

# Downstream due diligence Setting the record straight

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Why it is clear that the risk-based approach to due diligence expectations in the OECD Guidelines and United Nations Guiding Principles apply to the full value chain, including downstream business relationships

The due diligence expectations contained in the OECD Guidelines and United Nations Guiding Principles (UNGPs) have always, since their inception in 2011, been intended to take a risk-based approach that includes the full “value chain” of business relationships. This includes “downstream” entities and business relationships as well as “upstream” relationships. Despite overwhelming evidence and clarity on this point, some are currently attempting to take discussions at the OECD and EU back a decade in order to restrict and limit business responsibility by disingenuously claiming that established due diligence standards were not intended to have a full value chain scope. This briefing paper explains why it is clear that the risk-based approach to due diligence expectations in the OECD Guidelines and UNGPs apply to the full value chain, including downstream business relationships, drawing on provisions from the OECD Guidelines and UNGPs themselves as well as various OECD due diligence guidance documents, statements by OECD National Contact Points in various countries, and clarifications by the United Nations Office of the High Commissioner for Human Rights (OHCHR) and the OECD Investment Committee.

## International consensus on the risk-based approach in downstream value chain due diligence expectations

The OECD, ILO, and OHCHR, as well as a plethora of businesses and business associations, have all confirmed that the OECD Guidelines and UNGPs have always covered the full value chain and downstream relationships. In response to attempts to limit the scope of due diligence in the supply chain, the OHCHR, ILO, and OECD recently issued a joint public letter to the European Commission, noting “Coherence with the substantive elements of international standards can help bolster the impact and effectiveness of the EU’s efforts. For example, it can guard against box-ticking compliance approaches and overreliance on contractual assurances. It can also ensure that due diligence is embedded into enterprises’ oversight and management systems, *covers the entire value*

*chain*, and is sufficiently risk-based, dynamic, proportionate, and based on proactive and meaningful stakeholder consultation and dialogue, particularly with workers and all others potentially impacted by business activities” (emphasis added).<sup>1</sup> The OHCHR was even clearer in September 2022 in a separate paper on the importance of keeping downstream impacts in the scope of the EU’s Corporate Sustainability Due Diligence Directive, noting that not including downstream value chain relationships and impacts in the scope of due diligence directive as was being suggested by some would “undermine the international consensus”, “not align” with international standards, “neglect significant human rights impacts”, “undercut the stated objectives” of due diligence, and “lag behind” the efforts of many companies themselves.<sup>2</sup>

The **risk-based approach inherent to the OECD Guidelines and UNGPs** means that companies with severe potential and adverse impacts in their value chains should focus on these regardless of where in the value chain, or how many “tiers” away, they are. This approach enables flexibility by requiring companies to focus their attention where it is actually needed. **The risk-based approach thus means that arguments insisting on “supply chain” but not “value chain” miss the point** of due diligence, which is to prevent harm in the global economy in a risk-based manner, wherever it actually occurs – not according to an arbitrary upstream-downstream or tier-restricted designation. The OECD itself recently clarified that the risk-based approach to due diligence “means prioritising their most severe risks and impacts – *regardless of where they sit in the value chain*” (emphasis added).<sup>3</sup>

## The risk-based approach and downstream value chain due diligence expectations under the OECD Guidelines

Since the 2011 update, it is clear that the risk-based approach in the due diligence provisions of the **OECD Guidelines** includes downstream business relationships and impacts, consistent and in line with Principle 13 of the UNGPs.<sup>4</sup>

Although the Guidelines use the term “supply chain” rather than “value chain”, it is clear that the Guidelines use the term “supply chain” to refer to relationships and impacts both upstream and downstream, all of which are in the scope of the due diligence provisions. First, the OECD Guidelines explicitly refer to enterprises operating in “all sectors of the economy,” including sectors where impacts are almost always downstream, such as is the case with investors, financiers, consultants, advisors, etc.<sup>5</sup> Further, when defining the scope of business relationships covered by due diligence, the Guidelines list examples of downstream business relationships, such as “franchising, licensing or subcontracting”.<sup>6</sup>

The **OECD’s 2018 Due Diligence Guidance for Responsible Business Conduct**, which was unanimously endorsed by all OECD member states as well as business, union, and civil society representatives, further clarified that the due diligence provisions are intended to apply to the full value chain, both upstream and downstream. That authoritative document clarifies that due diligence is expected “across an enterprise’s own operations (e.g. activities and product lines) and its business relationships (*including all stages of the supply chain or value chain*)” (emphasis added).<sup>7</sup> The Due Diligence Guidance defines business relationships to include numerous downstream entities: “suppliers, *franchisees, licensees, joint ventures*, investors, *clients, contractors, customers*, consultants, financial, legal and other advisers, and any other non-State or State entities linked to its business operations, products or services” (emphasis added).<sup>8</sup> The Guidance explains that an enterprise’s risk-scoping exercise should cover “general areas of significant risk across an enterprise’s own operations (e.g. activities and product lines) and its business relationships (*including all stages of the supply chain or value chain*)”<sup>9</sup> (emphasis added). The Guidance also repeatedly illustrates its messages through examples of how to apply due diligence in a downstream manner, such as by suggesting that due diligence expectations be built into “side letters to investee entities,”<sup>10</sup> by listing “clients” among the business relationships subject to certain confidentiality expectations,<sup>11</sup> and by offering guidance on steps an investor may take to address risks identified in connection with an investee entity.<sup>12</sup> Further, various OECD sector-level due diligence guidance also clearly include downstream business relationships and impacts under the scope of due diligence, including in particular the financial sector due diligence.<sup>13</sup>

The **OECD Investment Committee**, the ultimate authority on the interpretation of the Guidelines, has also issued a formal clarification showing that business relationships both upstream and downstream are within the broad scope of the due diligence expectations, noting, “The Guidelines contain an expansive description of the term ‘business relationships’ [...] Their possible use or “scope” is not limited to certain kinds of enterprises or to certain kinds of business relationships.”<sup>14</sup>

Beyond formal clarifications by the OECD, **numerous National Contact Points (NCPs)** for the OECD Guidelines have interpreted and clarified downstream value chain impacts and relationships as being in scope of the Guidelines’ due diligence provisions. The OECD’s recent Stocktaking Report on the OECD Guidelines indicated that NCPs have clarified downstream due diligence expectations of enterprises when it comes to their customers and the buyers or users of their products or services.<sup>15</sup> The list of OECD Guidelines cases in which numerous NCPs have clarified downstream business relationships and impacts as being in scope is long. The following is a small selection, in chronological order:

- ❑ In 2013, the UK NCP confirmed the downstream responsibility of a company selling surveillance equipment used by security forces and police to perpetuate human rights abuses by an authoritarian regime.<sup>16</sup>
- ❑ In 2014, the Austrian NCP confirmed the downstream value chain responsibility of a hydro-power turbine manufacturer for adverse social and environmental impacts associated with the construction of a hydroelectric dam in which the turbines would be used.<sup>17</sup>
- ❑ In 2015, the Dutch NCP confirmed the downstream responsibility of a company selling drugs used in lethal injections for capital punishment.<sup>18</sup>
- ❑ In 2015, the French NCP confirmed the downstream value chain responsibility of a company selling tear gas to authoritarian governmental authorities.<sup>19</sup>
- ❑ In 2018, the Polish NCP confirmed the downstream due diligence responsibility of a company that provided an online platform for the advertisement and sale of products that posed severe environmental risks.<sup>20</sup>
- ❑ In 2019, the Swiss NCP confirmed the downstream responsibilities of multi-stakeholder initiatives and certification schemes allegedly involved in human and land rights violations.<sup>21</sup>
- ❑ In 2019, the UK NCP confirmed due diligence responsibility related to alleged links to a terrorist organization downstream in an audit enterprise’s value chain.<sup>22</sup>
- ❑ In 2021, the UK NCP confirmed downstream responsibility of a company manufacturing construction machinery used in property demolition and construction work associated with human rights impacts.<sup>23</sup>
- ❑ There have been numerous cases in which a wide range of NCPs have confirmed the **downstream value chain responsibility of financial institutions** providing various types of financing and financial services to companies and

projects associated with adverse impacts. For example, the Dutch NCP in 2019<sup>24</sup> and the Australian NCP in 2021<sup>25</sup> confirmed banks' responsibility to conduct due diligence on the downstream climate impacts of their investments and financial services.

- ❑ In 2022, the Norwegian NCP confirmed the downstream responsibility of a telecommunications company in relation to its sale of a subsidiary and sensitive user data to a new buyer associated with the military junta in Myanmar.<sup>26</sup>

These are just a few of the many examples of NCPs confirming and applying the OECD's risk-based approach to risks, impacts, and relationships downstream in the value chain.

### **Preventable harm: why risk-based downstream value chain due diligence is crucial for preventing severe adverse impacts in global value chains**

Downstream due diligence is particularly important in certain sectors such as financial services, ICT/surveillance, pesticides, arms, pharmaceuticals, and heavy machinery. The following case studies illustrate how adverse impacts on human rights and the environment could have been avoided if companies had abided by the OECD Guidelines and UNGPs and conducted due diligence to prevent and mitigate adverse impacts downstream in the value chain.

- ❑ **Military equipment and ship-building materials supplied to Russian Black Sea Fleet:** Between 2015 and 2021, a Danish company supplied the Russian Navy with engineering equipment.<sup>27</sup> This downstream value chain support to the Russian Navy by an EU company happened after the 2014 illegal Russian annexation of Crimea, after the EU imposed an arms embargo, and after UN findings of a wide range of human rights violations in Crimea. In particular, the Danish company allegedly supplied heat exchangers for two Russian weapon cargo ships, one of which would serve in the Black Sea Fleet that is based in the Crimean Peninsula. If the company had conducted downstream due diligence as expected under the Guidelines, these sales would not have gone through. Similarly, in 2019 a Danish paint manufacturer discovered through an internal audit that it had been supplying Russia's Black Sea Fleet shipyard based in Crimea, which Russia illegally occupied in 2014. The contracts were all signed after international and EU sanctions were imposed on Crimea. Although the first sale took place in 2016, the company did not uncover it until 2019, showing how appropriate downstream due diligence would have allowed the company to address the issue in a timely manner.<sup>28</sup>
- ❑ **Harmful pesticides supplied to India:** In the third quarter of 2017, hundreds of farmers were poisoned, some severely, in the central Indian region of Yavatmal. Official documents from India show that the pesticide Polo from

a Swiss agrochemical company played an important role in the fatal poisonings. Intensive pesticide use not only harms impacted people, but is also a major contributor to biodiversity loss and ecosystem degradation, undermining the supply of ecosystem services vital for climate change mitigation and adaptation.<sup>29</sup> Downstream due diligence by the manufacturer as expected under the Guidelines could have prevented or mitigated these adverse impacts.

- ❑ **Mining equipment associated with human rights abuses in Myanmar:** Irresponsible jade extraction has led to extensive human suffering and environmental degradation in the conflict-affected Kachin state. A 2018 United Nations report showed that the use of heavy mining equipment, manufactured by OECD-headquartered companies, enabled extraction to take place at an unprecedented speed and risk. The report found that the companies at the time relied on insufficient human rights safeguards to manage risks associated with the use of their equipment and that these risks would likely have been prevented had the companies conducted correct downstream due diligence.<sup>30</sup>
- ❑ **Surveillance software used in Syria:** The Syrian intelligence services, especially the military intelligence, have been collecting information about political opponents, members of the opposition, and human rights activists in order to perpetrate human rights violations against them. Numerous reports from Syria indicate that the government of Bashar al-Assad uses the intercepted data in part to identify, arrest, and interrogate critics. Spying in this case goes hand in hand with torture and forced confessions. According to information from Syria, software from several European corporations played a role in the violations, which could have been prevented or mitigated through appropriate downstream due diligence.<sup>31</sup>

### **Conclusion: downstream value chain due diligence is already expected under the Guidelines and UNGPs and crucial to ensuring responsible business conduct**

In conclusion, despite some claims to the contrary, international standards including the OECD Guidelines and UNGPs already expect companies to conduct due diligence on risks and relationships throughout their full value chain, covering downstream risks and impacts. Given the large number of severe adverse impacts on human rights and the environment that downstream due diligence is capable of preventing, it is crucial that governments not follow these conservative businesses' efforts to turn the clock backwards, and instead reconfirm and further codify these downstream value chain expectations in ongoing and future processes to update the OECD Guidelines and legislate due diligence.

## Endnotes

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[www.oecdwatch.org](http://www.oecdwatch.org)



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