Submission to Consultation on US National Action Plan for Responsible Business Conduct[1]

(April 24 2015)

We appreciate the opportunity of contributing to a National Action Plan for Responsible Business Conduct in the United States.

This submission is being made by RightingFinance,[2] Friends of the Earth and Global Witness and will address the following topics: accountability of financial firms for human rights abuses, investment agreements and tax cooperation.

I.Accountability of financial firms for human rights abuses

The US National Action Plan should:

Commit the Administration to action to expand corporate disclosure requirements for listed and non-listed companies on human rights, environmental and social issues, including: due diligence measures companies have in place to prevent such risks, including mechanisms for identifying and consulting with potentially affected communities before financing projects; any such process of identification or consultation that is ongoing and, for anyone in the relevant period that came to closure, the outcomes; reference to remedies they have available in compliance with pillar 3 of the Guiding Principles on Business and Human Rights.

Undertake a review of regulatory options which would strengthen requirements on financial companies to protect human rights and comply with effective remedies. Ensure that this review is undertaken within the period of the first US National Action Plan, in consultation with relevant stakeholders and that the results are published.

Principle 3 of the Guiding Principles on Business and Human Rights ("Guiding Principles") states that in meeting their duty to protect, States should: "(a) Enforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights, and periodically to assess the adequacy of such laws and address

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[2] A consortium of human rights organizations whose members are Association for Women's Rights in Development – AWID, Center for Economic and Social Rights –CESR, Center for Women's Global Leadership –CWGL, Center of Concern, CIVICUS: World Alliance for Citizen Participation, Development Alternatives with Women for a New Era –DAWN, International Network for Economic, Social and Cultural Rights -ESCR-Net – (Working Group on Economic Policy and Human Rights), IBASE (Brazil) and Social Watch.

any gaps; (b) Ensure that other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights;"

As clarified in August 2013 by the Office of the High Commissioner for Human Rights, in an authoritative opinion on the application of the Guiding Principles, the Guiding Principles apply to all investors – as they are also businesses – even institutional investors with minority shareholdings.[3] There are strong reasons for a higher standard of implementation when they undertake procedures to respect human rights. Firstly, the activities of financial corporations have broad impacts far beyond the borders of the country where they operate. A prime example of this is the impact on access to adequate food supplies around the world in the wake of the financialization of agricultural products, resulting from trading in Over The Counter (OTC) derivatives driven in large part by activities of US based financial trading firms.[4]

Furthermore, financial companies are particularly removed from affected rightholders, which emphasizes the importance of the UN Guiding Principles characterization of the nature of business involvement in human rights abuses also arising through 'business relationships'. It is through this context of a myriad of business relationships that financial firms must be especially attentive of their responsibility to ensure respect for human rights. Concerning whether financial firms avoid this responsibility due to these series of relationships, the opinion of the OHCHR is also a useful resource to address this question. OHCHR found again that financial firms, like all businesses, must uphold their responsibility to ensure they respect human rights, particularly focusing on the responsibilities of investors arising from their relationships, making sure they do not result in human rights violations, even if their investments are small.[5] As per Guiding Principle 19 (b)(ii), where violations involving financial firms are found to have occurred the responsibility to respect human rights requires firms to develop leverage in order to positively influence the situation, and ultimately consider divesting in cases where the situation is not improving. While this responsibility even applies to institutional investors with small holdings, more than other businesses, financiers often have significant leverage since their resources may be the principle determining factor upon which the viability of a business activity may turn. These considerations illuminate the importance of systems to adequately recognize human rights violations and in response evaluate leverage and exposure for financial firms to heightened financial and reputational risk.

<u>The situation of listed companies:</u>

The US legal regime prescribes certain reporting requirements for companies that issue publicly-traded securities -- listed companies. Current reporting requirements for listed companies may operate as a constraint for business respect for human rights by excluding issues that are not "material." This qualification in the requirement would not be so much of a constraint if human rights, environmental and social aspects of a

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[3] Office of the High Commissioner for Human Rights (August 2013) '*The issue of the applicability of the Guiding Principles on Business and Human Rights to minority shareholdings*', Letter to the Centre for Research on Multinational Corporations (SOMO), p. 2-3. Available at: http://www.ohchr.org/Documents/Issues/Business/LetterSOMO.pdf

[4] De Schutter, O. (September 2010) '*Food Commodities Speculation and Food Price Crises: Regulation to Reduce the Risks of Price Volatility*', Briefing Note 02 – September 2010, UN Special Rapporteur on the Right to Food. Available at: http://www2.ohchr.org/english/issues/food/docs/Briefing_Note_02_September_2010_EN.pdf

[5] Office of the High Commissioner for Human Rights (August 2013) '*The issue of the applicability of the Guiding Principles on Business and Human Rights to minority shareholdings*', Letter to the Centre for Research on Multinational Corporations (SOMO), p. 3-4.

company's operations were considered material. In our view, the US Supreme Court's statement that information is "material" if a reasonable shareholder would consider it important in deciding how to vote, means more than just financial materiality. However the SEC has understood, generally, materiality in a narrow way, as financial materiality. Also in practice the SEC has issued requirements that have gone beyond purely financial materiality for specific situations – for instance guidance on climate change risk[6] and some of the recently approved regulations on specialized corporate disclosures mandated by the Dodd-Frank financial reform-- but absent an explicit rule or a legal requirement, the narrower conception controls.

Such narrow interpretation of materiality is not consistent with requirements of Guiding Principle 3.

The narrow conception of materiality is particularly problematic in the case of companies that advertise compliance with certain guidelines –the Guiding Principles on Business and Human Rights, Principles on Responsible Investment, etc.–which may be taken as a key factor driving the investment by certain segments of the investor community and thus be by all means relevant to their decision.

The constraint is particularly relevant to the growing involvement of financial companies in spheres of activity that are very likely to be associated with human rights impacts: investment in infrastructure and in farmland

With regards to infrastructure, while the share of institutional investors' investment in infrastructure is still relatively low, it is growing. Recent policy decisions in the Group of 20, multilateral development banks and other forums that promote infrastructure as an asset class[7] are likely to lead to further increases. Infrastructure projects are particularly likely to affect human rights. From their selection to their implementation, they require participatory processes with citizen involvement under due process guarantees. When they involve resettlements or otherwise affect the livelihoods of communities they will require respecting human rights of such communities and ensuring they are compensated and their livelihoods fully restored after relocation. The distribution of benefits and losses in the ensuing contracts with the government will also need to abide by human rights principles such as equality and non-discrimination, ensuring State resources needed for satisfying the needs of the most vulnerable are not unduly compromised.

With regards to farmland, evidence also points to financial firms' growing consideration of agriculture and land itself as an investment asset class. Many such investments take the form of direct purchases or securing of long term use for large tracts of land. Purchases of large tracts of land tend to present high risks of human rights conflicts. These range from violations associated with how the land was initially acquired (for example, land tenure rights being ignored and involuntary resettlement) as well as violations of civil and political rights relating to long-term and entrenched disputes between local communities claiming legitimate land and resource tenure rights to the area, and the farmland leaseholder or purchaser (such as violations of the rights to freedom of expression, assembly and association). A survey of almost 73,000 concessions in eight tropical forested countries, more than 93 percent of land handed over by governments to the private sector for

[6] SEC 2010. Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule Release Nos. 33–9106; 34–61469; FR–82.

[7] Communiqué. Meeting of G20 Finance Ministers and Central Bank Governors, Cairns, 20-21 September 2014; Joint Statement from MDBs and IMF Head on Financing for Development, April 16 2015.

mining, logging, oil and gas drilling, and large-scale agriculture were found to involve land inhabited by Indigenous Peoples and local communities.[8]

In the cases of both of these sectors, a growing portion of investments are in developing countries, where weak governance environments often mean that mechanisms for addressing and mitigating such risks are poorly developed and more opportunities for unaccountable behavior by the companies are available.

The situation of unlisted companies

While the requirements for corporate disclosures for listed companies are not consistent with the said guidance, they represent an attempt to introduce some degree of transparency for the human rights dimensions of their activities. The fact that unlisted financial companies are able to operate without having to provide any public reporting on their activity – e.g. private equity funds – can clearly not be reconciled in any possible way with the above-mentioned principle. We are troubled by the increasing activity by private equity, hedge funds and venture funds in the same fields (namely, infrastructure and farmland) in which the behavior of listed companies is already prone to create conflictive human rights situations.

Fiduciary duty

The existing regulation on fiduciary duties of trustees or managers of institutional investors is another aspect of existing regulation that may constrain financial sector companies' ability to respect human rights. Although several studies find that there is nothing to prevent trustees and asset managers from considering human rights, social and environmental factors as part of their analysis, there is no encouragement or requirement to do so in the existing guidance. In the light of a very clear requirement responsibility to pursue "reasonable" returns it is understandable that some fiduciaries tend to consider that examination of other factors beyond short term financial return is a risk to be avoided. It is worth noting there are different sources of regulation for fiduciary duty. For instance, corporate pension funds are regulated by the Employee Retirement Income Security Act (whose regulation is issued by the Department of Labor) whereas public pension funds are regulated by the government entities that created them. Insurance companies are regulated by States.

Special cases: "Vulture funds"

The US National Action Plan should call for passing regulations to prevent financial firms that bought distressed sovereign debt in the secondary market from extracting gains superior to those a majority of creditors have agreed in a debt restructuring with the debtor country.

Vulture funds located in the US have been recently under the public spotlight. Vulture funds is a generic and popular name given to financial firms that rely on the strategy of buying distressed sovereign debt on the cheap and, when conditions for the debtor improve, sue for the full amount.

Vulture funds place at risk gains from debt restructuring that may otherwise allow debtor countries to fulfill their human rights obligations. Their activity has just turned more damaging as in a recent lawsuit, NML v Argentina, the US courts sided with a fund that had decided to remain out of a debt restructuring that counted

[8] Communities as Counterparties: Preliminary Review of Concessions and Conflict in Emerging and Frontier Markets, available at http://www.rightsandresources.org/news/communities-as-counterparties/

with the consent of 92 % of the creditors. The courts ordered Argentina to pay 100 % of the claim by the fund in question and forbade the country from paying any other creditor while it does not pay NML. The precedent likely will lead to sovereign debt restructurings becoming more difficult to achieve for any country in the future.

Available possible legislative remedies could prevent the behavior of these financial entities from harming human rights by setting limits to the extent to which they can profit from suing countries that are or have undergone a debt restructuring.

Special cases: Index funds

The US National Action Plan should introduce regulation for index funds to monitor and disclose human rights, environmental and social issues in the companies part of the index, and have processes for expedient removal of companies that exhibit lack of compliance. Apply meaningful position limits to each Commodity Index Trader and its affiliates and define each Commodity Index Fund as a core referenced contract for this purpose.

Index funds represent a very specific challenge when it comes to the accountability of financial firms for human rights, social and environmental impacts. Index funds are the most common form of passive investment. Since they are by definition constituted by a large number of companies, given a particular human rights issue with one of the companies, the equity owned by a particular asset manager would be extremely small. Since there would be so many companies represented in the index, it would be impossible for the managers to monitor human rights performance in all of them, even if they wanted to do so. If a human rights issue emerges, even in the case of an asset manager that has a mandate to disengage from investments representing human rights risks, short from having the index reconstituted – an option we should assume is never available -- it would be impossible to do so. Thus, index funds represent a way for investors to evade human rights accountability for the companies they are investing in.

In the case of commodities, commodity index funds serve speculative purposes that could be reduced by establishing position limits, ensuring these cover commodity index traders and that commodity index funds count as a contracts subject to the limits. This tool offers, thus, a partial remedy to address the scope of problematic activity by index funds.

II.Investment agreements

The US National Action Plan should review the US draft investment treaty template to include alternative approaches that guarantee human rights are enforced with primacy over companies' rights. Open review of investment clauses in existing US treaties to conform them to the newly-adopted template. Support the conducting of audits of existing treaties to identify cases where companies used them to limit the ability of other States to comply with their human rights obligations and ensure such companies provide compensation in line with ex post human rights impact assessments.

Investment provisions in investment and free trade agreements negotiated and signed by the United States have been used by US-based companies to attack government measures aimed at fulfilling human rights

obligations in other countries.[9] In fact, it cannot be ruled out that by reliance on the Most Favored Treatment[10] they may be used even by non-US companies to do just the same.

There are many other examples of non-US based companies relying on similar provisions to those existing under U.S. treaties, to successfully sue countries. For instance, a British company relied on investment treaty provisions to sue South Africa over legislation passed to ensure affirmative action as part of redress policies for the *apartheid* regime. Although similar action has not been taken by a US company, yet, examples like this show a way that any US company, taking advantage of similarly-worded agreement provisions, could take in the future.

Along these lines, the UN Special Rapporteur on the Right to Health recently found that "International investment agreements impose obligations on States vis-à-vis investors that may affect States' power to introduce health laws in the public interest. States may have to modify their laws to accommodate investors' rights."[11]

There is a range of actions that could address these issues in treaties. For instance, although investment treaties typically create rights and not obligations for the investors, they could do so. They could bind investors to respect national legislation or, at least, nationally-adopted international legal standards. They could state the primacy of standards such as those in the Guiding Principles on Business and Human Rights or other voluntary standards. Or they could include a generic provision to plainly exclude from its protection investor demands that enter into conflict with human rights obligations undertaken by the host country and measures the host country takes to implement them.

III.Tax cooperation

The US National Action Plan should:

Include due diligence requirements on the human rights risks of companies' tax and financial arrangements as part of any reporting guidelines for large US companies. Such due diligence requirements should include the users, but also the market makers and suppliers of tax abuse schemes (tax lawyers, accountants,

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[9] Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1, Award (August 30, 2000). Available at: http://italaw.com/sites/default/files/case-documents/ita0510.pdf; Azurix Corp. v. The Argentine Republic, ICSID Case No. ARB/01/12, Award (July 14, 2006). Available at: http://www.italaw.com/sites/default/files/case-documents/ita0061.pdf; CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8, Award (May 12, 2005). Available at: http://italaw.com/sites/default/files/case-documents/ita0184.pdf;Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador, Claimants' Notice of Arbitration, Ad hoc – UNCITRAL Arbitration Rules (2009). Available at: http://italaw.com/sites/default/files/case-documents/ita0155_0.pdf; Eli Lilly and Company v. The Government of Canada, Notice of Arbitration, Ad hoc – UNCITRAL Arbitration Rules (2013). Available at: http://italaw.com/sites/default/files/case-documents/italaw1582.pdf

[10] Most Favored Nation treatment clauses have become common in investment agreements. A nation that promises Most Favored Nation treatment to another commits to assure investors from that nation equal treatment and conditions as any other foreign investor enjoys in the giving nation. It has been used by investors/claimants seeking to import (allegedly) more favourable Investor-State Dispute Settlement or substantive provisions from a third-party treaty into the basic treaty.

[11] Report on the right of everyone to the enjoyment of the highest attainable standard of physical and mental health, A/69/299, August 11, 2014.

financial intermediaries). This will simultaneously provide greater transparency and access to information for tax authorities to better do their jobs.

Set out criteria under which companies should refrain from negotiating special tax holidays, incentives and rates that will prevent governments from fulfilling their human rights obligations.

Commit to conduct impact assessments to monitor the spillover effects of its tax policies and agreements on the achievement of human rights in other countries (as the Netherlands and Ireland have already done). These should be periodic and independently-verified, with public participation in defining the risks and potential extraterritorial impacts. These impact assessments should analyze not only the revenue implications, but also the distributive and governance spillover effects of a country's tax regime abroad. If and when the main problems are identified, these impact assessments should trigger policy action by including explicit recommendations and clear deadlines for remedies and redress of any negative impacts discovered. These types of impact assessments are essential tools to ensure policy coherence and evidence-based policy making in the 21st century.

Businesses decisions to invest overseas depend in no small part on the tax regime present in host countries. A large industry of tax lawyers, accountants and auditing firms has emerged over the past decades which enable multinational corporations to shield themselves from their national tax liabilities and thus invest in places there might not otherwise be a feasible business model. Corporate tax fraud, evasion and aggressive avoidance tactics has a tremendous material cost on all governments in terms of lost revenue, but especially in poorer countries who receive more corporate income tax as a proportion of their tax take. As a result, the realization of human rights of all types—from education to access to justice, health to freedom of expression, occupational safety to social protection—remain underfunded mandates.

But this loss of precious financing is not just a threat to the government's starving revenue base, but also undercuts its redistributive capacities to reverse growing economic and gender inequalities. These tax abuses also deepen mistrust in how fiscal policy is governed and thus how effective it can be, especially for the most disadvantaged.

Corporate tax practices, in other words, are fundamental to the business and human rights debate, and so they should be brought in line with the Guiding Principles, OECD Guidelines and relevant international human rights law.