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Irresponsible Exit: Exercising Force Majeure Provisions in Procurement Contracts

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The COVID-19 pandemic triggered the collapse of global supply chains. The world economy went into free fall. In order to preserve cash liquidity, many Western buyers reflexively cancelled or curtailed purchase orders that were completed or in process, without assessing or attempting to mitigate the impact on vulnerable workers in their supply chain. Tens of thousands of workers were suddenly unemployed, with no savings, no severance payments, and no government safety net.¹

The abandonment of vulnerable workers in such circumstances is tantamount to a declaration of moral bankruptcy, whether or not it is justified by contract.² The harm

¹ Corina Ajder, et al, European Center for Constitutional and Human Rights (ECHR), 'Garment supply chains in intensive care? Human Rights Due Diligence in times of (economic) crisis' (2020), <https://www.echr.eu/en/publication/garment-supply-chains-in-intensive-care/> (accessed 30 October 2020),

² Anna Triponel and John Sherman, 'Moral bankruptcy during times of crisis: H&M just thought twice before triggering force majeure clauses with suppliers, and here's why you should too' (1 April 2020) <https://www.business-humanrights.org/en/blog/moral-bankruptcy-during-times-of-crisis-hm-just-thought-twice-before-triggering-force-majeure-clauses-with-suppliers-and-heres-why-you-should-too/> (accessed 30 October 2020).

persists even after the contract is over. Just because an action is permitted by contract does not mean that it has acted responsibly and in the company's best interests, as viewed through the lens of the authoritative global standard on business and human rights, the UN Guiding Principles on Business and Human Rights ('UNGPs')³.

I. FORCE MAJEURE

To review the first quarter of 2020, buyers invoked so-called *force majeure* provisions in their contracts to justify the cancellation or curtailment of contracts due to unforeseeable and uncontrollable events.⁴ Their actions included cancellation or suspension of contracts, refusal to pay for completed orders (or orders in the process of completion), and demanding deep payment discounts.

It is estimated that approximately 450 million people work in global supply chains on which the world economy has relied for many years.⁵ Many suppliers were forced to close doors. The impact on workers in the Ready-Made Garment (RMG) sector in particular was particularly catastrophic. That sector has a long history of buyers pushing costs and risks down to workers at the very bottom of the supply chain, leaving them and their families highly vulnerable to the impacts of unemployment.⁶ Penn State Professor Mark Anner calculates that USD \$16 billion in workers wages in the garment industry

³ Human Rights Council, 'Guiding Principles on Business and Human Rights: Implementing the United Nations Protect, Respect and Remedy Framework', A/HRC/17/31 (21 March 2011), https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf. (accessed 30 October 2020). For a brief history of the background, content, and uptake of the UNGPs, see John F Sherman, III, 'Beyond CSR: The Story of the UN Guiding Principles on Business and Human Rights' in Rae Lindsay and Roger Martella (eds.), *Corporate Social Responsibility - Sustainable Business: 'Environmental, Social and Governance Frameworks for the 21st Century'* (Wolters Kluwer 2020), Ch. 20, sec. 20.04.

⁴ McDermott Will & Emery, 'Force Majeure and COVID-19: Frequently Asked Questions' (March 2020), <https://www.mwe.com/insights/force-majeure-and-covid-19-frequently-asked-questions/> (accessed 30 October 2020).

⁵ International Labor Organization, *Integrated Strategy on Fundamental Principles and Rights at Work, 2017-2023*, (2019), https://www.ilo.org/wcmsp5/groups/public/@ed_norm/@ipecc/documents/publication/wcms_648801.pdf (accessed 30 October 2020).

⁶ Mark Anner, 'Abandoned? The Impact of Covid-19 on Workers and Businesses at the Bottom of Global Garment Supply Chains' (20 March 2020), <https://www.workersrights.org/research-report/abandoned-the-impact-of-covid-19-on-workers-and-businesses-at-the-bottom-of-global-garment-supply-chains/> (accessed 30 October 2020).

were lost between April and June 2020 as a result of order cancellations.⁷ Global poverty rates are forecast to rise the first time since 1988, and the UN estimates that half a billion people will become destitute as a result of the COVID-19 pandemic.⁸ After being squeezed by buyers to keep costs as low as possible, suppliers had little margin to pay severance to workers. Most lived from paycheck to paycheck (often below a living wage standard), had no savings, and had no access to government social safety nets.

Some prominent companies, such as the retail clothing company H&M, took laudable action to mitigate the impact on workers, by agreeing to take delivery of already produced garments, to pay for goods in production, and to do so in accordance with previously agreed prices and payment terms.⁹ In contrast, the U.S. department store chain Kohl's invoked the force majeure provisions of its contracts to cancel, without consultation, its clothing orders from Korean and Bangladeshi suppliers. Weeks later, it paid its shareholders a USD \$109 million dividend.¹⁰ Jettisoning purchase orders during the pandemic, without first considering or attempting to mitigate the likely severe harm to vulnerable workers, is inconsistent with the UNGPs, may make a company less attractive to investors, and undermines to the company's ability to rebound from the pandemic.

I. HOW THE UNGPs APPLY TO PROCURMENT CONTRACT CANCELLATIONS

A. Background and Content of the UNGPs—The Importance of Leverage

⁷ Mark Anner, 'Unpaid Billions: Trade Data Show Apparel Order Volume and Prices Plummeted through June, Driven by Brands' Refusal to Pay for Goods They Asked Suppliers to Make', Center for Global Workers Rights (6 October 2020), https://www.workersrights.org/wp-content/uploads/2020/10/Unpaid-Billions_October-6-2020.pdf (accessed 30 October 2020).

⁸ Andy Sumner, et al, 'Estimates of the impact of COVID-19 on global poverty', at <https://www.wider.unu.edu/publication/estimates-impact-covid-19-global-poverty> (accessed 30 October 2020).

⁹ As of October 2020, H&M had been joined by 20 other companies who publicly committed to pay in full for orders completed and in production, Workers Rights Consortium, 'Covid-19 Tracker: Which Brands Are Acting Responsibly toward Suppliers and Workers?' (October 2020), <https://www.workersrights.org/issues/covid-19/tracker/> (accessed 30 October 2020).

¹⁰ Mei-Ling McNamara, 'Anger at huge shareholder payout as US chain Kohl's cancels \$150m in orders: Retailer paid \$109m in dividends just weeks after cancelling clothing orders, leaving suppliers in Bangladesh facing financial crisis' (June 2020), <https://www.theguardian.com/global-development/2020/jun/10/anger-at-huge-shareholder-payout-as-us-chain-kohls-cancels-150m-in-orders> (accessed 30 October 2020). As of October 2020, about 19 companies, including Kohl's, were reported not have committed to pay in full for orders completed and in production. See Workers Rights Consortium Covid-19 Tracker at n. 10 above.

The UN Human Rights Council unanimously endorsed the UNGPs in 2011, following six years of multistakeholder consultations, research, and pilot projects. The UNGPs have become the authoritative global standard on business and human rights. They are increasingly reflected in law, multistakeholder norms, the policies and practices of leading business enterprises, dispute resolution processes, and the advocacy of civil society.

For example, the OECD promptly imported the core UNGP concept of human rights due diligence (HRDD) into its revised Guidelines for Multinational Enterprises.¹¹ HRDD is a process that enables companies to identify, prevent, mitigate, and account for their involvement, both through their own activities and in their business relationships, in human rights harm to vulnerable people in their own activities and in their business relationships. In a nutshell, HRDD expects that companies will identify the risk of adverse human rights impacts in their own activities and in their business relationships, will respond to their involvement in an integrated basis, will track their human rights performance, and will be prepared to report on it publicly.

In response to such involvement, HRDD expects that companies should stop their activities that have caused or are likely to cause human rights harm, should attempt to exercise or build leverage to influence their business relationships to do so, and should provide or contribute to the remedy of harm that they caused or contributed to. HRDD is an ongoing process that applies to all stages of a business relationship from its outset to the negotiation of contract terms, to contract performance, to disputes, to cancellation, and to renewal of the relationship. It applies to both buyers and sellers in a contract and recognizes that both can contribute to harm.

B. The Changing Nature of Company Human Rights Due Diligence Obligations

1. HRDD is hardening into law

HRDD has become increasingly hardened into domestic law. This started with legislation requiring public disclosure of involvement in modern slavery legislation in

¹¹ OECD, 'OECD Due Diligence Guidance for Responsible Business Conduct (2018), <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf> (accessed 30 October 2020).

California, the United Kingdom, and now Australia. These laws were limited in scope and did not impose significant legal penalties for noncompliance. But more recent HRDD laws have become much more comprehensive and have grown teeth. The French 2017 “Plan of Vigilance” law requires the largest French companies to conduct human rights and environmental due diligence. They may incur civil penalties for noncompliance.¹² The 2019 Netherlands Child Labor Due Diligence Act¹³ applies to companies that sell or supply goods or services to Dutch end-users, wherever they are based or registered, and involves potential criminal penalties for directors.

Finally, the European Commission announced that in Q1 2021 it will issue a legislative directive mandating human rights and environmental due diligence for companies based within the EU and foreign firms that conduct significant business there.¹⁴ The reach of the EU legislation may well be extraterritorial.¹⁵

2. Investors are expecting companies to conduct HRDD

In parallel with the legal codification of HRDD is the sharp rise in ESG investing, which has continued to hold strong investor interest during the pandemic.¹⁶ The S in ESG

¹² Business & Human Rights Resource Centre, ‘France: Natl. Assembly adopts law imposing due diligence on multinationals to prevent serious human rights abuses in supply chains’, (14 February 2017) <https://www.business-humanrights.org/en/france-natl-assembly-adopts-law-imposing-due-diligence-on-multinationals-to-prevent-serious-human-rights-abuses-in-their-supply-chains> (accessed 30 October 2020).

¹³ Joseph Wilde-Ramsing and Manon Wolfkamp, MVO Platform, ‘Going Dutch: Four things you should know about the Netherlands’ new law to eliminate child labour’, (3 June 2019), <https://www.business-humanrights.org/en/blog/going-dutch-four-things-you-should-know-about-the-netherlands-new-law-to-eliminate-child-labour/> (accessed 30 October 2020).

¹⁴ Stéphane Brabant, et al, ‘2021 law will make human rights due diligence mandatory for EU companies’ (May 2020), <https://www.business-humanrights.org/en/latest-news/2021-law-will-make-human-rights-due-diligence-mandatory-for-eu-companies/> (accessed 30 October 2020).

¹⁵ Directorate-General for External Policies, ‘Human Rights Due Diligence Legislation - Options for the EU’, (June 2020), [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/603495/EXPO_BRI\(2020\)603495_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/603495/EXPO_BRI(2020)603495_EN.pdf) (accessed 30 October 2020).

¹⁶ See, e.g., Samantha Lamas, ‘Can Interest in ESG Investing Hold Up During a Pandemic? Morningstar's latest behavioral research shows that interest in sustainable investing persists despite the coronavirus’ (26 August 2020) <https://www.morningstar.com/articles/998953/can-interest-in-esg-investing-hold-up-during-a-pandemic> (accessed 30 October 2020); Sabri Ben-Achour, et al, ‘Sustainable investing is actually up during the pandemic recession’, (3 August 2020) <https://www.marketplace.org/2020/08/03/sustainable-investing-esg-covid-19-social-environmental-causes/> (accessed 30 October 2020); Investment News, ‘ESG Funds outperformed through the pandemic, S&P finds’ (14 August 2020) <https://www.investmentnews.com/esg-funds-outperformed-through-pandemic-sp-finds-196098> (accessed 30 October 2020).

stands for social impact, which includes many human rights factors.¹⁷ As a result, ESG investors will want to know whether and the extent to which companies have invested in their workforces and will be able to resume with a well-trained and committed workforce when business resumes. Do they provide paid leave? Do they prioritize health and safety for workers? Do they take every measure to retain workers? Do they maintain sustainable supplier/customer relationships?¹⁸ These are all questions that investors interested in ESG factors will want answers to.

Indeed, the resiliency of a company's supply chain to disruption is a key question for all investors. The pandemic has highlighted the extreme fragility of highly fragmented global supply to major disruptions, which will continue to occur. To quote McKinsey:

Businesses that successfully implemented a lean, global model of manufacturing achieved improvements in indicators such as inventory levels, on-time-in-full deliveries, and shorter lead times.

However, these operating model choices sometimes led to unintended consequences if they were not calibrated to risk exposure. Intricate production networks were designed for efficiency, cost, and proximity to markets but not necessarily for transparency or resilience. Now they are operating in a world where disruptions are regular occurrences. Averaging across industries, companies can now expect supply chain disruptions lasting a month or longer to occur every 3.7 years, and the most severe events take a major financial toll.¹⁹

To 'build back' better following the pandemic, companies should develop more resilient, simpler, and transparent supply chains that place greater reliance on fewer trusted suppliers whom the buyer will support in tough times, knowing that they will be able pick up the slack when demand rebounds. Indeed, as discussed above the hardening of due diligence requirements, and the increase in investor expectations means companies need to address their contracting practices as part of their adherence to the UNGPS.

¹⁷ Fiona Reynolds and John Ruggie, 'What institutional investors need to know about the 'S' in ESG, Responsible Investor, (22 October 2020), <https://www.responsible-investor.com/articles/fiona-reynolds-and-john-ruggie-what-institutional-investors-need-to-know-about-the-s-in-esg> (accessed 30 October 2020).

¹⁸ E.g., the statement of 251 long-term investors representing US\$6.4 trillion in assets under management with regards to the impact of the pandemic, 'Investor Statement on Coronavirus Response', (23 June 2020) <https://www.domini.com/uploads/files/INVESTOR-STATEMENT-ON-CORONAVIRUS-RESPONSE-06.23.2020.pdf>

¹⁹ McKinsey Global Institute Report, 'Risk, resilience, and balancing in global value chains', (6 August 2020) <https://www.mckinsey.com/business-functions/operations/our-insights/risk-resilience-and-rebalancing-in-global-value-chains#> (accessed 30 October 2020).

C. HRDD expects that companies will identify and address the risks of the most vulnerable persons in their supply chains.

Under HRDD, a buyer is expected to map its entire supply chain to identify likely risks of harm to vulnerable people. And where it is involved in such risks, its response should be based on whether it caused, contributed, or is directly linked to an actual or potential harm that it neither caused nor contributed to. This includes stopping buyer conduct that causes or contributes to the harm and exercising leverage to influence suppliers to stop harming people. Where the buyer causes or contributes to such harm, it is expected to provide or contribute to remedy as appropriate. And where the buyer is merely linked through its goods or services to harm it did not cause or contribute to, it is not expected to provide remedy.

No bright line separates whether business conduct ‘contributed’ to an impact from whether it is merely ‘linked’ to the impact. They sit on a continuum, and according to Prof. John Ruggie, author of the UNGPs, where they sit in a particular case depends on a variety of factors, including “the extent to which a business enabled, encouraged, or motivated human rights harm by another; the extent to which it could or should have known about such harm; and the quality of any mitigating steps it has taken to address it”.²⁰

The risks of human rights harm to vulnerable supply chain workers has been known for many years, as companies have pushed costs and risks down to workers at the bottom of the supply chain. As Professor Anner has observed:

Decades of low prices have left many suppliers with minimal capital and now mounting debts. Years of low wages with no savings and little hope sustained government support will leave workers in dire situations. And chronic low tax revenues from buyers have left exporting country governments with weak social safety nets to assist workers in this time of crisis.²¹

²⁰ John G. Ruggie, ‘Comments on Thun Group of Banks Discussion Paper on the Implications of UN Guiding Principles 13 & 17 In a Corporate and Investment Banking Context’, (21 Feb. 2017) <https://business-humanrights.org/sites/default/files/documents/Thun%20Final.pdf> (accessed 30 October 2020).

²¹ Mark Anner, *Abandoned? The Impact of Covid-19 on Workers and Businesses at the Bottom of Global Garment Supply Chains* (27 March 2020), p.7, <https://www.workersrights.org/wp-content/uploads/2020/03/Abandoned-Penn-State-WRC-Report-March-27-2020.pdf> (accessed 30 October 2020).

Abandoned workers in such circumstances have limited ability to feed or house themselves or their families. Therefore, when buyers cancel or curtail purchase orders, it is critical to understand the likely human rights impacts on workers of doing so and the quality of efforts to mitigate that impact.

II. CONTRACT CANCELLATION UNDER THE PANDEMIC

As noted above, HRDD applies to all stages of a contractual relationship, including the negotiation and exercise of contract terms providing for termination of the relationship. The term ‘responsible exit’ has been used to describe the HRDD responsibility of investors in major infrastructure projects to anticipate and provide in the agreement for the mitigation of adverse impacts on vulnerable persons at throughout the project’s lifecycle, including its termination and afterwards.²²

The UNGPs focus on contract cancellation in the context of ending the relationship based on a party’s violation of human rights standards. This also provides helpful guidance for force majeure terminations where neither party is at fault. The comment to UNGP 19 provides that where the business cannot exercise or increase its leverage, it should ‘consider ending the relationship, taking into account credible assessments of potential adverse human rights impacts of doing so.’²³ Thus, even where a buyer is confronted with an unforeseeable and uncontrollable event that justifies termination, it should try to exercise or build its leverage to prevent the supplier from laying off vulnerable workers.

Consequently, the decision whether to cancel or curtail a supply contract based on the pandemic’s disruption to the supply chain should not be a binary or a unilateral one.

Retrenchment should be a last resort.²⁴ The Better Buying Institute has suggested that

²² Malena Wåhlin, Swedwatch, ‘NO BUSINESS, NO RIGHTS: Human rights impacts when land investments fail to include responsible exit strategies. The case of Addax Bioenergy in Sierra Leone article on Sierra Leone’, (8 November 2017), https://swedwatch.org/wp-content/uploads/2017/11/86_Sierra-Leone_NY.pdf (accessed 30 October 2020).

²³ McDermott Will & Emery, n. 23.

²⁴ IHRB, ‘RESPECTING HUMAN RIGHTS IN THE TIME OF THE COVID-19 PANDEMIC: Examining Companies’ Responsibilities for Workers and Affected Communities’ (April 2020), n. 115, <https://www.ihrb.org/focus-areas/covid-19/report-respecting-human-rights-in-the-time-of-covid19> (accessed 30 October 2020).

buyers should collaborate with suppliers in order to make contract cancellation or curtailment a last resort by:

- Exploring available options for raising the cash needed to cover accounts payable to suppliers, such as liquefying assets, issuing corporate bonds, drawing down credit, and securing loans;
- Discussing with suppliers their financial health and whether they have the cash/liquidity necessary to retain workforce for at least three months;
- Accepting and paying all existing purchase orders for goods that have been shipped, are ready or in progress, or are cut, and not resorting to outright cancellations;
- Rationalizing current assortment plans and reconfigure orders to continue producing viable products;
- Engaging with suppliers to manufacture masks and other needed personal protective equipment for workers on the front lines;
- Extending delivery dates/accepting shipping delays as necessary; and
- Paying a portion of orders that have not been cut and future orders that are affected by changes in volume, have delayed shipping deadlines, or are on hold.²⁵

As noted, HRDD applies to the negotiation of procurement contract terms. Termination and cancellation provisions drafted by buyers typically allow the buyer wide discretion. This is not uncommon, given the power-asymmetry between buyers and suppliers in many sectors, particularly the RMG sector, and the take-it-or-leave it approach to contract terms by buyers. However, procurement contracts rarely address the contribution that buyers can make to adverse human rights impacts, which is highly relevant to the buyer's responsibility under the UNGPs.²⁶

²⁵ Better Buying Institute, 'Better Buying: Special Report. Guidelines for "Better" Purchasing Practices Amidst the Coronavirus Crisis and Recovery' pp. 2-3 (2 April 2020), <https://betterbuying.org/wp-content/uploads/2020/04/Better-Buying-Special-Report-COVID-19-Guidance-for-Brands-and-Retailers.pdf> (accessed 30 October 2020).

²⁶ John F Sherman, III, 'The Contractual Balance Between "Can I?" and "Should I?": Mapping the ABA's del Supply Chain Contract Clauses to the UN Guiding Principles on Business and Human Rights' (11 April 2020) HKS Corporate Social Responsibility Initiative Working Paper No 55, https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=3265940. See also, Sarah Dadush, 'Contracting for Human Rights: Looking for Version 2.0 of the ABA Model Contract Clauses' (2019) 68

Parties can address the risks of supply chain disruption up front in the contract formation and negotiation stage. Unfortunately, it is a rare procurement contract that addresses contribution by the buyer to adverse human rights impacts by the supplier, whether related to cancellation or otherwise. Generally, lawyers for buyers have drafted them with a top-down compliance approach, imposing penalties for supplier's non-performance, rather than addressing the need for both parties to collaborate with each other to exercise human rights due diligence. As a result, the American Bar Association is currently debating model contract provisions that would incorporate buyer obligations to engage in responsible buying practices.²⁷

It could be argued the responsibility to mitigate the adverse effects of cancellation is unreasonable in the context of unforeseeable and uncontrollable supply chain disruptions, where the buyer has to act quickly and make tough decisions. However, as noted earlier, the likelihood of major supply chain disruptions, such as financial crises, terrorism, extreme weather, and pandemics, is foreseeable. This is particularly true for highly fragile, intricate and opaque supply chain networks. And the risk of collateral harm to vulnerable workers from disruption is equally foreseeable. Moreover, while the immediate cause of the actual disruption may be beyond the buyer's control, many buyers chose to build and rely on fragile supply chains that are highly susceptible to disruption. In order to drive costs down as far as possible and shorten lead times.

CONCLUSION

In sum, buyers cannot simply check out of their responsibility to mitigate human rights harm to vulnerable stakeholders when exercising *force majeure* clauses in the contracts that they drafted. That harm will continue long after the contractual relationship is over. Having built and relied upon highly fragile supply chain networks in order to push costs down to the lowest level and reduce lead times, buyers cannot responsibly leave their human rights responsibilities behind as they exit.

Am ULREV, <http://www.aulawreview.org/contracting-for-human-rights-looking-to-version-2-0-of-the-aba-model-contract-clauses/> (accessed 30 October 2020).

²⁷ Ibid.

Draft