



# Integrating Concern for Human Rights into the Mergers & Acquisitions Due Diligence Process

A Good Practice Note endorsed by the United Nations Global Compact Human Rights Working Group<sup>1</sup> on 26 July 2013.

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The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment, and anti-corruption. In June 2006, the Global Compact Board established a Human Rights Working Group. The goal of the working group, which is currently co-chaired by Mr. Pierre Sane and Sir Mark Moody-Stuart, is to provide strategic input to the Global Compact's human rights work. The following is one of an ongoing series of notes on good business practices on human rights endorsed by the working group. Rather than highlighting specific practices of individual companies, Good Practice Notes seek to identify general approaches that have been recognized by a number of companies and stakeholders as being good for business and good for human rights.

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<sup>1</sup> Grateful acknowledgement is given to UN Global Compact Advisor and Good Practice Project Leader Prof. Chip Pitts of Stanford University

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## **I. Executive Summary**

Mergers & Acquisitions (M&A) are an extremely important facet of the global economy. In recent years, global M&A activity has ranged between \$3 and \$5 trillion (USD) annually, meaning that the economic scope of M&A activity is larger than the annual GDP of all but a handful of nations. Further, M&A activity is something that involves not only nearly all larger and multinational corporations but also numerous medium-sized and smaller companies, many of which at least strive and adopt practices to position themselves to participate in an M&A event as the target of an acquisition. Since a precursor to the completion of any M&A transaction is an intense due diligence process during which all of a target company's practices and liabilities are closely examined by a team of legal and other experts, the due diligence process is a particularly effective area of focus for embedding and implementing good practices that will assist companies and other stakeholders in identifying potential human rights issues, planning for their amelioration, and otherwise assessing the impact of individual or combined business practices on human rights. This good practice note seeks to provide guidance to corporate leaders and M&A practitioners at all levels across the corporate, finance, private equity and legal sectors on how the due diligence process within M&A is being utilized and can be utilized to enable companies to more effectively carry out their responsibility to respect human rights as contemplated by the UN Framework and Guiding Principles for Business and Human Rights. In particular, the note will highlight ways in which incorporating human rights due diligence into the M&A due diligence process provides opportunities that are particularly conducive to both helping companies characterize the human rights practices of companies they are targeting for acquisition as well as help those acquiring companies to incorporate

human rights considerations into one of their seminal contractual, legal and corporate processes.

## **II. Introduction**

M&A activity is a ubiquitous and frequently recurring dynamic in the corporate world that touches companies across nearly all geographies, industries and sizes, from multi-national giants to small and medium sized family businesses. Although M&A is an ever-present part of corporate existence and growth, relatively little attention is paid specifically to human rights issues and impacts during the M&A transaction process. Yet, as this note details, that transaction process provides a highly effective and efficient avenue to companies engaging in M&A to integrate human rights due diligence as well as other practices promulgated by the Guiding Principles for Business and Human Rights in regard to those companies' responsibility to respect human rights in relation to their current and future activities. Businesses that are signatories to the UN Global Compact and that, as such, have already pledged an elevated level of commitment with regard to human rights, should especially welcome the opportunity to enhance their human rights due diligence practices by embedding human rights standards, language and terminology into what is one of the most fundamental contractual relationships entered into by any company.

Although efforts to truly integrate human rights considerations into key business functions inevitably contend with complex challenges, the existing M&A processes and framework offer some unique circumstances and motivations for doing this effectively. In fact, the due diligence process within M&A transactions already serves as an effective tool for reviewing many target company activities that are directly related to human rights, such as labor practices and environmental and social impacts. This note outlines ways in which corporations can proactively use the M&A process to more specifically focus on and fulfill their broader responsibility to respect human rights. It highlights existing practices by a number of forward-thinking corporate and private equity leaders that could and should serve as a model for other M&A practitioners and business leaders. Developing a human-centered approach within the realm of M&A would help to spread human rights consideration across new geographies and into many smaller companies where such considerations and the goals of the UN Global Compact have yet to gain sufficient attention or fully take root. Leveraging M&A due diligence to integrate respect for human rights would also be of benefit to the corporations themselves from a financial and reputational standpoint, as the process can unearth practices and potential liabilities that no responsible business would wish to inherit, and those discoveries are made at a time when the acquirer is in a position to avoid those liabilities or have the leverage to insist that the target company alter practices constituting actual or potential abuses or violations. In addition to the alignment between the acquiring company's financial self-interest and the M&A due process goal of fully vetting liabilities related to all practices of a target company, the M&A due diligence process is also a highly suitable mechanism for the discovery of abuses or violations because it is staffed and run by large numbers of attorneys and other professionals that generally have considerable levels of skill, experience and resources to carry out the process successfully. Incorporating some or all of the practices described in this note into that process, to be carried out by this team of professionals, can play a significant role in widely promoting the corporate responsibility to respect human rights.

➤ ***Focus of this Note***

Many businesses looking to expand in size, or into a new business segment or geographic market, choose to do so through an acquisition of or merger with another company. These potential acquirers, which like all businesses have the recognized responsibility to respect human rights, as a key step in executing an M&A transaction end up engaging in an M&A due diligence process by which they identify and assess the practices and liabilities of companies they are attempting to acquire. This note identifies and recommends some best practices that serve the purpose of leveraging the already robust traditional practices involved with M&A due diligence by integrating into it practices that reflect and promote each company's responsibility to respect human rights. The M&A due diligence process, when supplemented with additional criteria for assessing human rights issues, can be an effective tool for investigating the practices of target companies. Additionally, the process is so central to the growth and exit strategies of so many companies around the world that creating a linkage between M&A and human rights due diligence will serve to significantly buttress the efforts of companies seeking to more fully integrate a human rights focus into key aspects of their business operations. This note will outline the advantages of such an approach, as well as specific practices that can be considered by corporate leaders. A great opportunity exists for companies to adopt practices that at once will protect the bottom line and their reputations, while also spreading human rights considerations into many new corners of the global corporate landscape.

Further, this note will highlight ways in which associating and integrating good practices with regard to the promotion of human rights with the all-important corporate touchpoint of M&A activity, would serve to reinforce a beneficial link between globalization and human rights. As corporations of all sizes continue to act as agents of globalization, an ever greater degree of benefit will enure to persons and stakeholders that are the intended beneficiaries of human rights protections to the extent that the ever-expanding M&A activities of corporations merge their economic objectives with the promotion of and respect for human rights.

### **III. Human rights standards**

The United Nations Guiding Principles on Business and Human Rights were unanimously endorsed by the UN Human Rights Council in 2011. The Guiding Principles served to elaborate on and make implementable the "Protect, Respect and Remedy" UN Framework presented to the Council in 2008.

The Guiding Principles deal with the state's duty to protect against human rights abuses, including those committed by businesses, as well duties by both states and corporations with regard to remedies. Importantly, the Guiding Principles also reaffirm a corporate responsibility to respect human rights, which requires businesses to avoid infringing on human rights and to address human rights abuses or violations in which they may already be complicit or involved. The implementation of these duties involve companies adopting effective human rights due diligence practices that should include the development of human rights policies, the assessment of activities in relation to their impact on human rights, the integration of human rights into corporate processes and functions, and the monitoring of corporate activities in relation to compliance and effectiveness. The corporate responsibility to respect human rights is a standard applicable to all businesses, irrespective of whether they are signatories to the UN Global Compact.

#### **IV. Advantages of Incorporating Aspects of Human Rights Due Diligence into M&A Due Diligence**

- ***Prevalence of M&A transactions would help to scale the UN Framework across more companies of all sizes***

The “Protect, Respect, and Remedy” UN Framework, which has now been reaffirmed through the endorsement of the Guiding Principles, sets out the corporate responsibility to respect human rights as a standard applicable to businesses of all sizes.<sup>2</sup> The challenge for businesses has been in finding effective ways to implement this standard and operationalize its underlying goals. An effective way to accomplish this is to incorporate the standard into key contractual processes and growth-oriented strategies that most companies regardless of size participate or desire to participate in as a regular part of their activities.

One such nearly universal activity of businesses is the already well-established M&A due diligence process. By creating and incorporating human rights due diligence standards and assessments that would be accomplished as part of the existing M&A due diligence process, participating corporations would elevate the relevance of human rights related responsibilities within their own corporations as well as significantly raise awareness among medium and smaller sized companies, which often desire to eventually be acquired or to grow through mergers, of the existence and responsibilities described in the Framework.

M&A activity already involves reviewing and analyzing all contracts and business activities of a company. Therefore, the process is already highly aligned with proactively integrating assessments in relation to human rights. Larger companies often acquire many companies each year, which would introduce the relevance of human rights considerations to those many acquisition targets, a significant proportion of which may have otherwise deemed themselves before as being too small to undertake a robust internal program for integrating human rights. Given the widespread nature of M&A activity, making human rights due diligence a key element of that activity would serve to spread human rights standards quickly into many companies of all sizes focused on this key contractual relationship.

- ***Growing number of cross-border M&A transactions would help scale the UN Framework across more geographies***

One factor in the accelerating pace of globalization has been the increasing tendency of companies to spread into new regions, often through M&A activity. While many states today could be characterized as not being in full compliance with international human rights standards, very few countries around the world are not touched by frequent corporate M&A activity. Therefore, incorporating human rights standards into global M&A due diligence practices would have the effect of broadening the reach of human rights issues into regions and states where those issues have not been a key consideration. Further, assessing cross-border acquisitions utilizing consistent international human rights standards as part of the due diligence process would serve to universalize those standards and to possibly elevate how those standards would be defined as having been met even in countries which currently lag in their duties to protect and promote human rights. To the extent that this embedded human rights due diligence

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<sup>2</sup> An overview of the Framework and the business responsibility to respect can be found in “The ‘State of Play’ of Human Rights Due Diligence: Anticipating the next five years, Institute for Human Rights and Business, found at [http://www.ihrb.org/pdf/The\\_State\\_of\\_Play\\_of\\_Human\\_Rights\\_Due\\_Diligence.pdf](http://www.ihrb.org/pdf/The_State_of_Play_of_Human_Rights_Due_Diligence.pdf).

process would include practices such as including all stakeholders affected by a proposed acquisition, the process of combining human rights and M&A due diligence would also go beyond just instilling a human rights sensitivity at the corporate level and could, rather, enable individuals and groups residing in nations with weak human rights protections to participate in relevant human rights related processes and dialogues.

Advancing universalization of the UN Framework through incorporating human rights into M&A due diligence would encourage new and existing companies in states with weak human rights protections that aim to be acquired, or that aim to become acquirers of companies located in states with stronger protections, to proactively adopt practices that are mindful of their human rights responsibilities, since doing so will lessen the hurdles to planned growth through future M&A activities. Such universalization would have the effect of raising human rights standards of business entities located in states with weaker protections, since the key would be to be compliant not merely with the standards within their own countries but with those of a global corporate norm adhered to by businesses that are concerned with being compliant with the standards of all nations in which they operate. Those reinforced global standards could serve as entry points for human rights awareness into other aspects of those nations with weaker protections, as more stakeholders get to participate in human rights dialogues and seek to elevate such issues before their governments and in other aspects of their societies.

➤ ***Unique opportunity when team of professionals obtains access to full range of information***

The M&A process affords a unique opportunity for companies to be able to review all of the practices and activities of target companies, including activities that are interrelated with human rights such as labor practices, supply chain practices and environmental impact. Importantly, this thorough review is conducted by an often large team of talented professionals (e.g. lawyers, consultants, compliance personnel) that are empowered and tasked with the responsibility of uncovering problematic practices and identifying potential areas of liability. All members of that team are motivated to uncover such issues prior to the closing of the transaction, so that the cost of ameliorating the liabilities related to problematic practices can be accounted for in a lower acquisition price of the target company or so that the acquiring company can cancel the acquisition entirely. The team typically has the benefit of having many specialists that have expertise at assessing practices across a wide range of corporate activities, and the teams are not usually resource constrained should the need to bring in additional experts arise, since the cost of the M&A due diligence process would be typically dwarfed by the cost of missing something that an M&A due diligence process is designed to uncover. All of this focused effort by motivated professionals makes the M&A due diligence process a highly likely process by which an acquiring company will identify existing abuses or violations involving human rights.

Further, the traditional practice of M&A due diligence assumes a high degree of transparency on the part of the target company. Such target companies are expected to assemble “data rooms” containing all relevant contracts and documents involving the company and its suppliers, to give the due diligence team access to its personnel and other partners and stakeholders, and to otherwise cooperate with all requests for further information. Companies that appear hesitant to provide this transparency, or that are discovered to have not been complete in their cooperation, risk the very real possibility of having the acquisition of their company cancelled, since all acquisition offers are “subject to the successful completion of due diligence.” The self-serving need on the part of target companies to be transparent during M&A due diligence provides an opportune venue for in-depth assessment in relation to practices bearing on human rights.

➤ ***There is unusual leverage to require a target company to perform ameliorative acts***

At no time are most companies as amenable to changing practices and performing ameliorative acts as they are during the time they have a potential acquirer conducting M&A due diligence on them. Since the completion of acquisitions hinges on the completion of M&A due diligence and the close out of issues discovered during that process, the M&A due diligence process is already characterized by a flurry of corrective activities, such as the modification of existing contracts with suppliers and the settlement, or at least a fuller risk assessment, of situations that may lead to legal liabilities. Typically both sides to an acquisition or merger see great benefit in the completion of the transaction and act accordingly. Therefore it is also a time when corporate self-interest is aligned with businesses taking on actions and costs that they might not otherwise choose to take.

In particular, in cases where a large company is buying a smaller one, M&A due diligence enables the acquiring company to have an unusual level of leverage to compel the acquisition target to take on costs and perform acts to address human rights issues and impacts that especially smaller companies would not normally address. This dynamic shifts the smaller company's view on such costs, in that the cost is now seen not in absolute terms relative to the company's current financial position but rather as a percentage of what the company would receive as part of the acquisition, which will generally make the cost appear as a wise investment and one with a short term return. The M&A process serves to coerce such positive steps by simply asserting that the transaction will not continue until a particular problem is remedied.

➤ ***Enables companies to avoid taking on legacy costs and risks of other companies***

The reduction of costs, including through proactive risk management, is always a driving factor in the successful conduct of business. Merging aspects of human rights diligence with the M&A due diligence process may be viewed by some as inducing an unnecessary or additional cost on the M&A process, yet the successful use of the M&A process to uncover current or legacy practices of an acquisition target could provide very significant financial and reputational savings to the prudent acquirer.

Even when companies acquire businesses that had abuses or violations long ago, there is a very real reputational cost in terms of associating those past incidents with the new parent company, and those costs are becoming greater as the world continues down the path of greater interconnectivity via social sharing and online activist communities. At the very least, discovering human rights issues earlier, such as at the M&A due diligence stage, enables acquirers to demand actions from the acquisition target or at least that funds be set aside to address found issues. In either case, the full cost of those violations and risks will not fall fully on the acquirer, and that acquirer will gain reputational currency by uncovering the issues themselves and being proactive in trying to have them addressed. Importantly, the self-interest of acquirers during M&A drives them to discover pitfalls to transaction completion as early as possible. That motivation will cause acquiring companies not to "turn a blind eye" to problems, since the various costs of fixing something prior to ownership are significantly less than they will be after their ownership begins.

➤ ***Attracting socially conscious employees and partners and maintaining social license***

Businesses, especially those attuned to the benefits of integrating human rights consideration

into their operations, increasingly understand the financial value of being known as a good corporate citizen. These businesses are also increasingly aware that their “social license” to operate a particular business or in a particular neighborhood or region, should be of high concern if that business hopes to receive the cooperation and good faith efforts of all stakeholders involved in successful long term business growth. When entering into a new situation or region, acquiring companies always face the risk of resistance from new or arguably perceived negative social impact. Adding a human rights component to their M&A efforts, especially one that involves stakeholders in open dialogue, will help employers to not only uncover issues but also to navigate the critical post-transaction stage during which the acquired company is integrated into the parent company. The more an organization can do to eliminate issues upfront, the easier the transition will be into a new environment.

Further, as citizens, employees and consumers continue to place more value on corporate social responsibility and good corporate citizenship, which have been unmistakable and stark trends over the past several decades, companies that thoughtfully and effectively integrate human rights concerns into key activities such as M&A will earn an advantage relative to their competitors in attracting and retaining socially conscious employees, partners, investors, and customers.

## **V. Practical Pitfalls of Incorporating Aspects of Human Rights Due Diligence into M&A Due Diligence**

As with all significant changes to existing ways of doing things, there are potential difficulties and risks that come with incorporating aspects of human rights due diligence into the M&A due diligence process. These are some such pitfalls companies and M&A practitioners should consider as part of implementing the highlighted good practices.

### **➤ *M&A due diligence teams may not have required expertise to assess human rights***

M&A due diligence teams are typically comprised of attorneys and business professionals who are adept at assessing legal and business risks. They do not usually have the training to consider human rights issues, except for those that overlap with very specific compliance or legal issues such as labor practices, and they would rarely have the training to more conceptually assess nuanced human rights impacts, such as those on stakeholders like members of the nearby community. Even to the extent that a human rights expert is included on the team, the team as a whole may tend to discount his or her presence or input to the extent the rest of the team is not sensitized to the central role that management would like human rights to play in the M&A due diligence process.

To attempt to overcome this challenge, it would be necessary to make sure all members of the M&A team are educated and motivated on the assessment of human rights as part of the M&A process. Just as with the rest of the M&A due diligence process, human rights due diligence has certain requirements and criteria that must be properly assessed by the full team so as not to render that part of the process irrelevant.

### **➤ *Costs and possible delays stemming from additional review***

There is no doubt that the addition of a robust human rights due diligence process into the already complex area of M&A due diligence will serve to create additional costs or to slow down the process, if not both. In addition to just conducting the human rights portions of the process,



additional delays and costs may arise from the need to actually address findings of abuses or violations or possible liabilities relative to human rights. As with all costs, these should be weighed against the potential benefits of taking the additional action. Until more companies begin to take steps to incorporate human rights into M&A due diligence and begin to report on case studies and best practices of how such actions should be taken, the concern over costs and delays may prove compelling and thwart wider adoption.

- ***May have the unintended consequence of discouraging human rights due diligence integration at companies that are not contemplating M&A transactions***

To the extent that human rights due diligence becomes too closely associated or synonymous in the minds of business leaders with the M&A due diligence process, this may have the unintended consequence of encouraging the erroneous thinking that only those entities that are working or planning on imminent transactions need to be actively working on human rights due diligence activities. Some support for this proposition can be found in the recently published report “The ‘State of Play’ of Human Rights Due Diligence: Anticipating the next five years,” in which the authors noted that it was “striking that a large majority of interviewed companies mentioned this on their own,” in that they immediately equated ‘human rights due diligence’ with M&A due diligence.<sup>3</sup> To attempt to counter this challenge, it would be key to find ways to communicate that while integrating aspects of human rights due diligence into M&A due diligence would be a highly beneficial practice, it is by no means sufficient to assume that human rights due diligence should only be thought about or acted when an M&A due diligence process is a current consideration.

- ***It may provide opportunities for companies to whitewash their human rights due diligence efforts***

Incorporating human rights due diligence into M&A due diligence may provide opportunities for some companies to use the appearance of a highly structured and well-resourced process to whitewash their inadequate human rights efforts, especially with regard to assessing human rights impacts on stakeholders that are broader or more complex than the purely legal issues involving employees (e.g. child labor, gender discrimination, etc.). Further, in some organizations, M&A due diligence is driven by outside law firms or other M&A service practitioners, which may feel pressure to simply point out obvious legal issues related to human rights, without delving into sufficient detail to provide true and complete understanding of the issues. M&A practitioners that are internal to an acquiring entity may also feel pressure not to cause delays to desirable corporate transactions, therefore performing perfunctory investigations or viewing the data they encounter through a very narrow or self-serving prism. Such a dynamic could make the human rights assessment within M&A more akin to a “check-the-box” exercise that would enable companies to point to a seemingly thorough process, but one that would be ultimately ineffective at more accurate and complex human rights impact analysis. There have been similar concerns about seemingly genuine corporate practices that on further review were viewed as constituting greenwashing, bluewashing or pinkwashing.

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<sup>3</sup> The ‘State of Play’ of Human Rights Due Diligence: Anticipating the next five years, Institute for Human Rights and Business, found on page 20, at [http://www.ihrb.org/pdf/The\\_State\\_of\\_Play\\_of\\_Human\\_Rights\\_Due\\_Diligence.pdf](http://www.ihrb.org/pdf/The_State_of_Play_of_Human_Rights_Due_Diligence.pdf)

- ***Still vague and non-standardized tools for human rights due diligence may expose companies to the agendas of third parties***

One key concern of corporate leaders, as also outlined in the “State of Play” report, is that there are currently no clear and standard tools or practices for human rights due diligence. Therefore, trying to incorporate non-standardized and nuanced human rights assessments into a highly standardized and clear process like M&A due diligence may not only prove complex, but could be viewed as possibly enabling outside groups with their own agendas to have a tool to slow down the M&A transaction process. For instance, if a community group that claims to be a stakeholder to a transaction issues a letter voicing concern about a proposed acquisition, to what extent is the acquirer obligated to try to address those concerns before moving forward? To the extent third party concerns cannot, in the belief of an acquirer, be addressed or are worthy of being addressed, how much has the acquirer exposed themselves to claims or surrounding publicity that their human rights impact assessments were inadequate?

This potential pitfall stems in part from the fact that there are still relatively few Key Performance Indicators (KPIs) that enable companies to quantify human rights compliance. This generally means companies are required to determine what they need to do relative to human rights integration. Yet without clear measures and tools, it is easy for a state or other third party to argue that a company is not in compliance, since there are not enough guidelines to actually establish what is necessary for compliance.

## **VI. Good Practices in Incorporating Aspects of Human Rights Due Diligence into M&A Due Diligence**

- ***Including highly knowledgeable human rights practitioners on the M&A due diligence team***

Adding individuals to the due diligence team who are particularly knowledgeable in human rights assessment and due diligence would provide those teams with the expertise and mandate to focus on human rights elements within the broader due diligence process. It is key for the M&A team to have that kind of specialized knowledge partially because most M&A attorneys and transactional practitioners have had very little exposure to the broader conceptual elements of human rights law. For most non-specialists, human rights would largely seem an exercise mixing legal elements that happen to overlap with human rights (e.g. labor practices, industrial pollution, etc.) with the kind of risk mitigation process that is only centered on risk to the acquirer. Human rights law is a complex and evolving field, and the way human rights practitioners are able to understand and assess human rights issues relative to a broad array of stakeholders is not likely to be able to be duplicated by non-experts.

Further, human rights experts would not only focus on ascertaining whether abuses or violations exist, but they could also focus on the general impact of certain practices, irrespective of whether those impacts happen to rise to the level of an abuse. As detailed further in this note, incorporating human rights due diligence into M&A due diligence should not be purely about making a binary determination of whether a risk or violation exists or not. Rather, as with analogous determinations such as environmental impact assessments and social impact assessments more broadly, there are qualitative and directional determinations that conscientious companies would attempt to make in regard to the broader array of effects their M&A activities may have. Finally, having an expert in human rights on the team (or more than one, e.g. regarding particular issues such as the rights of indigenous peoples, women, children,

the disabled, the poor, minorities) would signal to the rest of the team, as well as to the acquisition target, the importance of human rights considerations in the completion of the transaction.

➤ ***Reporting human rights abuses or violations discovered during M&A due diligence to authorities***

While many elements of performing due diligence are done under the reasonable expectation of confidentiality, there should be certain exceptions for situations where the acquirer has discovered serious abuses or gross violations during due diligence.<sup>4</sup> To clarify what constitutes those sorts of abuses or violations so that the acquirer is not put in the difficult position of deciding in cases of uncertainty, pre-diligence confidentiality agreements could specify the level of violations that would enable the acquirer to do what would otherwise be deemed a breach of the confidentiality agreement. Further, such contracts could contain language enabling the acquirer to make such determinations in its reasonable judgment, which would create a more clear and defensible position for the acquirer in such circumstances.

Most importantly, the acquiring company should actually implement policies and practices to be followed by its M&A personnel that they can and should report defined serious abuses or gross violations to local or other appropriate authorities. This kind of communication will also signal both internally and to the acquisition target the primacy with which the acquirer views the protection of human rights. This will incentivize companies wishing to be acquired to cease or not engage in gross human rights violations, as the cost of doing so will not only be the loss of a possible acquisition offer but potentially more severe penalties for those involved. This practice is also most consistent with the business responsibility to respect human rights, since it is difficult to argue that just walking away from a business merger rather than reporting violations of which a company has become aware is more indicative of such respect for human rights.

➤ ***Creating stand-alone human rights impact assessments as part of M&A due diligence***

While environmental impact assessments and, increasingly, social impact assessments, are relatively common outputs of the M&A due diligence process, creating stand-alone human rights impact assessments as part of M&A due diligence is currently rare. Yet, it appears to be a beneficial practice to create such stand-alone assessments. While the complex general issue of whether it is most effective to integrate human rights due diligence into existing policies and practices or create stand-alone policies and practices is beyond the scope of this note, it seems that doing stand-alone assessments creates an expectation and atmosphere that puts human rights sensitivities into more of the forefront. Rather than risking that some human rights components merged into a broader document will get overshadowed by other considerations, having stand-alone assessments forces companies to focus on and navigate the difficult tasks involved in thorough human rights impact assessments. Perhaps as the business community develops more standards and quantifiable measures around human rights due diligence, those measures can more safely be included alongside checklists that contain analogous areas of concern. Yet as the business community continues to grapple with the development of effective tools and practices in this area, at least having the responsibility and focus implied by needing to complete stand-alone reports should help companies in the interim to integrate a human rights centered approach through their M&A and other functional areas. Having stand-alone

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<sup>4</sup> Many states already may have laws enabling such reporting, yet this contractual right of the acquirer to breach confidentiality would provide a comfort level and latitude to actually do so in more circumstances.

reports will also encourage companies to allocate more experts and other needed resources for the successful completion of such reports, which also should serve to signal internally the relevance of such issues to the company.

➤ ***Having due diligence teams report their human rights findings to the Board of Directors***

A process by which the due diligence team, or at least the designated members of it that are charged with overseeing human rights due diligence, report their findings relative to human rights directly to the acquiring company's Board of Directors would encourage a higher level of sensitivity about human rights within the company. To the extent that such information merely would accompany the larger M&A due diligence findings, the human rights findings may be minimized or naturally given less weight. Providing this information directly to the Board, even if that information contains no negative findings, serves the purpose of sensitizing companies at the highest level about their own recognized duties to respect human rights.

A key component in integrating human rights into the corporate DNA is that the lexicon and common issues surrounding human rights must find their way into key conversations and onto the desks of senior decision-makers. The language of human rights must be encouraged to be spoken internally and not just externally, and a separate reporting out to the Board would help fulfill that goal. In addition to fostering fluency with the issues, reporting such information to the Board serves to make the topic itself relevant, since it is established corporate practice that the Board only deals with and is exposed to highly significant and strategic decisions. Additionally, in addition to their duties to stakeholders and the enterprise as a whole, Boards have particular fiduciary responsibilities to shareholders to act diligently to preserve shareholder value. To the extent that Boards would now be exposed to information about human rights issues and risks that are part of acquisition decisions, the Board members would be personally motivated to consider the issues more deeply. Doing so would, in addition to hopefully leading to wiser decisions, insulate them from any potential claims that their lack of diligence rose to the level of a breach of fiduciary duties in determining whether to move forward with an acquisition.

➤ ***Providing resources to due diligence teams earmarked for engaging local and other stakeholders***

While the standard M&A due diligence practice focuses on the contracts and direct activities of the business being acquired, human rights impact assessment naturally requires that a broader array of stakeholders related to the acquisition be taken into account. Engaging and conducting the discussions necessary to take these other stakeholders into account requires that due diligence teams be provided with resources specifically designated for these types of discussions that are not likely to occur as part of usual M&A due diligence. Such resources could pay for the additional due diligence team members needed to conduct such extensive discussions, or for the travel or other expenses required for dealing with, and more deeply understanding, the issues and the context related to the concerns of such stakeholders.

Having specific resources to engage the local community will also help to inform the local stakeholders of the acquisition and its consequences. This could involve creating an effective grievance or feedback mechanism to enable such stakeholders to participate in the discussion. Having the needed resources to conduct such extended discussions may also assist the due diligence team as a whole in uncovering human rights issues which would otherwise have stayed unknown, as well as assist the acquirer to build the kinds of relationships with local

constituencies that would later facilitate a social license to operate in the new environment.

➤ ***Involving human rights practitioners prior to M&A due diligence, at the strategic planning phase***

Prior to the inception of formal M&A due diligence, a strategic planning phase ensues during which companies consider key objectives of their M&A strategy as well as consider specific acquisition targets. During that phase, the M&A team already is compiling information on possible target companies and weighing their relative strengths and weaknesses as acquisition candidates, including what liabilities each may bring with them. Involving human rights practitioners at that earlier stage of M&A practice, so that they can provide input from a human rights perspective with regard to possible acquisition scenarios, would serve multiple purposes. First, it may save the potential acquirer considerable time and resources, since those practitioners may be able to articulate considerations about human rights impacts that would deter the acquirer from pursuing certain targets earlier. Secondly, adding a human rights-focused professional at the strategic phase of the M&A process would also reflect in the eyes of colleagues and decision-makers that human rights are relevant enough to be considered at multiple phases of M&A decision-making. Finally, human rights experts would be able to earlier advise about and plan for any enhanced or special strategies with regard to conducting any customized human rights due diligence activities during the subsequent M&A due diligence process.

➤ ***Enabling the human rights team member to have an independent reporting structure***

An independent reporting structure for the human rights due diligence expert(s) on the M&A team is highly helpful in producing an honest and unbiased assessment of human rights issues. Corporations often set up reporting structures to encourage and foster rigorous internal investigations and communications. Such roles often deal with functions such as quality assurance, regulatory compliance and legal counsel. Companies attempt to insulate individuals in these roles from ramifications related to the internal oversight and feedback they provide. For instance, these functions will often not report to functional units whose work they are tasked to oversee, but rather report to some central unit or a senior manager that is not directly in the reporting chain relative to such functional unit.

Similarly, the human rights expert should optimally report into a senior and influential group that is nevertheless as isolated as possible from the pressures to complete M&A transactions. This will lessen the possibility of professional peer pressure from fellow M&A practitioners or other business leaders involved with that particular M&A transaction. To the extent possible, the human rights expert on the M&A team should be viewed as there to represent broader societal interests and to uphold the corporate responsibility to respect, much in the same way ombudsmen are selected within certain organizations (e.g. utility suppliers, newspapers, governmental units) and provided the organizational leeway to express their views and findings without undue fear of consequences in response to their honesty.

➤ ***Publishing standards and best practices used to assess human rights during M&A due diligence process***

In an effort to proactively create effective tools and standardized approaches for effectively using M&A due diligence to enhance human rights due diligence, companies that have begun to combine these processes should share and publish the standards they have found to be most

helpful to them. Many businesses do not wish to be early adopters in terms of developing effective human rights due diligence practices for fear that treading into poorly defined territory may either expose them to negative consequences or cause other costs and delays. Those companies that have begun to combine these two types of due diligence activities using a trial and error approach could serve themselves and other corporations well by making available information about which methods proved most effective (especially in terms of the business duty to respect human rights). This type of shared information will facilitate the earlier introduction of widespread standards, which will ultimately benefit all corporate actors.

- ***Reporting internally not just on minimum standards met but also on ways company exceeded such standards and made positive contributions involving human rights***

Although it may be more in keeping with typical M&A due diligence practice to simply focus on compliance with minimal standards and to just note areas as either constituting abuses/violations or not, companies benefit from qualitatively and quantitatively measuring and reporting internally, including possibly to the Board and shareholders, when those minimum standards have been exceeded (and how) with respect to human rights. This role of reporting “positive impact” or areas of “over-compliance” relative to human rights could be fulfilled by the human rights specialist assigned to the M&A due diligence team. For instance, if a parent company is acquiring a target company with particularly good human rights-related practices, there is benefit to the company and its goal of fully integrating human rights to have a mechanism for internal acknowledgement and communication of that fact. Such a mechanism fosters sensitivity to the importance of a commitment to human rights. Finally, this mechanism for communicating the positive helps to take human rights due diligence out of a purely “negative risk” mitigation framework and put it into a wider corporate-wide framework that includes “positive risk” or opportunity.