GLOBAL FORUM ON RESPONSIBLE BUSINESS CONDUCT

SESSION NOTE

Responsible disengagement

30 June 2017, 14:30-16:00
Room CC10 - OECD Conference Centre

Due diligence under the OECD Guidelines is designed to be a tool for engagement. By carrying out due diligence on risks related to disclosure, human rights, bribery and corruption, employment and industrial relations and the environment, companies can operate and source responsibly in high-risk contexts. The OECD Guidelines and supporting OECD sector due diligence guidance provide a range of practical strategies by which companies can prevent and mitigate risks of harm in their supply chains while continuing to engage with suppliers. For example, under these standards, companies may:

- **Use leverage** – The company acts alone or in co-operation with other entities, as appropriate, to use its leverage to influence the entity causing the adverse impact to prevent or mitigate that impact.[1]
- **Prequalify suppliers and other business relationships** – The company assesses a supplier or business relationahip prior to the placement of orders or other forms of engagement.
- **Create business incentives** – The company creates incentives for responsible business conduct by (i) integrating expectations of suppliers and business relationships in line with the enterprise policy on responsible business conduct into supplier contracts; and (ii) by increasing orders or giving prospective orders to suppliers that perform well in relation to quality of production and responsible business conduct.
- **Support the supplier or business relationship in the implementation of corrective action measures** – For example, a company may: (i) provide technical guidance – for instance, in the form of training, management systems upgrading, etc; (ii) facilitate participation in broader sector-wide initiatives or regional initiatives to prevent impacts; (iii) facilitate linkages with local service providers; (iv) facilitate access to financing, for example, through direct financing, low-interest loans, guarantees of continued sourcing, and assistance in securing financing.

While the OECD Guidelines promote engagement with suppliers and business relationships during the course of risk prevention and mitigation, they do recognise that disengagement may be necessary in some contexts. They state that "appropriate responses with regard to the business relationships may include continuation of the relationship with a supplier throughout the course of risk mitigation efforts; temporary suspension of the relationship while pursuing ongoing risk mitigation; or, as a last resort, disengagement with the supplier either after failed attempts at mitigation, or where the enterprise deems mitigation not feasible, or because of the severity of the adverse impact."[2]

OECD sector guidance on disengagement

To assist companies in carrying out due diligence and to address the specific challenges arising in various sectors, the OECD has developed due diligence guidance in the minerals, agriculture, extractives, garment and footwear and financial sectors. All OECD sector guidance align with the recommendations in the OECD Guidelines in that they only encourage disengagement as a last resort, after failed attempts at mitigation, or where the enterprise deems mitigation not feasible, or because of the severity of the adverse impact. Table 1 provides specific recommendations under the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk

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Areas, the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector and the OECD paper on Responsible Business Conduct for Institutional investors regarding disengagement.

This session will explore what 'responsible disengagement' looks like in-practice as a component of a company's human rights, labour or environmental supply chain due diligence. It will explore questions pertaining to when should companies disengage, what policies should govern disengagement and what the disengagement process looks like once a decision has been taken.

Table 1. Recommendations concerning disengagement under OECD sector due diligence guidance

Minerals sector	**Specific cases of disengagement** Under the Annex II, Model Supply Chain Policy the OECD Minerals Due Diligence Guidance calls on companies to: • Immediately suspend or discontinue engagement with upstream suppliers where they identify a reasonable risk that they are sourcing from, or linked to, any party committing serious abuses.[3] Serious abuses are defined as: – any forms of torture, cruel, inhuman and degrading treatment; – any forms of forced or compulsory labour, which means work or service which is exacted from any person under the menace of penalty and for which said person has not offered himself voluntarily; – the worst forms of child labour; – other gross human rights violations and abuses such as widespread sexual violence; – war crimes or other serious violations of international humanitarian law, crimes against humanity or genocide.[4] • Immediately suspend or discontinue engagement with upstream suppliers where the company identifies a reasonable risk that they are sourcing from, or linked to, any party providing direct or indirect support to non-state armed groups.[5] In adherence with commitments to the Model Supply Chain Policy, the OECD Minerals Due Diligence Gudince also states the following: • Companies should "take immediate steps to disengage with a refiner (directly or through sub-suppliers) if the refiner has not immediately suspended or discontinued engagement with its suppliers where reasonable risks of serious abuses (see paragraphs 1 and 2 of Annex II) or direct or indirect support to non-state armed groups exist."[6] • "[C]ompanies should conduct an additional risk assessment on those risks requiring mitigation after the adoption of the risk management plan. If within six months from the adoption of the risk management plan there is no significant measurable improvement to prevent or mitigate the risk of direct or indirect support to public or private security forces, as identified in paragraph 5, companies should suspend or discontinue engagement with the supplier for a minimum of three months. Suspension may be accompanied by a revised risk management plan, stating the performance objectives for progressive improvement that should be met before resuming the trade relationship."[7] • "[C]ompanies should conduct an additional risk assessment on those risks requiring mitigation after the adoption of the risk management plan. If within six months from the adoption of the risk management plan there is no significant measurable improvement to prevent or mitigate the risks of bribery and fraudulent misrepresentation of the origin of minerals, money-laundering and payment of taxes, fees and royalties to governments, companies should suspend or discontinue engagement with the supplier for a minimum of three months. Suspension may be accompanied by a revised risk management plan, stating the performance objectives for progressive improvement that should be met before resuming the trade relationship."[8] **Disclosure of disengagement** Under Step 5: Report annually on supply chain due diligence of the OECD Minerals Due Diligence Guidance, companies are expected to: "disclose the number of instances where the company has decided to disengage with suppliers and/or supply chains… without disclosing the identity of those suppliers, except where the company deems it acceptable to do so in accordance with applicable laws. Companies should aim to report all instances of disengagement to relevant international and national investigative bodies and/or law enforcement authorities, having regard for the potential harmful effects of that reporting, and in accordance with applicable laws."[9]

Garment sector	**Cases of disengagement** The OECD Due Diligence Guidance for Responsible Supply Chains in the Garmet and Footwear Sector includes general guidance for disengagement in Section I, Core due diglience guidance (section 3.2.5) which are relevant across risk categories. Specific recommendations on disengagement are included in Module 5, Occupational health and safety and Module 6, Trade Unions and Collective Bargaining. ***Occupational health and safety*** • "When immediate and critical danger has been identified, the enterprsie should ensure that production does not take place at the affected production site until the immediate and critical danger ahs been adequately addressed." • "In cases in which neither the enterprise nor the supplier can secure adequate financing to prevent or mitigate the adverse impact and/or in cases in which prevention is not feasible, the enterprise should weigh the risk of continuing to engage and disengage if necessary." • "Disengagement is an option if a supplier refuses to prevent impacts after a notice and warning process." ***Trade unions and collective bargaining*** • "In cases in which severe human rights impacts have been identified, such as violence against trade unionists, the enterprise should disengage." **Process of disengagement** The OECD Garment and Footwear Guidance likewise provides recommendations on the process of disengagement once the decision has been taking. It states that **"**if an enterprise determines the need to disengage, it should seek to do so responsibly. Specifically, the enterprise should: • comply with national laws, international labour standards and the terms of collective bargaining agreements • provide detailed information supporting the business decision to management and to the union, where one exists • give the supplier sufficient notice of the ending of the business relationship."[10]
Financial sector	**Considerations for divestment or exclusion** The OECD paper, "Responsible Business Conduct for Institutional Investments" identifies factors to consider when deciding if divestment is an appropriate response including: "the investor's leverage over the company; how crucial the relationship is to the investor; the severity of the impact; and whether terminating the relationship with the company would result in adverse impacts." Each of these factors are further described in the paper and below. As noted in the paper, this decision will also depend on the nature of the asset class and strategy and whether divestment is prudent as understood in the context of a relevant jurisdiction's laws on fiduciary duty or prudent investment."[11] • ***Leverage*** — "Where a company continues to exert leverage, it may be inappropriate to divest as it may deprive the company of an engaged investor." [12] • ***Crucial business relationship*** — "…In some instances, the company may represent a crucial business relationship, or investment. Under the UN Guiding Principles, a relationship could be deemed as crucial if it provides a product or service that is essential to the enterprise's business, and for which no reasonable alternative source exists. In the context of investment, this is likely to be less relevant to specific investee companies but may be relevant for categories of companies of a given size or sector which are necessary to adequately diversify a portfolio (e.g. high market-cap energy companies)." [13] • ***Severity*** — "Generally the more severe the adverse impact, the more quickly the investor will need to see change before it takes a decision on whether it should end the relationship." [14] • ***Investor policy dictates exclusion*** — "Many investors have exclusion or divestment policies tied to specific impacts or standards. For example, some investors have exclusions with regard to companies that are involved in the production of cluster weapons, anti-personnel (land) mines, and chemical and biological weapons or coal production. Investors may also review the performance of companies in their portfolios against certain standards such as the OECD Guidelines or UN Global Compact principles. If companies which breach these standards are unresponsive to engagement and do not improve their conduct, divestment may be considered."[15] The paper also recognises that "in some circumstances divestment will be particularly difficult or even impossible (e.g. in pooled passive portfolios, and other situations in which an investment manager's clients do not agree that divestment is appropriate)."

Links

- OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas
- OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector
- Responsible Business Conduct for Institutional Investments
- "Should I stay or should I go? Exploring the role of disengagement in human rights due diligence", Somo, 2016.

Notes

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[1] The OECD Guidelines state that companys "are encouraged to

[2] OECD Guidelines for Multinational Enterprises, Commentary on General Principles, Paragraph 22.

[3] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Annex 2, 2.

[4] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Annex 2, 1.

[5] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Annex 2, 4.

[6] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Section II, C2a.

[7] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Annex II, Footnote 8.

[8] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Annex II, Footnote 10.

[9] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Step 5, A.1.3.

[10] OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector, Section I. 3.2.5.

[11] Responsible Business Conduct for Institutional Investments, "Considering Diverstment and Exclusion".

[12] Ibid.

[13] Ibid.

[14] Ibid.

[15] Responsible Business Conduct for Institutional Investments, Box 14. OECD.