviations

HRDD	Human Rights Due Diligence
M&A	Mergers and Acquisitions
UK	United Kingdom
UN	United Nations
UNGPs	United Nations Guiding Principles on Business and Human Rights

1 Introduction

1.1 Background

Mergers and acquisitions (M&A), although common, may involve significant risks for the companies involved if not managed correctly.¹ These risks may include adverse human rights risk.² Although the concept of human rights and M&A transactions may at first glance appear unrelated, experience show that companies that neglect to consider human rights aspects when involved in a merger or an acquisition, may expose itself to severe consequences. One example is Finnish company Nokia, who suffered severe reputational damage in 2009, after divesting³ its business to Iran Telecom. Nokia's products were subsequently believed to have been used by Iranian authorities to target political dissidents during the Iranian elections. The major media campaign on the issue resulted in a public boycott of its products.⁴ Another well-known example is US/Canadian multinational corporation Meridian Gold, which acquired Brancote Holdings plc, the sole owner of the Esquel Gold mine in Argentina, in July 2002. The surrounding community opposed the mine project due to the negative consequences on locals that the exploitation of the mine would entail. Although compliant with local laws, Meridian Gold suffered significant financial consequences because of the opposition of the surrounding community.⁵

The United Nations Guiding Principles on Human Rights and Business (UNGPs), adopted in 2011, explicitly recognize that human rights risks may

¹ Sevenius, Robert. *Företagsförvärv*, Edition 2:1, Studentlitteratur, Lund, 2011, p. 77

² The UNGPs describe 'human rights risks' as "the business enterprise's potential adverse human rights impacts". For further reading see commentary to principle 17 UNGPs

³ A divestment occurs when a substantial part of the seller's business is sold or otherwise disposed of. See Bainbridge, Stephen M. *Mergers and Acquisitions*, 3rd edition, Foundation Press, New York, 2012, p. 27

⁴ Dehghan, Saeed Kamali. (2009). *Iranian consumers boycott Nokia for 'collaboration'*, The Guardian, 14 July. Available <https://www.theguardian.com/world/2009/jul/14/nokia-boycott-iran-election-protests> [Accessed 12 Dec 2018]

⁵ Valente, Marcela (2007). *Argentina: Local Opponents of Mine Sued by Meridian Gold*, Inter Press Service News Agency, 15 Feb. Available at: <http://www.ipsnews.net/2007/02/argentina-local-opponents-of-mine-sued-by-meridian-gold/> [Accessed 27 Nov 2018]

be assumed through M&A. In order to identify and mitigate these risks, companies should therefore conduct a thorough human rights due diligence (HRDD).⁶ The importance of HRDD has since been incorporated into legislation in several jurisdictions. Foremost is the adoption by France on a new law on duty of care, requiring larger multinational corporations to conduct due diligence on human rights and labour conditions across their production chain.⁷ The significance of including human rights issues in the due diligence process should also be viewed against the background of the increased pressure from various stakeholders to develop a legally binding framework for business and human rights.⁸

1.2 Purpose

The purpose of this essay is to examine human rights risks in M&A transactions, and the importance of integrating human rights issues in the due diligence process of the transaction. This essay will also review the legal developments in the area of business and human rights, and the impact that these may have on M&A transactions.

1.3 Research Questions

For the purpose of this essay, I will answer two main research questions:

- In what ways are human rights risks relevant in M&A transactions?
- How can corporations address human rights risks in M&A transactions?

⁶ See Commentary to Principle 17

⁷ 'The French Corporate Duty of Vigilance Law', for further reading see European Coalition for Corporate Justice (2017), *The French Duty of Vigilance Law - Frequently Asked Questions*, 23 Feb (revised 24 March). Available at: <http://corporatejustice.org/documents/publications/french-corporate-duty-of-vigilance-law-faq.pdf> [Accessed 11 Dec 2018]

⁸ See for example the 'UN Guiding Principles Reporting Framework Investor Statement' available at <https://www.ungpreporting.org/framework-guidance/investor-statement/> [Accessed 2 Jan 2019]

1.4 Previous Research and Delimitations

Although there is a vast amount of research on the area of business and human rights in general, less can be found on human rights in M&A more specifically. Though it has been concluded that HRDD is in fact a winning concept in M&A transactions,⁹ few have elaborated on the underlying reasons for this, or the consequences that companies may suffer in assuming human rights liabilities. This essay therefore aims to address this gap, and will begin by reviewing already conducted research.

This essay will focus on transnational M&A transactions, as they typically face higher exposure to human rights risk than transactions conducted on domestic markets, due to culture aspects and foreign regulations.¹⁰ Although the terms of mergers and acquisitions are often used interchangeably, the rules and principles of the two forms may vastly differ.¹¹ Acquisitions in the form of share purchases or asset purchases have been chosen as the main focus of this essay purely to narrow down the scope. Further, the UNGPs is the most widely accepted international standard on corporate responsibility and human rights, and will therefore be of primary focus in this essay.

1.5 Methodology and Material

This essay uses an interdisciplinary method, which means that two traditional fields of study are combined.¹² Internationally recognized aspects of corporate law are compared with international standards and principles in the area of human rights, in order to address how human rights risks may be inherited through mergers and acquisitions. By applying an international perspective, this essay aims to outline internationally recognized principles

⁹ See for example, Shift, *Human Rights Due Diligence in High Risk Circumstances: Practical Strategies for Businesses*, (March 2015). Available at: https://www.shiftproject.org/media/resources/docs/Shift_HRDDinhighriskcircumstances_Mar2015.pdf [Accessed 28 Dec 2018]

¹⁰ *ibid*

¹¹ Bainbridge, 2012, p. 19

¹² Korling, Fredric., Zamboni, Mauro (red.), *Juridisk Metodlära*, Edition 1:2, Studentlitteratur, Lund, 2013, p. 428

in corporate law as well as determine if these rules can provide sufficient protection against human rights risks.

The primary material used for this essay is literature and academic writings by scholars well acquainted with the subject of business and/or human rights. The UNGPs have been used as a reference point on the area of business and human rights throughout this essay. Although not binding to companies or states, the principles to date serve as the most relevant and widely accepted international standard on the matter. Official documents have further been examined to elaborate on the matter.

1.6 Structure

This essay begins with an overview of the basic structures of M&A transactions, as well as the traditional and internationally recognized principles of corporate law in M&A transactions (chapter 2). Chapter 3 will discuss the international legal framework for business and human rights, as well as describe the core features of the UNGPs. This chapter also covers a section on human rights due diligence from the perspective of the UNGPs. In chapter 4, the legal developments on the area of business and human rights are discussed. The final chapters (chapter 5 and 6) outline an analysis and a conclusion based on the examination presented.

2. Mergers and Acquisitions

2.1 Definition of M&A

Mergers and acquisitions can be defined as transactions where the ownership of companies is either merged into one entity (a merger) or when one entity takes control of another entity's shares or assets (an acquisition). Under an acquisition, the acquired company (henceforth the 'target company' or 'target') will not cease to exist, but all assets and liabilities will be under the ownership of the acquirer.¹³ M&A transactions can generally be divided into public transactions (where the target and sometimes the acquirer is a public company) and private transactions (where the target is a private company or certain assets).¹⁴ As abovementioned, the primary focus of this examination will be on the structure of acquisitions.

2.2 Private Target M&A Transactions

Although there are several ways to acquire control of a company, acquisitions generally take the form of a share purchase or an asset purchase.¹⁵ The preferred choice of structure for the purchaser may depend on different circumstances, including tax and financial issues, if the seller is in insolvency or not, and what assets and liabilities that the purchaser is interested in acquiring.¹⁶

2.2.1 Share Purchase or Asset Purchase

Under a share purchase contract, the acquiring company purchases all, or at least a majority of the target company's stock from the target company's shareholders. The purchaser will hence acquire all of the target company's

¹³ Bedier, Mohammad. *Cross-Border Mergers and Acquisitions, the Case of Merger Control v. Merger Deregulation*, Edward Elgar Publishing Limited, 2018, p. 73

¹⁴ Sevenius (2011), s. 37

¹⁵ Matheson, John H. *Successor Liability*, 96 Minn. L. Rev. 371, (2011), p. 374, available at http://www.minnesotalawreview.org/wp-content/uploads/2012/02/Matheson_MLR.pdf. [Accessed 14 Dec 2018]

¹⁶ Singleton, Susan. *Beswick and Wine: Buying and Selling Private Companies and Businesses*, 10th edition, Bloomsbury Professionals, Haywards Heath, 2018, p. 126

assets, but also its liabilities. If the purchaser acquires a controlling equity interest in the target company, the target company becomes a subsidiary of the acquiring company. The purchaser will in turn become a parent company of the subsidiary.¹⁷ The parent company will hold limited liability for the actions of its subsidiary.¹⁸ This is based on the principle of separate legal personality whereby the company's rights and obligations will be separate from those of its owners.¹⁹ In most jurisdictions this form of business is known as a limited liability company.²⁰ Only in exceptional circumstances may the company's owners be held liable for the company's liabilities. This is known as "piercing the corporate veil".²¹ Responsibility for a subsidiary company's obligations can also arise on contractual basis, e.g. by way of parent company guarantees, in which the parent company may become liable if the subsidiary fails to perform its obligations.²²

Under an asset purchase contract, the buyer will purchase all, or a part of, the target company's individual assets.²³ According to the principle of non-liability, the purchaser will not become liable for any liabilities not expressly acquired or agreed upon.²⁴ The purchaser in an asset transaction is generally therefore able to choose the assets and liabilities it wishes to contractually assume, hence reducing the risk of becoming liable for unknown liabilities.²⁵

¹⁷ Matheson (2011), p. 376

¹⁸ Mares, Radu, Legalizing Human Rights Due Diligence and the Separation of Entities Principle (October 17, 2017). Surya Deva and David Bilchitz (eds.), Building a Treaty on Business and Human Rights: Context and Contours (CUP, 2017) pp. 266-296. Available at: SSRN: <https://ssrn.com/abstract=3054492> [Accessed 26 Nov 2018]

¹⁹ Blumberg, Phillip I. *Limited Liability and Corporate Groups*, 11:4 J. Corp. L., (1986), p. 577, available at: <http://heinonline.org/HOL/P?h=hein.journals/jcor111&i=583>. [Accessed 15 Dec 2018]

²⁰ Human Rights Council, *Human rights and Corporate Law: Trends and Observations from a Crossnational Study Conducted by the Special Representative, Addendum 2 to the Report*, A/HRC/17/31/Add.2 (23 May 2011) p. 11

²¹ *ibid*

²² Thompson, Stuart (2011), *Don't judge a parent company by its cover!* Mills & Reeve. 11 Sept. Available at: https://www.mills-reeve.com/files/Publication/a9e5d3f3-f722-4c25-8c62-3e1cdb5ef61d/Presentation/PublicationAttachment/b7ce2ec1-a24e-41e0-b9a3-492c381e7a16/Parentcompanyguarantees_Sept11.pdf [Accessed 27 Dec 2018]

²³ Sevenius (2011), s. 35

²⁴ Matheson, p. 381

²⁵ Singleton (2018), p. 126

2.2.2 Agreements

The preliminary agreements in a private M&A transactions normally consist of a non-disclosure letter (which protects the parties from the disclosure of any confidential information) and a letter of intent (which outlines the key terms of the transactions, such as the transaction scope, price and price structure).²⁶ Following preliminary agreements, the parties will proceed to draft a definitive purchase agreement, typically in the form of a share purchase agreement or an asset purchase agreement. The purchase agreement will typically outline the provisions related to the specification of the shares or assets and will normally also include so-called warranties and indemnities. Warranties can be described as the disclosure of certain facts, which the seller will guarantee are or will be true. Warranties hence enable the purchaser to hold the seller responsible for breach of contract, should the warranty be incorrect.²⁷ The seller will normally try to limit its liability for matters related to the warranties by disclosing as much as possible regarding the warranties in a disclosure letter. Through the disclosure letter, the seller can avoid liability for a breach of a warranty concerning the matters disclosed.²⁸ By including indemnities, the purchaser is further protected in situations where a breach of warranty might not generate a claim for damages, as the purchaser will not need to determine loss in order to be reimbursed for a certain liability.²⁹

2.3 Public Target M&A Transactions

A public target M&A transaction (or a “takeover”) refers to the acquisition of a target company whose shares are listed on a stock exchange, through the launching of a public bid.³⁰ If the target company is public, there may be no letter of intent following the non-disclosure agreement, nor will there be

²⁶ Bainbridge (2012), pp. 70-71

²⁷ *ibid* at p. 79

²⁸ Singleton (2018), p. 217

²⁹ Sevenius, Robert, *Due Diligence Besiktning av Företag*, 1st edition, Sanoma Utbildning, Stockholm, 2013, p. 178

³⁰ Sevenius (2011), s. 37

a share purchase agreement as the shares are owned by disparate shareholders. Instead, the target company board of directors will have to decide if an indicative bid for the shares of the target company would be in the best interest of the shareholders, whether or not to allow the bidder to conduct a due diligence and ultimately, and whether or not to recommend the shareholders to accept or reject the offer.³¹ If the offer is likely to be recommended by the board of directors, (a *friendly bid*) the purchaser will be permitted to conduct a due diligence review of the target. If the board of directors of the target company finds an indicative offer not to be in the interest of the shareholders, the target board can decline due diligence and recommend its shareholders to reject the offer.³² The buyer can nonetheless make an offer for the target company without conducting due diligence. This is referred to as a *hostile bid*.³³ Naturally, due to the lack of a purchase agreement, contractual protection in the form of warranties or indemnities in public target M&As will not be possible.

2.4 Due Diligence

The due diligence review can be described as a comprehensive investigation of the target company and its business by the purchaser before entering into the purchase agreement or before making the public offer. The review normally consists of a commercial, financial and legal due diligence, in which the acquirer will try to gain as much information as possible about the target's business, as well as identify potential risks related to the transaction.³⁴

³¹ Kollegiet för svensk bolagsstyrning, (2018) *Takeover-regler för Nasdaq Stockholm och Nordic Growth Market NGM*. 1 April. Available at: http://www.bolagsstyrning.se/takeoverregler/takeoverregler-for-reglerade-marknader/reviderade-takeoverregler-2018__657 [Accessed 27 Dec 2018]

³² *ibid*

³³ Bainbridge (2012), p. 16

³⁴ Singleton (2018), p. 147

Due diligence is normally not required by law in most jurisdictions, but rather the common law rule of caveat emptor (buyer beware) applies.³⁵ This prevents the acquirer from relying on the law, should the target company not be what the purchaser expected. For this reason, warranties and indemnities serve as a form of protection for unwarranted liabilities. However, as warranties and indemnities do not exist in public M&A transactions, and may provide limited contractual protection in private transactions, the acquiring company often seeks to gain as much information about the target company and its business before making any commitments or launching a public offer.³⁶

³⁵ Singleton (2018), p. 147

³⁶ *ibid* at p.148

3. Legal Framework for Business and Human Rights

In examining the available instruments on corporate responsibility in regard to human rights, it is vital to comprehend the distinction between soft and hard law. Whereas hard law regulations are defined as legally binding obligations, soft law is not legally binding.³⁷ According to the previous Special Representative of the Secretary-General John Ruggie, soft law instruments do not by themselves create legally binding obligations, but rather “[derive] [their] normative force through recognition of social expectations by states and other key actors”.³⁸ Although attempts to create international hard law standards have been made, there is to date no international legally binding regulation that imposes direct obligations on business corporations in regard to human rights abuses.³⁹ Instead, international human rights guidelines such as the UNGPs have emerged.

3.1 UN Guiding Principles on Business and Human Rights

The UNGPs were adopted by the United Nations in 2011.⁴⁰ The UNGPs rested on the “Protect, Respect and Remedy” framework, created by Special Representative of the UN Secretary General John Ruggie whose main task was to investigate the issues of corporate responsibility in regard to human rights issues.⁴¹ He concluded that the responsibility rested on three differentiated but interrelated pillars; the state duty to protect against human

³⁷ European Center for Constitutional and Human Rights E.V., Glossary, *Hard Law/Soft Law*. Available at: <https://www.ecchr.eu/en/glossary/hard-law-soft-law/> [Accessed 15 Dec 2018]

³⁸ U.N. Human Rights Council, “Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts”, A/HRC/4/035 (9 Feb 2007), para. 45

³⁹ Ruggie stipulates in “Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts”, para. 44, that sources such as the International Bill of Human Rights, the Universal Declaration of Human Rights and the two Covenants, the other core UN human rights treaties and the ILO:s core conventions, do not impose direct legal obligations on corporations.

⁴⁰ U.N. Human Rights Council, Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework, HR/PUB/11/04 (2011).

⁴¹ UN Commission on Human Rights, Human rights and transnational corporations and other business enterprises - Human Rights Resolution 2005/69 (2005) (E/CN.4/RES/2005/69), para. 1.

rights abuses, the corporate responsibility to respect human rights, and the need for more effective access by victims to remedies.⁴²

To date, the UNGPs serve as the most recent international standard on business and human rights. The UNGPs are not legally binding international obligations, and do not undermine the legal obligations that States are subject to under international human rights law.⁴³ Rather, the aim to elaborate on existing standards for states and corporations in regard to human rights and illustrate how corporations can identify and mitigate human rights risk in their business operations.⁴⁴ As the focus of this essay is that of corporate responsibility, this examination will henceforth focus solely on the second pillar, namely the corporate responsibility to protect.

3.1.1 Corporate Responsibility to Protect

The UNGPs stipulate that all companies have a responsibility to respect and protect human rights, regardless of its size, scale, sector or geographic location.⁴⁵ The responsibility entails that corporations must refrain from infringing on human rights, as well as address adverse human rights impact related to its own business operations and its relationships with business partners.⁴⁶ In order to fulfil its responsibilities, companies must respect international human rights as set out in the International Bill of Human Rights and the International Labour Organization Declaration on Fundamental Principles and Rights at Work.⁴⁷ Further, businesses should undertake HRDD, to assess actual and potential human rights impacts.⁴⁸

⁴² U.N. Human Rights Council, *Protect, Respect and Remedy: a Framework for Business and Human Rights - Report of the Special Representative of the Secretary-General on the issue of Human Rights and Transnational Corporations and other Business Enterprises*, John Ruggie, U.N. Doc. A/HRC/8/5 (Apr. 7, 2008), p. 4; see also Bijlmakers, Stéphanie, *Corporate Social Responsibility, Human Rights, and the Law*, Routledge, Oxon & New York, 2018, p. 54.

⁴³ Special Representative of the Secretary-General, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, Human Rights Council, 'UNGPs', U.N. Doc. A/HRC/17/31, (March 21, 2011)

⁴⁴ *ibid*

⁴⁵ Principle 11 UNGPs and Commentary to Principle 14, UNGPs, p. 15

⁴⁶ Principle 11, UNGPs

⁴⁷ Principle 12, UNGPs

⁴⁸ Principle 17 UNGPs

3.1.2 Human Rights Due Diligence

The UNGPs explicitly recognize that human rights risk may be inherited through M&A transactions and that a thorough HRDD should be conducted as early as possible in order to mitigate human rights risk.⁴⁹ A typical HRDD review according to the UNGPs should aim to “identify, prevent, mitigate and account for how [the company] [addresses] human rights impact”, and the assessment should include adverse human rights impacts that the company may “cause or contribute to through its own activities, or which may be directly linked to its operations, products or services via its business relationships”.⁵⁰ This can be done by first and foremost determining the relevance of human rights issues in the transaction.⁵¹ For example, transnational M&A transactions may incorporate higher levels of human rights risk than transactions conducted on domestic markets, due to culture aspects and foreign regulations. If relevant, the purchaser should integrate these human rights issues in their due diligence review. This can be done by assessing actual and potential human rights impacts, preventing and mitigating the likelihood of impact occurring and engaging with affected stakeholders.⁵²

⁴⁹ See Commentary to Principle 17, UNGPs

⁵⁰ Principle 17, UNGPs

⁵¹ Shift, (2015), *Human Rights Due Diligence in High Risk Circumstances: Practical Strategies for Businesses*

⁵² *ibid*

4. Legal and Regulatory Developments in regard to Human Rights

As stated, the UNGPs entail no legally binding obligations for corporations. They are however reflected in binding instruments and legislation across several jurisdictions. For example, France has recently adopted a new law on duty of care by larger MNCs requiring due diligence on human rights and labour conditions across their production chain.⁵³ Further examples include the 2015 UK Modern Slavery Act,⁵⁴ and the Canadian Ombudsperson for Responsible Enterprise (CORE).⁵⁵ In addition, pressure from various stakeholders such as institutional investors to develop legally binding frameworks for business and human rights is increasing. One example is the investor coalition supporting the UN Guiding Principles Reporting Framework, which includes 87 investors representing \$5.3 trillion assets under management.⁵⁶

4.1 International Development

Regulatory development is also occurring on international levels. In 2016, the Council of Europe issued ‘Recommendation on Human Rights and Business’. According to the Recommendation, all member states are required to encourage, or when appropriate, require that corporations domiciled in, or conducting “substantial activities within their jurisdiction” perform human rights due diligence.⁵⁷ In addition, developments across the EU and OECD, as well as the United States' and Canada are showing signs

⁵³ ‘French Corporate Duty of Vigilance Law’

⁵⁴ The Modern Slavery Act requires companies with an annual turnover of 36 million pounds to report on issues related to slavery and human trafficking in its operations. For further reading see National Archives, *UK Modern Slavery Act*, (2015 c.30)

⁵⁵ CORE has mandate to investigate Canadian corporations for alleged human rights abuses abroad, and may make recommendations of sanctions, including the access to government export credit. For further reading see Global Affairs Canada, *The Government of Canada brings leadership to responsible business conduct abroad*, (2018)

⁵⁶ UN Guiding Principles Reporting Framework Investor Statement (31 Jan 2017).

⁵⁷ Council of Europe, CM/Rec(2016)3, (2016)

of increased requirements on human rights due diligence through export credit agencies and government procurement agents and ‘State National Action Plans’.⁵⁸ The EU has additionally adopted legislation including human rights due diligence through the EU Non-Financial Reporting Directive⁵⁹ and the new EU regulation concerning EU importers of conflict minerals.⁶⁰ In July 2018 the UNHRC open-ended intergovernmental working group on transnational corporations and other business enterprises with respect to human rights (OEIGWG), also published a ‘Zero Draft’ legally binding document to “provide appropriate protection, justice and remedy to the victims of human rights abuses directly resulting from or related to the activities of some transnational corporations and other business enterprises” with the goal of negotiating a treaty instrument on business and human rights.⁶¹

4.2 Case-law Developments

Furthermore, recent legal cases in several jurisdictions have raised questions as to the circumstances in which a parent company may be held responsible for the actions of its foreign subsidiaries. In the United States, claimants have attempted to use the 1789 US Alien Tort Claims Act to sue multinational corporations for alleged human rights abuses in foreign countries.⁶² In addition, a number of companies are currently facing legal claims in English and Canadian courts on the same grounds. The courts in the United Kingdom (UK) and Canada have illustrated a willingness to pursue these claims, by not dismissing charges on the grounds of

⁵⁸UN Working Group on Business and Human Rights, Guidance on National Action Plans on Business and Human Rights (Nov 2016)

⁵⁹ The EU Non-Financial Reporting Directive requires larger companies to address and report on human rights risks in their own activities and throughout their supply chains. See Council Directive 2014/95

⁶⁰ The EU Conflict Minerals Regulation will enter into force on 1 January 2020. See Council Directive 2017/821

⁶¹ UN Human Rights Council, ‘Legally Binding Instrument to Regulate in International Human Rights Law, the Activities of Transnational Corporations and other Business Enterprises’, Zero Draft (16 July 2018)

⁶² Samp, Rich (2018). *U.S. Supreme Court Continues to Nibble Away At Alien Tort Statute’s Sweep*, Forbes, 25 Apr. Available at: <https://www.forbes.com/sites/wlf/2018/04/25/u-s-supreme-court-continues-to-nibble-away-at-alien-tort-statutes-sweep/#218f2704d9fe> [Accessed 20 Dec 2018]

jurisdiction.⁶³ Recent cases have also illustrated a possibility of claiming individual accountability for human rights abuses conducted by corporations abroad. Examples include the recent case of Swedish company Lundin Petroleum AB, whose chief executive and chairman are currently facing claims for aiding and abetting gross crimes against international law in accordance with the Swedish Penal Code.⁶⁴

5. Analysis

While contractual protection against risks in the target company is available in private target M&A transactions, the above examination illustrates that this may not always be sufficient. This is especially apparent in the issue as to which liabilities the acquirer will contractually assume. Known liabilities will typically be disclosed by the seller in the purchase agreement, through a disclosure letter, warranties and indemnities. This will naturally enable the purchaser to renegotiate terms based on the risk that these liabilities will entail. However, quantifying the extent of the damage following adverse human rights impacts may be hard. Moreover, most human rights risks may not be found in the target company itself, but rather within the target company's supply chain or business relationships. Although general due diligence might not have identified any human rights issues in the target, the target may be connected to human rights issues through third parties. The responsibility to address these impacts will subsequently be inherited by the acquiring company. Even when an issue within the target company's own relationships is known, obtaining third party guarantees from the seller might prove difficult.

The possibility of contractual protection against human rights risk is even more limited in the case of unknown liabilities, which naturally, cannot be resolved through contractual agreements. Here, the issue of inherited

⁶³ See *Lungowe v Vedanta* (2017) and *Choc v Hudbay Minerals Inc* (2013)

⁶⁴ Rolander, Niclas., Hoikkala, Hanna (2018). *Oil Bosses Battling War-Crime Allegations Fear Broader Fallout*, Bloomberg, 5 Dec. Available at: <https://www.bloomberg.com/news/articles/2018-12-05/oil-bosses-battling-war-crime-allegations-fear-broader-fallout> [Accessed 2 Jan 2019]

liability differs depending on the structure of the M&A transaction. Under an asset purchase, the acquiring company will not be protected through limited liability and the principle of separate entity, but rather the protection lies within the possibility of choosing which assets (and liabilities) will be acquired in the transaction. The problem herein however, lies in the risks of the assumed assets. By contractually assuming certain assets such as supplier contracts, companies may expose themselves to significant risks further down the supply chain of the target company, which may not be discovered by conducting a customary legal due diligence. The purchaser may thereby expose itself to severe financial and reputational damage due to unknown human rights issues in their supply chain. It is therefore essential that contracts throughout the supply chain be thoroughly vetted from a human rights perspective during legal due diligence.

Under share purchases on the other hand, the purchaser will typically be protected under the principle of limited liability as they normally hold separate legal personalities. The purchaser in the form of a parent company will hence generally not be held liable for any misconduct of the subsidiary after the deal is made.⁶⁵ However, although there might be hard law regulations protecting a parent company from direct liability, there are other consequences that companies should consider, even if legal liability cannot be established. Among these are the financial consequences that may be linked to reputational damage. As was apparent in the case of Nokia, public opinion and negative media campaigns may cause the purchaser serious damage, including lost revenue, the loss of business opportunities and an overall deterioration to the company name. Considering the increase in societal pressure that companies are facing in regard to human rights impact, in combination with increasing media coverage and social media, this aspect is something businesses should take seriously.

Furthermore, experience shows that companies can suffer significant opportunity costs as well as delayed projects due to conflicts with affected

⁶⁵ Unless, as abovementioned, there is an exception, such as for instance a parent company guarantee.

stakeholders. This is especially crucial in sectors and geographic locations that are considered more high-risk in regards to human rights issues. Even if the purchaser is compliant with local laws on human rights, it may still expose itself to significant human rights implications. Local laws may not always reflect international standards on human rights, or might not take into consideration surrounding communities that may be affected by the acquisition. This was apparent in the case of Meridian Gold. Although the company was compliant with local laws regarding the legal title of the sought-out land, the project resulted in increased expenses due to the conflict with the opposing community. Local legal advice and external reports may therefore be necessary to provide an in-depth understanding of the human rights issues at stake.

Moreover, the due diligence process is even more significant in public M&A deals, where there typically are no contractual guarantees about the target company's business. Instead, the purchaser must ensure that all relevant liabilities and risks are known before closing the deal, including human rights risks that may be embedded in the supply chain or business relationships of the target company. This can only be done by conducting a thorough HRDD. Although the acquiring company in a public transaction typically can legally shield itself through limited liability in the same way as in a private share purchase, the acquiring company is subject to the very same reputational and financial risks. Hence a company seeking to acquire a target through a (friendly) bid in a public M&A transaction must ensure that their due diligence process comprises relevant human rights issues that may expose the company to unwarranted risks. A company attempting to undertake a M&A transaction through a hostile bid, will naturally have no protection against unknown human rights risks, other than the material obtained from publicly available information.

Finally, new regulatory standards on corporate responsibility on both national and international levels may expose purchasers in both private and public M&A transactions to severe legal risk in the form of potential

lawsuits. The increase in case-law illustrates that courts in several jurisdictions are now willing to hear claims on corporate responsibility for the actions of foreign subsidiaries, both in the form of parent company liability and individual liability. As governments and export credit agencies are starting to increase requirements on HRDD, the purchaser can also suffer adverse commercial consequences in cases of non-compliance. In addition, investor pressure is rapidly increasing, as investors are starting to demand human rights consideration for investment projects. This may impact the purchaser's ability to gain financial support.

The foregoing developments should evidently serve as an incentive for companies to consider human rights issues when undertaking an M&A transaction. However, implementing human rights in the traditional form of due diligence may of course give rise to challenges. For one, human rights issues may not be easily located. Identifying risks throughout the target company's own supply chain and business relationships may require timely and costly investigations. A seller might be reluctant to agreeing to such extensive examinations. In addition, in sectors and geographical locations where the risk of human rights impacts is higher, local expertise may be necessary, which requires an even larger budget. The purchaser might moreover find it difficult to integrate human rights risks into existing traditional due diligence systems, as the focus of the HRDD should be on the risks to stakeholders, as opposed to the business overall. However, the cost and effort of integrating human rights aspects in the purchaser's initial due diligence is evidently not outweighed by the consequences the purchaser may suffer resulting from failure to do so.

6. Conclusion

As this examination has illustrated, failure by companies to include human rights aspects in their risk management may evidently have serious consequences. Although substantial seller guarantees are crucial in any M&A transaction, experience show that contractual protection may not

always be sufficient. In public target transactions, human rights issues may present an even greater risk to the purchaser, where contractual protection is limited. In addition, although the area of law has not yet been clarified, recent cases illustrate the possibility of bringing legal claims against parent companies (and their foreign subsidiaries) in the parent company's home state. Hence, the duty of care of parent companies in regard to their foreign subsidiaries might be extended. By conducting a thorough human rights due diligence, the purchaser can identify and mitigate human rights risk at an early stage in the transaction. This is especially important in certain sectors that are considered being having more high-risk exposure in regards to human rights issues. The result of the human rights due diligence review will thus enable the purchaser to renegotiate terms, require more extensive contractual protection, or even back out of the deal before exposing itself to significant consequences in the form of legal, reputational, commercial or financial damage.

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