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Deborah DeMott and Tan Cheng Han (eds), *Agency and Intermediation* (Edward Elgar, forthcoming)

Intermediaries - the Data Linchpins of Human Rights Due Diligence

Lisa Hsin* and Ernest Lim**

Abstract: This chapter examines the role of intermediaries in Human Rights Due Diligence (HRDD), a component of the UN Guiding Principles on Business and Human Rights that requires companies to identify and mitigate human rights violations in their supply chains. As HRDD regulations expand globally, businesses increasingly rely on third-party intermediaries—auditors, consultants, and ratings providers—to collect and analyze supply chain data. We critically assess these intermediaries, finding they often have to navigate significant challenges including conflicts of interest, unreliable data, superficial assessments, and audit fraud. We explore how intermediaries occupy an ambiguous space between public interest and commercial motivations, functioning as data linchpins with considerable influence yet minimal accountability. We conclude that effective HRDD implementation requires better regulation of intermediaries to ensure they balance public interest with private gain while maintaining integrity in human rights assessments.

Keywords: Human rights due diligence; supply chain; intermediaries; ESG

1. Introduction

Human Rights Due Diligence (“HRDD”) is a key component of the 2011 United Nations Guiding Principles on Business and Human Rights (“UNGPs”), the first international instrument to impose on private actors the responsibility to prevent human rights violations by carrying out due diligence on their supply chains or value chains. John Ruggie, the author of the UNGPs designed the principles around the concept of “principled pragmatism,”¹ which

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affords companies “an unflinching commitment to the principle of strengthening the promotion and protection of human rights as it relates to business, coupled with a pragmatic attachment to what works best in creating change where it matters most”.

Therefore, HRDD, as set out in the UNGPs, is intended to be a flexible process, capable of being adapted and absorbed into different contexts, business models, and industries to minimise the potential or actual harm to the human rights of individuals operating within the supply chain. The process comprises four elements. It expects businesses to: (1) assess risks; (2) integrate findings to take appropriate preventative and mitigating action; (3) track effectiveness of the response; and (4) publicly communicate how they address their human rights impact.

Over the past few years, these procedural steps have been incorporated into a range of domestic and regional regulations with varying degrees of alignment. HRDD and its related regulations, such as the French Duty of Vigilance², the German Supply Chain Regulation³ and the EU Corporate Sustainability Due Diligence Directive (CSDDD)⁴ disrupted the ability of supply chains to allow responsibilities to be outsourced, and to limit liability by contract. In reality, this approach has allowed a range of social ills to proliferate in supply chains.⁵

Since the adoption of the UNGPs, Business and Human Rights has become a new area of practice and research.⁶ In turn, HRDD has become an area of commercial interest and growth, fuelled by the interactions between businesses, activists, consultants, lawyers, civil society, and academics, who debate and discuss new ideas. As companies respond to new regulations on environmental impact, labour conditions and supply chain practices, service provider offerings have steadily risen. Between 2017 and 2020, vacancies in

¹ On principled pragmatism, see John Ruggie, “Promotion and Protection of Human Rights”: Interim Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises (2006) (U.N. Doc E/CN.4/2006/97). UN Commission on Human Rights.

² See Section 2.

³ Ibid.

⁴ Ibid.

⁵ Anita Ramasastry, “Corporate Social Responsibility Versus Business and Human Rights: Bridging the Gap Between Responsibility and Accountability” (2015) 14 *Journal of Human Rights* 237, 242.

⁶ Marisa McVey, “Untangling the authority of external experts in the corporate implementation of the UN Guiding Principles on Business and Human Rights (2022) 21 *Journal of Human Rights* 620.

sustainability/environmental, social and governance (ESG)-related posts have doubled.⁷ This is partly because the loosely described HRDD steps have been challenging for companies to put in place. Compliance would mean disrupting how things have always been done, by turning a blind eye to activities further down the supply chain, and to contract out of financial and reputational exposure.

New legal requirements to identify, mitigate, and prevent the adverse impacts arising from corporate supply chains require considerable restructuring and reallocation of internal resources, particularly as supply chains inevitably turn out to be more far-reaching and complex than at first glance. Some consist of far-reaching economic restructuring, such as product manufacturing including raw material extraction, provision of services and may include all business operations relating to transportation, distribution, storage and even disposal. Untangling existing supply chains that are formed by a complex web of legal and non-legal instruments ranging from written or oral contracts to customary practices can be a massive headache too. To state the obvious, supply chains do not merely consist of the relationship between the buyer and the supplier. They also include the supplier contracting with other suppliers who will further subcontract to other suppliers. In other words, the adverse human rights impacts arise not only from the parent company and its subsidiaries, but also from the formal and informal relationships and networks that the parent and its subsidiaries have with supply chain partners.

Given the complexity of supply chains, large multinationals may not necessarily know the origins of their products and services, nor be able to easily describe the process by which they are made. HRDD, radically, moves businesses away from purely thinking about risks to its profitability, to taking on responsibility for preventing risks of potential adverse effects on human rights.

Due diligence is a familiar concept in business to mean investigation and analysis of an organisation before initiating a transaction — may it be with a client, vendor, or a third party. The approach is employed to vet issues that can potentially affect the business, preventing major problems in the enterprise arrangement. For instance, due diligence in mergers and

⁷ Kate Birch, Sustainability Jobs Boom as Corporate ESG Efforts Accelerate, Sustainability Magazine, 20 January 2024, <https://sustainabilitymag.com/sustainability/sustainability-jobs-boom-as-corporate-esg-efforts-accelerate>.

acquisitions means looking into pending litigation, financial stability, labour relations, and sales. Proper due diligence can be considered as an investigation or audit, gathering and verifying all facts and figures. As for implementing due diligence, companies generally require written procedures and policies. This may call for the cooperation of third-party experts such as lawyers, insurance agents, and other experts. Different types of transactions may call for different due diligence requirements. For example, companies or individuals selling an asset or business can also perform due diligence to clearly understand potential liabilities before entering into a deal. Due diligence can be performed at various stages of the decision-making process, including compliance with regulatory requirements. Traditionally, due diligence may be facilitated by accountants hired to examine financial records, check the accuracy of financial statements, and identify accounting irregularities; financial analysts or consultants typically assist buyers and sellers by providing their expertise in financial analysis, risk assessment, and market research; and lawyers particularly review contracts, identify legal risks, and ensure regulatory compliance concerning the transaction. These third parties typically work together to analyse information, assess risks, and make informed decisions based on their findings during the due diligence process.

HRDD, sometimes referred to as ESG due diligence in practice, differs from transactional or risk management due diligence. First, the process is meant to be iterative, rather than a snapshot in time. Second, it focuses on risks to the human rights of individuals, rather than financial or reputational risk to the business. Third, HRDD is meant to be conducted across multiple jurisdictions, across different products with different supply chains, labour intensity and risk profiles. HRDD focuses on the supply chain's various entities' adherence to ethical, sustainable, and well-governed policies. It aims to uncover material human rights risks, liabilities, and opportunities with the significance on non-financial factors that affect an enterprise's reputation, financial performance, and regulatory standing. In practice, it helps to uncover a company's human rights risk factors, but it is meant to do more than enable ethical investment decisions, mergers, and acquisitions. To align with the UNGPs, the purpose of HRDD is to prevent human rights violations and adverse impacts.

<i>Transactional due diligence</i>	<i>Human rights due diligence</i>
Pre-deal/exits	Iterative

Risk-based	Harm-based
Third parties facilitate fact-finding and analysis	Intended to be carried out inhouse but increasingly outsourced to third parties
Issues are not addressed unless the deal goes through	Issues must be addressed based on saliency
Negative findings can lead to termination or contractual assurances and safeguards	Remediation approaches are subject to the facts
Responsible to shareholders/investors	Responsible to third party stakeholders, civil society, regulators

2. Domestic Legislation Driving HRDD

This section provides a brief overview of the regulations that align with HRDD. In the domestic context, the UNGPs and an understanding of business responsibility for human rights are increasingly incorporated into legislation. For example, in 2015, the UK passed the Modern Slavery Act.⁸ Under s 54 of the statute, companies that meet certain thresholds must prepare a slavery and human trafficking statement stating the steps the company has taken to ensure that slavery and human trafficking is not taking place in any of its supply chains or a statement that the organization has taken no steps. The MSA imposes no penalties on companies to make the statement. Section 54 is essentially an obligation of disclosure. It lacks teeth. Companies are not required to take steps to mitigate, let alone to prevent, adverse human rights impacts. This approach is not reflective of HRDD, but there are signs that new regulations inspired by the MSA have started to incorporate elements of the UNGP. In Australia, which adopted its own Modern Slavery Act in 2018, largely modelled on the UK MSA, has broader application and better accountability mechanisms.⁹ Both statutes rely on the effects of ‘trickle down’¹⁰ to impose obligations extraterritorially, though they similarly focus on ‘modern slavery’ instead

⁸ Modern Slavery Act 2015 (c. 30).

⁹ Modern Slavery Act 2018.

¹⁰ Justin Nolan and Martijn Boersma, *Addressing Modern Slavery* (UNSW Press, 2019), pp137-138.

of human rights more broadly. Canada and New Zealand have similarly been working on proposals for supply chain transparency.¹¹

In contrast, the French *Loi de Vigilance* is the first legislative example of a general mandatory due diligence requirement for human rights and environmental impact. The law imposes a ‘duty of vigilance’ on certain large French companies (employing 5000 employees in France, or 10,000 globally), and the law extends to activities of French companies’ subsidiaries ‘with which the company maintains an established commercial relationship’. This is the test by which companies are held to have a legal duty. Under the French Duty of Vigilance,¹² companies must implement a ‘vigilance plan’ which should include reasonable measures to adequately identify serious violations of human rights and the environment. The plan must include measures to prevent human rights violations and environmental damage relating to the operations of the suppliers with whom the company maintains an established relationship.

The CSDDD¹³ has also aligned with the UNGPs and HRDD. Although the scope was watered down through a lengthy political process, the directive was adopted by the European Union in April 2024.¹⁴ The CSDDD requires in-scope EU and non-EU entities to exercise due diligence to identify, mitigate, prevent and end the adverse impacts in their chain of activities.¹⁵ Adverse impacts include child labour, slavery, labour exploitation, environmental degradation, pollution and biodiversity loss.¹⁶ As part of compliance, businesses in scope must carry out due diligence on their ‘chain of activities’, which has been defined to include upstream and downstream production and supply of goods and services, and the activities of direct and

¹¹ Shareholder Association for Research and Education, *The Rise of Supply Chain Transparency Legislation: What is at stake for Canadian Investors*, February 2017,

http://share.ca/documents/investor_briefs/Social/2017/Supply_Chain_Transparency_Legislation.pdf.

¹² Loi no. 2017-399 du 27 Mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d’ordre (French Duty of Vigilance Law – English translation, <https://www.business-humanrights.org/en/latest-news/french-duty-of-vigilance-law-english-translation/>) codified in Article L. 225-102-4 of the French Commercial Code. For critiques, see eg, Elsa Savourney and Stephane Brabant, “The French Law on the Duty of Vigilance: Theoretical and Practical Challenges since its Adoption” (2021) 6 *Business and Human Rights Journal* 141.

¹³ The CSDDD was adopted and approved by the European Union in May 2024. The European Parliament legislative resolution of 24 April 2024 on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022)0071 – C9-0050/2022 – 2022/0051(COD)).

¹⁴ The CSDDD applies to EU companies that have more than 1000 employees and a net worldwide turnover exceeding €450 million, and non-EU companies with over €450 million net turnover generated in the EU. Article 2 of the CSDDD.

¹⁵ Articles 6, 7 and 8 of the CSDDD.

¹⁶ Recitals (9)-(14) of the CSDDD.

indirect business partners.¹⁷ The directive, which is set to enter into force in 2026 should drive more companies to undertake due diligence and employ service providers and intermediaries.

In particular, the CSDDD contemplates the involvement of such professionals to help companies discharge their obligations, stating that companies could also use “independent third-party verification on and from companies in their chain of activities to support the implementation of due diligence obligations to the extent that such verification is appropriate to support the fulfilment of the relevant obligations. Third-party verification could be carried out by other companies or by an industry or multi-stakeholder initiative.” Importantly, recital (37) states that “Companies participating in industry or multi-stakeholder initiatives or using third party verification or contractual clauses to support the implementation of due diligence obligations should still be able to be sanctioned or found liable for violations of this Directive and damage suffered by victims as a result.” Interestingly, the EU Commission noted that independent third-party verifiers should be objective, independent, free from conflicts of interest, and competent – a concern which will be further explored in this chapter.

3. HRDD Intermediaries

In light of the complexities of supply chains and the multi-dimensional nature of human rights risks, HRDD requires different skillsets beyond the usual accountants and lawyers. A new industry of broader ESG service providers or ‘intermediaries’ has emerged to offer HRDD regulatory compliance solutions. In 2023, it was estimated that the global ESG (of which HRDD is part of ‘Social’) advisory has grown to be worth around US\$ 39.3 billion with the trend set to continue to grow to an estimated US\$ 72.4 billion by the end of 2033.¹⁸ The service providers at the centre of this new booming industry are intermediaries in the sense that they straddle between the buyer companies and suppliers (or subcontractors). In this chapter, the term ‘intermediaries’ is used deliberately to illustrate the role of service providers as go-betweens for corporate businesses and those of their suppliers, business partners or other third parties. We believe it is important to note that they act on behalf of corporate businesses subject to HRDD requirements. In effect, the process of identifying, mitigating and preventing human

¹⁷ Article 3(g) of the CSDDD.

¹⁸ ESG & Sustainability Advisory Market Outlook (2023-2033), Fact.MR, <https://www.factmr.com/report/esg-and-sustainability-advisory-market>.

rights risks is outsourced. These service providers, ranging from human rights legal advisors to ratings providers, claim to help buyer companies with HRDD compliance by offering to establish internal compliance programs and structures, conduct investigations, and manage data and information to enable public communication.

In effect, these actors work by problematising human rights HRDD, to reframe these regulations as opportunities to create value and potentially a competitive edge over other companies. We observe that the cast of HRDD intermediaries is an “ever-evolving and increasingly variable range of both public and private actors” that leverage business and human rights for power, legitimacy, and a connection to human rights as “public interests”.¹⁹ Additionally, as Ramasastry points out, management consultants, lawyers, and professional education providers all inhabit this Business and Human Rights space, at once advising and enabling its development. David Karp notes that the normative foundation of HRDD is rooted in neoliberalism’s ‘public–private’ divide. For Karp, the UNGPs (including the HRDD concept) are an extension and product of, rather than a meaningful response to, the neoliberal world order. In other words, they do not challenge the view of the company as purely private, which inevitably means commercial profitability is prioritised.²⁰ This chapter critically assesses the activities of auditors, management consultants and ratings providers.

Whether expressly permitted by law or implied, the use of third parties is likely to grow. The question at the heart of this chapter is who these third-party intermediaries are and what roles do they play within the HRDD process. To identify relevant third-party intermediaries, we looked to the multinationals with greater resources to recruit specialists whose job descriptions encompass sustainability, human rights and ‘ESG’. The analysis identified several large multinational organisations undertaking HRDD compliance and by following the contacts of corporate personnel, such as inhouse counsels or heads of procurement, we observed different multinational organisations operating around and with them, on a formal basis, and selectively delved into how they are connected to HRDD compliance efforts. Such specialists tended to offer solutions and expertise that did not already exist in traditional corporate

¹⁹ McVey (n 6); and Janne Mende, “Business Authority in Global Governance: Companies Beyond Public and Private Roles” (2023) 19 *Journal of International Political Theory* 200.

²⁰ David J. Karp, “Business and Human Rights in a Changing World Order: Beyond the Ethics of Disembedded Liberalism” (2023) 8 *Business and Human Rights Journal* 135.

departments and sought to advise multinational companies subject to the various domestic regulations.

a. Data supply chain

The first step of HRDD is to identify where human rights risks might lie. This is often referred to as ‘mapping’ supply chains and to undertake risk assessments for human rights issues. The mapping process is supplemented or based on data collected from various sources, such as news articles, ESG-related benchmarks, audits, surveys, and questionnaires or expert advisors. HRDD of a supply chain produces parallel lines of data on suppliers and subcontractors, consisting of their geographic risks, policies, employment processes, and employee details. The data is then gathered, analysed, interpreted, interrogated and in some cases, verified to form an assessment of risk. This parallel data chain can be shared by a range of companies that may use the same suppliers, which means the collectors of such information can consolidate and hold information monopolies, generating an income stream unseen prior to the introduction of HRDD. Many organisations and actors carry out more than one of these workstreams, but very few organisations or actors can do it all. This is because fundamentally, the HRDD process is designed to be specific to the inner workings of each company and its supply chain, which can be just as complex as the production/service supply chains they seek to dissect.

The work that intermediaries do appears to fall into three main categories: (1) facilitation of collaborations of corporate actors; (2) data management and analysis of supply chains; and (3) investigations of supply chains. Analysing the data in this way helps to capture the vast range of actors involved in the different types of work. For example, regarding the facilitation of collaborations of corporate actors, this workstream is usually undertaken by multistakeholder organisations, industry groups and commercial organisations that organise events to facilitate discussions of the applicable legislation. As for the second workstream ‘data management and analysis’, it is an umbrella term used for a range of activities relating to the gathering, analysis and reporting of information concerning adverse human rights impacts in supply chains. This includes risk assessments of suppliers for commercial organisations and

the analysis and synthesis of information concerning adverse human rights impacts. This workstream is carried out by nearly all of the actors featured in this chapter to varying degrees. The third workstream (‘investigation of supply chains’) describes activities including paper audits, on-site audits, surveys and research of suppliers. Many intermediaries carry out more than one of these workstreams, but very few intermediaries do it all. In practice, the workstreams overlap, and the intermediaries work together. It is not always clear cut which intermediaries are doing what or how. This chapter explores the activities and objectives of these intermediaries, the ways they work together, and their contributions to HRDD.

b. Agents, service providers or public interest actors?

As HRDD is at a nascent stage of implementation, most of our analyses in this chapter relate to service providers that offer to collect data and analyse the gathered details. In practical terms, this means collecting data from suppliers and business partners, which form the factual basis for risk mitigation plans, also sometimes known as a ‘heat map’, which can guide businesses on where the risks of human rights violations are high, e.g. in certain parts of the world where human rights protection is lacking or in countries where the legal or political infrastructure is unstable. Therefore, in this chapter, we have chosen to focus on three key intermediaries: auditors, consultants, and ratings providers. We discuss their activities and drivers.

A further explanatory note: the intermediaries we focus on in this chapter are mostly fixed-term contractors or retained advisors. Few are employees and it is unlikely that they have authority to act on behalf of the companies that engage them. Therefore, legally speaking, they are not agents. They bear liability for the advice they give, and their activities are not an extension of the companies’ businesses they advise on. Ultimately, they are paid by the companies even though it is their role to challenge the business to reconsider ‘risk’ and deliver constructive, factually accurate information, from the perspective of risk to human rights, and not direct risk to companies. Practically, it is often impossible for contractors to do this. The terms of their contract determine the extent of their influence, and as external advisors, they do not have access to the relevant C-suite managers to hold businesses accountable and to act as critics. As service providers, it is very difficult to objectively critique the hands that feed you.

It is even less likely that businesses want to find problems and be responsible for them. Instead, commercial pressures demand such expenditure to be kept low and executed quickly, to enable the task to be completed for the sake of annual reports, compliance with regulations and to satisfy investors or shareholders.

Among the intermediaries identified, a particular finding to note is the involvement of traditionally public-interest actors, such as NGOs acting as intermediaries within the HRDD process. This finding coincides with research in the past decade, which notes a leap in the ‘scope, scale and variety’ of NGO engagement in commercial activities.²¹ In particular, recent studies suggest that ‘marketisation’ or ‘commercialisation’ of NGOs are making them increasingly ‘firm-like’.²² That is, they resemble corporations in their structures.²³ The adoption of corporate practices and processes appears to be driven by increasing financial independence as NGOs are relying less on charitable donations and more on self-generated earned income through social entrepreneurial ventures.²⁴ MacLean and Brass identified three major organisational forms that have emerged through this process of commercialisation: NGOs with commercial programmes, NGOs with for-profit spin-off subsidiaries, and businesses with a social mission, or social enterprises.²⁵ In each of the categories of intermediaries below, we observed NGOs joining the market and their organisational composition combined some form of commercial activity with their social mission. These commercially-oriented NGOs displayed tensions between the motivation to make profits and their social mission – characterised by one legal informant as a ‘conflict of interest’. The variety among NGO objectives is often overlooked because the assumption is that NGOs seek to promote the greater good and are lumped together as a uniform group with a common purpose. This is not the case. In practice, they disagree, compete with social enterprises, and challenge one another.

²¹ Dennis R. Young and Lester M. Salamon, “Commercialization, Social Ventures, and For-Profit Competition” in Lester M. Salamon (ed) *The State of America's Nonprofit Sector Project* (Brookings Institution Press 2002), 423–446.

²² Debra C. Minkoff, “The Emergence of Hybrid Organizational Forms: Combining Identity-Based Service Provision and Political Action” (2002) 31 *Nonprofit and Voluntary Sector Quarterly* 377; Lauren M. MacLean and Jennifer N. Brass, “Foreign Aid, NGOs and the Private Sector: New Forms of Hybridity in Renewable Energy Provision in Kenya and Uganda” (2015) 62 *Africa Today* 57, 61.

²³ MacLean and Brass (n 22).

²⁴ Jutta Joachim and Andrea Schneiker, “Humanitarian NGOs as Businesses and Managers: Theoretical Reflection on an Under-Explored Phenomenon” (2018) 19 *International Studies Perspective* 170.

²⁵ MacLean and Brass (n 22) 75.

c. Types of intermediaries

i. Auditors

Auditors operate as data collectors. Usually, buyer companies will have a code of conduct or a set of systems or procedures that are benchmarked against the applicable legislation or market practices. Buyers often require suppliers sign up to or abide by their codes. The policies and processes are cascaded down the supply chain. To check whether such standards are being adhered to, the buyer companies may commission audits or collect the data themselves with surveys or questionnaires, to be filled out by the suppliers. But we have mentioned earlier that supply chains are complex, murky and far-reaching, and a buyer can have numerous suppliers the latter of whom then subcontract the work to other suppliers. Further, the collection of data is not a one-off exercise; HRDD requires the monitoring process to be iterative. Given the complex, dynamic and open-ended nature of supply chains, companies have to constantly monitor, track and refine the data of their direct and indirect suppliers. It is an on-going process. In other words, buyers may not have the capacity to identify and monitor the adverse human rights impacts caused by their direct and indirect suppliers, which are required by the likes of CSDDD. They may have to outsource this task to third parties, the social auditors.²⁶

The work of social auditors includes but is not limited to document review, site inspections, interviews and report of findings.²⁷ Document review includes reviewing the employment contracts, pay slips, company policies, collective bargaining agreements and other relevant documents. Site inspections (whether announced or unannounced)²⁸ are intended to check for compliance with health and safety regulations and procedures, treatment of workers, and relations between employers and workers. Interviews will be conducted with the management, workers, labour unions, and maybe even NGOs. Social auditing is not a recent phenomenon. It arose in 1990s in response to US firms using sweatshops in developing

²⁶ Examples of social auditors include Bureau Veritas, TuV Rheinland, Underwriters' Laboratories, ELEVATE, RINA, ALGI, SGS,

²⁷ Looking for a Quick Fix: How Weak Social Auditing is Keeping Workers in Sweatshops (Clean Clothes Campaign, 2005), 23, <https://cleanclothes.org/file-repository/resources-publications-05-quick-fix.pdf/view>.

²⁸ The problem of announced visits is that these can facilitate "gaming the system" and in the worst case, audit frauds and deception. For example, factory managers can prepare the workers to say the right things and not to disclose certain matters. See *ibid*, Looking for a Quick Fix at 67.

countries.²⁹ As of 2019, social audits account for around 80% of the ethical sourcing budgets.³⁰ Numerous social audit firms perform thousands of audits of the environmental, labour and safety practices of numerous companies. It is a lucrative industry. The Association for Professional Social Compliance Auditors found that auditing firms generate more than US\$300 million per year of revenue by conducting audits on suppliers.³¹

This set-up has become subject to considerable critique. One comprehensive report by an NGO states: “researchers and campaigners have managed to produce a substantial body of evidence which credibly demonstrates that corporate-controlled social audits are not only ineffective as tools to detect, report, and remediate worker violations in apparel supply chains, but can even exacerbate dangerous working conditions and obstruct, delay and/or undermine more credible and effective remedial measures. By relying on inadequate methodologies which produce flawed, unverifiable outcomes, these audits provide false assurances around worker safety and deflect attention away from the underlying mechanisms and power imbalances (price pressure, time pressure, payment terms, etc.) within brands’ supply chains, which often contribute to the violations rather than preventing or mitigating them.”³² In support of this contention, the report cited at least 5 notorious cases (two in Bangladesh, one in Vietnam, one in Pakistan and one in Malaysia) where there were systemic violations of workers’ rights and breaches of safe working conditions, despite audit checks prior to those incidents. The audits either failed to detect those problems or provided a positive assessment. For example, more than 250 workers died in a factory in Pakistan that was burned down three weeks after being awarded a certification as a result of the audits performed by a social auditor. The auditor failed to identify safety defects such as locked fire escapes, defective fire alarm system, and deficient firefighting equipment.³³ Another example is where more than 1000 workers died after the Rana Plaza Factory in Bangladesh collapsed, despite the positive assessments of several auditing firms. For example, the social auditors TUV Rheinland (Germany) and Bureau Veritas (Canada) audited factories in the Rana Plaza in the months prior to the collapse.³⁴ Tellingly, a social audit firm, ELEVATE remarked that “social audits are not designed to capture sensitive

²⁹ Liangrong Zu, “Social Auditing”, in Samuel O Idowu (ed), *Encyclopedia of Corporate Social Responsibility* (Springer, 2013), 2179

³⁰ Abigail Higgins, Corporations are paying for worker abuse audits that are ‘designed to fail’, say insiders (Guardian, 10 Oct 2023).

³¹ Human Rights Watch, “Obsessed with Audit Tools, Missing the Goal” (15 Nov 2022), 6.

³² Clean Clothes Campaign, *Fig Leaf for Fashion: How Social Auditing Protects Brands and Fails Worker*, (2019) at 7.

³³ *Ibid* at 58.

³⁴ Gariela Quijano and Joseph Wilde-Ramsing, *A Piece, not a Proxy* (SOMO, Nov 2022), 11.

labour and human rights violations such as forced labor and harassment.”³⁵ What has exacerbated matters is that these social auditing firms continue to be approved auditors.³⁶

Further, eight problems are well-documented in the literature. First, data produced by the social auditors are unreliable. Research conducted by Cornell University’s School of Industrial and Labour Relations found that the percentage of unreliable data from 13 industries (such as toys, soft goods, kitchen/houseware, jewelry, hard goods, accessories) ranged from approximately 5% to over 60%.³⁷ The research also discovered that there is a significant discrepancy between the incorrect and correct data concerning workers’ salaries, working hours per week and continuous working days.³⁸

Second, there are considerable variations in the audit programs of buyers who sourced from the same supplier. A survey was conducted on 74 buyers. 32% had neither audit nor compliance programs.³⁹ 12% had compliance programs but no audit programs.

Third, the same auditing firm hired by different buyer companies to perform audit on the same suppliers arrived at different audit findings.⁴⁰ The same auditing firm conducted 3 audits with respect to the working conditions of the employees and the safety conditions of the workplace. Nevertheless, different recommendations (good; major deficiencies; and zero tolerance) were produced by the same auditing firm, although the subject matter of the audit was the same, and the dates of the audits were fewer than 2 weeks apart.

Fourth, there are serious conflict of interest. Although social audit firms are supposed to assist the buyer companies to collect, process and analyse data on the suppliers for the purpose of promoting HRDD, auditing firms fundamentally suffer from conflicts of interest.

Independence is often compromised. The social audit firms are often hired and paid by the buyer companies. One study found that these auditors were pressured to delete certain adverse findings in their report or to orally convey the adverse findings to their clients rather

³⁵ ELEVATE Response to Clean Clothes Campaign report, “Fig Leaf for Fashion: How social auditing protects brands and fails workers,” September 30, 2019, <https://www.business-humanrights.org/sites/default/files/documents/ELEVATE%20response%20to%20CCC%20report%20Fig%20Leaf%20for%20Fashion%2020190930.pdf> (accessed October 31, 2022), p.2.

³⁶ Clean Clothes Campaign, Fig Leaf for Fashion (2019) at 69.

³⁷ Where do we go from here: Social Dialogue in the 21st century (Global Garment Industry), at 11, <https://cornell.app.box.com/s/swgaexrjs1bne4tk4magraf14894hpr7>

³⁸ Ibid, 12.

³⁹ Ibid, 14.

⁴⁰ Ibid, 16.

than to insert them in the report.⁴¹ Other research, which examined a social auditing firm's more than 16,000 audits of over 5000 factories in over 60 countries, found that the audit reports had fewer negative findings if the reports are paid for by the buyer.⁴²

As one report puts it, they are “commercial companies catering to the needs of their clients”, and thus, “risk management and protection of brand image seems to trump detecting and remedying actual workers’ rights violations.”⁴³ Unsurprisingly, the social auditing firms prioritise the interests of their paymasters (the buyer companies) over the workers’ interests. The purpose of the audit has become a compliance checklist exercise to protect the reputation of the buyers. It is no surprise that buyers do not publicise the audit findings.

Fifth, there is evidence of audit fraud. For example, there have been instances of workers having been “trained” to say the right thing to the auditors, bribery of factory workers by inspectors, records about working hours and pay being doctored. One study found that as many as 40% of suppliers had fake documentation on salaries of workers.⁴⁴ Auditors have been hired to “game the system”.⁴⁵ A 2021 report by the NGO Transparentum which investigated audit practices of 20 factories in India, Malaysia and Myanmar found the fraudulent practices include “falsifying documents, coaching workers to lie, and hiding workers who appeared to be employed unlawfully.”⁴⁶ Other research found that most payrolls in China, Indonesia and Vietnam were falsified.⁴⁷

Sixth, the social auditing firms seem to lack expertise in detecting unsafe or illegal working conditions. For example, social audit firms failed to detect the structurally unsafe and illegal extra floors that were installed in Rena Plaza and other factories that collapsed. Unsurprisingly, after the collapse of those factories which caused the deaths of thousands of workers, firms like Amfori BSCI, which trains and provides audit services, disclaimed responsibility, asserting that their scope of work did not cover building construction or integrity, although the audit forms required the auditors to comment on building safety. While Amfori

⁴¹ Human Rights Watch, “Obsessed with Audit Tools, Missing the Goal” (15 Nov 2022), 5.

⁴² Sarosh Kuruvilla, “Chapter 2: Practice Multiplicity in the Implementation of Private Regulation Programs,” in Sarosh Kuruvilla, *Private Regulation of Labor Standards in Global Supply Chains: Problems, Progress, and Prospects* (Ithaca: Cornell University Press, 2021), p. 53.

⁴³ Clean Clothes Campaign, *Fig Leaf for Fashion* (2019), 7.

⁴⁴ *Ibid*, 73.

⁴⁵ Human Rights Watch, “Obsessed with Audit Tools, Missing the Goal” (15 Nov 2022), 16.

⁴⁶ Transparentum, “Hidden Harm: audit deception in apparel supply chains and the urgent case for reform” oct 2021, p.11.

⁴⁷ Adam, Corine, François Beaujolin, and Martine Combermale (2005), “Codes of Conduct Implementation and Monitoring in the Garment Industry Supply Chain; Summary Evaluation of the Field at the 10-year Mark”, *Fondation des droits de L’Homme au travail*, Geneva, at 9.

BSCI asserts (without providing evidence) that it would continue to improve its systems, it said “it is very important not to expect too much from the social audit ...”⁴⁸

Further, studies have also found that the auditors were not required to have human rights expertise. They do not have human rights policies or procedures in place.⁴⁹ Thus, it is highly questionable that they will be equipped to undertake audit checks for the purpose of ascertaining whether there are adverse human rights impacts.

There is also evidence that auditors lack capacity and capability to detect and prevent illegal practices in companies. For example, an NGO found numerous cases of illegal logging, bribery, and corruption involving forests that had been audited by an auditing firm in Ukraine. This was due to the failure of auditors to detect illegal practices. They mainly relied on the statements and materials provided by the company that were subject to audit, instead of conducting their own independent verification.⁵⁰

Seventh, these audit reports lack transparency.⁵¹ Audit reports are critical for identifying and monitoring adverse human rights impacts. The data from these reports enable buyers to take steps to prevent and mitigate these adverse human impacts. This all sounds good in theory. However, these reports are not publicised. Only the clients of the social auditing firms – the buyers - have access to these reports. It is thus impossible for the workers to challenge the contents of the report. There seems to be no way of finding out if the buyers have taken remedial actions to address the problems highlighted in the report. Thus, it becomes difficult to hold the buyers accountable for their actions or inactions.

Finally, audit firms have insufficient time to do their audits which adversely affects the quality of the audits.⁵² Clients of audit firms are price sensitive. This puts pressure on the number of days that audit firms can devote to auditing, the nature and type of audits, and the depth and rigour with which the audit can be conducted. Further, if audits last for only a few days, the audit firm has hardly any time left to follow up on the leads they receive regarding labour abuses. For example, a recent study found that more than 21,000 audit reports for the

⁴⁸ Clean Clothes Campaign, Fig Leaf for Fashion (2019) at 75.

⁴⁹ European Center for Constitutional and Human Rights (ECCHR), Brot für die Welt and MISEROR, “Human Rights fitness of the auditing and certification industry? A Cross-Sectoral Analysis of Current Challenges and Possible Responses”, 2021, p. 18 (Sep 2022).

⁵⁰ Earthsight, “Complicit in Corruption – How Billion-Dollar Firms and EU Governments are Failing Ukraine’s Forests”, July 2018, p. 62-64.

⁵¹ Clean Clothes Campaign, Fig Leaf for Fashion (2019) at 77; Gariela Quijano and Joseph Wilde-Ramsing, A Piece, not a Proxy (SOMO, Nov 2022), 16.

⁵² Human Rights Watch, “Obsessed with Audit Tools, Missing the Goal” (15 Nov 2022), 12-14.

period from 2011 to 2017 in different industries identified a lower number of issues (such as forced labour, harassment, child labour, and discrimination) due to the short time frame of the audits (which lasted only a few days).⁵³ It has also been found that social auditors systematically failed to detect cases of sexual harassment in garment factories in Pakistan, Cambodia, India, and Bangladesh.⁵⁴ The reasons given by the auditors for failing to detect these abuses were that they had little time and had not been paid enough to conduct off-site interviews with women-only groups. Audit firms have insufficient time because companies are not willing to pay more for better quality audits which takes time.

In light of these problems, it is unsurprising that NGOs have delivered a somber warning that social audits per se do not provide reliable sources of information on the suppliers. Social audits cannot, without more, be equated with human rights due diligence. Regulators and those tasked with monitoring buyer companies and supply chains as well as with enforcing the applicable legislation must ask probing questions such as: who paid for the audit? What is the nature and scope of the auditor's work? Does the audit team have the requisite expertise and experience? What is the duration of the audit? What is the methodology used? Who are the interviewees? Are the political or social contexts in which the audit was conducted relevant? And did the audit reports recommended any corrective or follow-up actions and if so, how did the company respond. Finally, regulators should consider adopting a certification regime to verify the quality and monitor the performance of the social auditors.

ii. Consultants⁵⁵

Companies hire management consultancy firms to help them develop or implement strategy and guide their decisions in the competitive marketplace. These decisions often include whether or not to enter a market or exit a country, with whom to merge and consolidate their operations, the kind of partners to seek, as well as whether to expand operations or downsize. Targets that companies seek to achieve are usually determined on parameters that are driven solely by business objectives – increasing profit, efficiency, and

⁵³ Sarosh Kuruvilla and Jinsun Bae, "Chapter 4: Has Private Regulation Improved Labor Practices in Global Supply Chains?" in Sarosh Kuruvilla, *Private Regulation of Labor Standards in Global Supply Chains: Problems, Progress, and Prospects* (Ithaca: Cornell University Press, 2021).

⁵⁴ Human Rights Watch, "Combating Sexual Harrassment in the Garment Industry", 12 Feb 2019.

⁵⁵ See generally, Mariana Mazzucato and Rosie Collington, *The Big Con: How the Consulting Industry Weakens Our Businesses* (Penguin, 2023).

market dominance, while complying with the law. According to the Harvard Business Review, consulting's eight fundamental objectives, arranged hierarchically are:⁵⁶

1. Providing information to a client
2. Solving a client's problems
3. Making a diagnosis, which may necessitate redefinition of the problem
4. Making recommendations based on the diagnosis
5. Assisting with implementation of recommended solutions
6. Building a consensus and commitment around corrective action
7. Facilitating client learning—that is, teaching clients how to resolve similar problems in the future
8. Permanently improving organizational effectiveness

However, traditionally, consultancies have not focused on human rights-related issues. From the 1960s, the consultancy sector has expanded and 'consulting' is most readily associated with management and business consulting services in the field of strategy, management and organisation. The global consulting market has grown to become a multi-billion industry with extensive international reach. Industry analysts estimate that over 200 different types of consulting areas can be distinguished, the result of dozens of combinations of different sector and expertise areas. With the introduction of Corporate Social Responsibility (CSR) and sustainability regulatory measures, supply chain consulting has become a specialised and lucrative profession. CSR consultants are individuals or agencies that help businesses develop ethical, environmentally responsible and/or community-minded programs that create links between a business and the community. CSR consultants are not a homogenous group. The actors working as CSR consultants include academics, commercial consultants and even NGOs. Consultants are not bound to examine the impact of their advice in a more holistic manner, for instance, by ensuring that corporate responsibility commitments are not being undermined by more lucrative work offering strategic advice to business.⁵⁷

⁵⁶ Arthur N. Turner, "Consulting is More than Giving Advice" Harvard Business Review (October 1982) <https://hbr.org/1982/09/consulting-is-more-than-giving-advice>.

⁵⁷ Institute for Human Rights and Business, "Top Ten Business and Human Rights Issues 2023", December 2022, <https://www.ihrb.org/library/top-10/top-ten-issues-in-2022>.

Leading consulting firms have faced increased scrutiny over their advice, in cases involving conflicts of interest during the opioid controversy in the United States, as well as marketing investment destinations with a poor human rights record, such as Saudi Arabia.

Increasing attention has been paid to the roles consulting companies play in enabling decisions that lead to adverse human rights impacts.⁵⁸ For example, while it may seem to increase diversity to hire senior managers of ethnic minority origin, the impact is undermined if the consulting firm recommends mass layoffs to clients where employees losing jobs are disproportionately from ethnic minorities.

In 2020, McKinsey was criticized for its engagement with the opioid industry and Purdue Pharmaceuticals, the maker of the drug OxyContin, and its connection to opioid addiction in the United States. In a lawsuit filed by the Massachusetts Attorney-General, McKinsey was accused of aiding Purdue to ‘fuel’ the opioid epidemic. Allegedly, McKinsey’s consultants had instructed Purdue on how to ‘turbocharge’ sales of OxyContin and ways to counter law enforcement authorities’ efforts to decrease opioid usage.⁵⁹ In a 2017 PowerPoint presentation, according to court records submitted in action on behalf of multiple state attorneys-general,⁶⁰ McKinsey suggested financial rebates for OxyContin distributors for every overdose attributable to prescriptions they sold. The PowerPoint presentation estimated how many customers of companies, including major pharmacy chains, might overdose. The slide forecast that in 2019, for example, approximately 2,484 CVS customers would either overdose or develop some type of opioid use disorder. A rebate of \$14,810 per ‘event’ meant that Purdue might lead to CVS receiving approximately \$36.8 million that year. McKinsey settled a multistate lawsuit with 47 attorneys-general for \$573 million. In a December 2020 statement on its website, McKinsey also issued an apology and noted it would take into account the larger context of its actions in the future:⁶¹

⁵⁸ Institute for Human Rights and Business, “Top Ten Business and Human Rights Issues 2023”, December 2022, <https://www.ihrb.org/library/top-10/top-ten-issues-in-2022>.

⁵⁹ Michael Forsyth and Walt Bogdanich, “McKinsey Advised Purdue Pharma How to “Turbocharge” Opioid Sales, Lawsuit Says” *New York Times* (1 February 2021), <https://www.nytimes.com/2019/02/01/business/purdue-pharma-mckinsey-oxycontin-opioids.html>

⁶⁰ Massachusetts Attorney General, Amended Complaint and Jury Demand, ‘Commonwealth of Massachusetts v Purdue Pharma’, Superior Court C.A. No. 1884-cv-01808 (BLS2) (21 January 2019), <https://www.documentcloud.org/documents/5715954-Massachusetts-AGO-Amended-Complaint-2019-01-31.html>

⁶¹ McKinsey & Company, ‘Statement on its Past Work with Purdue Pharma’ (5 December 2020), <https://www.mckinsey.com/about-us/media/mckinsey-statement-on-its-past-work-with-purdue-pharma>

Our work with Purdue was designed to support the legal prescription and use of opioids for patients with legitimate medical needs, and any suggestion that our work sought to increase overdoses or misuse and worsen a public health crisis is wrong. That said, we recognize that we have a responsibility to take into account the broader context and implications of the work that we do. Our work for Purdue fell short of that standard.

In another case, the Financial Times reported in December 2023 that the consultancy firm, Löning, hired by Volkswagen to investigate allegations of forced labour in the carmaker's Xinjiang plant in China faced a staff rebellion after the report cleared the German company of human rights abuses.⁶² All of Löning's 20 employees, except the founder Markus Löning and another executive, refused to back the conclusions of the report, which stated that the firm did "not find any indications or evidence of forced labour among the employees". However, a few days later, the consultancy issued a statement on LinkedIn that appeared to distance the firm from its own findings. "The project was overseen and facilitated by Markus Löning and Christian Ewert," the post by the firm's official LinkedIn account read, adding that "no other team member from Löning participated in, supported or backed this project". The statement further noted that "[t]he human rights situation in China and Xinjiang and the challenges in collecting meaningful data for audits are well known", adding that such challenges had been encountered "in this project". The statement was issued to reflect the outrage among staff at the firm. According to insiders, there were concerns over the veracity of data collected in a region where the Chinese government has severely repressive policies in place. According to Volkswagen, the actual audit had been carried out by an unnamed Shenzhen-based law firm, while the Löning consultancy had "accompanied on site". Löning, therefore, had been hired as a consultant to effectively rubberstamp the findings of the social auditor. Both the executives' behaviour can be understood as the lack of independence. Additionally, unlike lawyers, whose ultimate obligations to the court and the professional bodies can arguably curb some bias, management consultants may be less likely to go against the companies that commission their work.⁶³

Other consulting firms have been criticized by civil society groups for their work in Saudi Arabia including Boston Consulting Group and Oliver Wyman. They have been called out for their advisory work on the NEOM Megacity project and their linkage to adverse human

⁶² Patricia Nilsson, "Staff rebel at Consultancy Behind VW Review of Xinjiang Rights Abuse", 13 December 2023, Financial Times, <https://www.ft.com/content/46b37a15-054e-4d40-b42b-f31a0e3a07c3>.

⁶³ See eg, Mariana Mazzucato and Rosie Collington, *The Big Con: How the Consulting Industry Weakens Our Businesses* (Penguin, 2023).

rights impacts including the forceable eviction of a nomadic Bedouin tribe, the al-Huwaitat tribe.⁶⁴ These two firms worked alongside McKinsey on the NEOM project. In April 2020, activist Abdul-Rahim al-Howeiti, a land rights defender, was killed by Saudi security forces when protesting against his community's forced expulsion from their land.⁶⁵

Since these events, McKinsey has signed up to the UN Global Compact and now states that it expects its clients to adhere to its professional code of conduct. KPMG, for example, notes that it has a human rights statement and complies with the UNGPs in its policies and procedures. But these case studies demonstrate how easily consulting firms can incidentally or otherwise ignore the big picture of human rights impact and potential harm for the sake of increasing financial return, and the reluctance of some consultants to challenge the corporate brief.

iii. Ratings providers

Environmental social and governance (ESG) ratings providers analyse data to provide information on the ESG performance and risk profiles of companies to investors, analysts and the market. Investors and the market rely on such synthesized information in their risk assessment and investment decision-making process. Companies need accessible and easy to understand information to determine how their products and services are being perceived by the market.⁶⁶

The risks of adverse human rights impacts fall within the scope of the “social” or “S” component of ESG within supply chains. This S component of ESG, just like the E(nvironmental) and G(overnance) components, are expansive categories. S generally includes employment policies and practices, labour standards and regulations on suppliers, safety etc, which should subsume matters on supply chain and human rights impacts. Within each of E, S and G components, ratings providers use numerous variables and different methodologies. An OECD working group found that “a key challenge is that most financial actors fail to connect

⁶⁴ MENA Rights Group, “NGOs Call on Management Consulting Firms Involved in Saudi Arabia’s NEOM Project to Publicly Condemn Human Rights Violations Accompanying It” (2 June 2020), <https://menarights.org/en/articles/ngos-call-management-consulting-firms-involved-saudi-arabias-neom-project-publicly-condemn>.

⁶⁵ Ibid.

⁶⁶ See eg, Amir Amel-Zadeh and George Serafeim, “Why and How Investors Use ESG Information: Evidence from a Global Survey,” *Financial Analysts Journal* (2018); Survey of 130 fund management professionals conducted by Ninety One, cited in: Natalie Kenway, “Investors ‘Overly Reliant’ on ESG ratings,” *ESG Clarity* (May 23, 2022).

human rights standards and processes with ESG criteria and investment practices because of a prevailing lack of understanding on how human rights issues should be reflected in social criteria, environmental and governance indicators”.⁶⁷

This problem reflects a much broader issue. ESG ratings providers do not provide information on the ESG impact of companies, despite their assertions.⁶⁸ MSCI, Sustainalytics and ISS ESG are some of the largest ratings providers.⁶⁹ These ratings providers claim that by providing information on the effects of ESG on companies, the companies will better understand the risks which will in turn improve financial performance (financial materiality). ESG ratings providers also claim that they provide information on a company’s impact on the environment, community and other stakeholders (double materiality). However, research has shown that ESG ratings providers in effect provide information only on financial materiality.⁷⁰ This seems to be inconsistent with HRDD. The premise of HRDD is that companies through their supply chain cause or may cause adverse human rights impacts on societies, and thus the aim of HRDD is for companies to take steps to identify, prevent and end the adverse human rights impacts arising from their supply chain as well as to provide remedies for the violation. In other words, the information provided by ESG ratings providers will be useful to companies in mitigating the supply chain risks (such as adverse human rights impacts) to their financial condition. But it will not help investors or analysts who want to assess the human rights impacts caused or contributed by companies.

In addition to the above problem of ESG ratings provider not providing information on impact materiality and thereby undermining HRDD, studies have also uncovered issues pertaining to the variables used.⁷¹ For example, there are methodological differences pertaining to the variables or indicators used. There is no consistency among the ratings providers as to which variables are material. There are also differences on assessing materiality in terms of how the variables should be weighted. Even if the variables (and their weightage) are agreed upon, they may be reported differently and thus may be difficult to compare within and across

⁶⁷ A/HRC/47/39/Add.1, para 46.

⁶⁸ Cam Simpson, Akshat Rathi, and Saijel Kishan, “The ESG Mirage,” Bloomberg BusinessWeek (December 10, 2021); Andreas Engert, ESG Ratings—Guiding a Movement in Search for Itself. European Corporate Governance Institute - Law Working Paper No. 727/2023, Available at SSRN: <https://ssrn.com/abstract=4525932> or <http://dx.doi.org/10.2139/ssrn.4525932>.

⁶⁹ Gabi Lovas, Top ESG Ratings providers (Dec 2023), <https://brokerchooser.com/education/investing/top-esg-rating-providers#:~:text=Major%20ESG%20rating%20providers,Fitch%20also%20provide%20ESG%20ratings>.

⁷⁰ See n 65.

⁷¹ David F. Larcker, Lukasz Pomorski, Brian Tayan and Edward M. Watts, “ESG Ratings: A Compass Without Direction” Stanford Closer Look Series (2 Aug 2022).

industries. Even if the variables are standardized and comparable, the data that is needed may be missing or of poor quality.

More importantly, there are conflicts of interest which call into question the integrity of the ratings.⁷² For example, organisations that are affiliated with the rating agencies tend to get higher scores. There are also business relationships between the rating agencies and the companies on which they provide ratings.⁷³ For example, one ratings provider, which began as a consultancy revealed in an industry seminar attended by one of us that independence can be difficult, and they often feel that they have to tread a fine line when providing ratings to the companies that employ their services.⁷⁴ Additionally, they are often asked to produce analysis within impossibly tight deadlines, such that it leaves little time to be thoughtful and critical. Their methodologies may be modified and tailored for each client and sometimes, they have to produce different outputs based on different frameworks, which means a lack of consistency and therefore, meaningful comparison in the marketplace. However, despite this, they believe that their work is important for the integrity of the marketplace, and though they cannot guarantee improvements, the scores that are given can push businesses to do more than just tick a box.

d. Regulation of intermediaries

Finally, we discuss the potential regulation of intermediaries' activities using legal mechanisms, including legislation, contracts, and the duty of care.

In light of the problems discussed above, the EU has recently come up with new rules to regulate ESG ratings providers.⁷⁵ Under the rules, ESG ratings providers established in the EU must be authorised by the European Securities and Markets Authority. Ratings providers outside the EU who wish to operate in the EU must obtain the endorsement of their ratings from an authorised ESG ratings provider.⁷⁶ The regulation includes rules to address conflicts of interest. For example, ESG ratings providers are prohibited from engaging in activities

⁷² Ibid.

⁷³ Larcker (n 71).

⁷⁴ Anonymous, private seminar (17 July 2024).

⁷⁵ Regulation of the European Parliament and of the Council on the Transparency and Integrity of Environmental, Social and Governance (ESG) Rating Activities, and Amending Regulations (EU) 2019/2088 and (EU) 2023/2859, <https://data.consilium.europa.eu/doc/document/PE-43-2024-INIT/en/pdf>.

⁷⁶ Ibid, Art. 4.

including but not limited to consulting activities to investors and investment services and activities.⁷⁷ Further, rating analysts and employees involved in the provision of ratings are not permitted to buy or sell any financial instruments issued by the rated entity or any group within the rated entity.⁷⁸ In addition, the rules also require ratings providers to be transparent about the methodologies they use.⁷⁹ ESG ratings providers are also required to ensure that the methodologies they employ are rigorous, systematic, independent, and justifiable. They must also implement policies and procedures to ensure that their ratings are based on a thorough analysis of all information available.⁸⁰

The CSDDD has also advanced contractual solutions to hold intermediaries accountable. CSDDD requires companies to implement a corrective action plan and to seek contractual assurances from its direct business partner that the latter will comply with the company's code of conduct or corrective action plan.⁸¹ The direct business partner can then seek corresponding contractual assurance from its partners insofar as their activities fall within the company's chain of activities.⁸² The CSDDD states that the contractual assurances have to be verified using appropriate measures at the company's expense.⁸³ Further, the CSDDD states that when contractual assurances or when a contract is entered into with a small or medium enterprise, the terms used shall be fair, reasonable and non-discriminatory.⁸⁴

But contractual assurances alone cannot address fundamental problems such as the company's and consumers' purchasing practices and business models (including the incessant demand for cheap goods that are quickly delivered, and short-term contracts between the company and supplier) which cause or contribute to the demand for workers who are paid low wages in poor working conditions.⁸⁵

Further, seeking enforceable contractual assurances from the company's supplier can bring about additional problems for small suppliers and under-resourced companies, particularly in developing economies, such as increases in professional insurance liability, the use of indemnities by buyers in which their liabilities may be exempted or reduced, and

⁷⁷ Ibid, Art. 16.

⁷⁸ Ibid, Art. 17.

⁷⁹ Ibid, Annex I(i), Annex II(1)(d), (g) and (h).

⁸⁰ Ibid, Art. 15.

⁸¹ Article 8(3)(b) and 8(3)(c) of CSDDD.

⁸² Article 8(3)(c) of CSDDD.

⁸³ Article 8(5) of CSDDD.

⁸⁴ Ibid.

⁸⁵ Human Rights Watch, "Obsessed with Audit Tools, Missing the Goal" (15 Nov 2022) at 20-21; Clean Clothes Campaign, Fig Leaf for Fashion (2019) at 89.

increased claims by buyers for breaches of warranties. For example, if the buyer company is supplied with inaccurate information, it may be possible to sue the auditors for breach of contractual obligations or for negligence under tort law.

While lawsuits based on breaches of contract law and tort law have been brought against auditors in connection with the defective or fraudulent audits of factories that had collapsed or burnt down, remediation for victims remains uncertain.⁸⁶ Because, for contractual liability, given that the parties to the contract to engage the auditors consist of either the buyers or suppliers and the auditors themselves, victims of collapsed or burnt down factories do not have standing to bring a claim against the auditors (unless a specific right to do so has been conferred on them in the contract). For negligence liability, the auditor could argue that the limited scope of the audit and the limited time frame in which it was conducted meant that it would be unreasonable to impose a duty of care on it. However, even if the workers can establish that there is a duty of care and there is a breach, the workers' claim may be defeated on the ground of causation because a defective audit report might not have caused the injuries to the workers. Rather, it could be argued that it was the failure of the supplier to ensure a safe working condition that caused the building to collapse.

Additionally, the CSDDD also states that companies continue to be responsible for respecting and protecting human rights and the environment under international law. The grounding of adverse impacts in international conventions may have the effect of expanding EU courts' jurisdiction to judge disputes on breaches of these conventions, for example, where a supervisory authority initiates an investigation into a company under the CSDDD, or in a civil liability claim.

Alternatively, given the UNGP's requirement for states to protect human rights from corporate activities, we suggest that public authorities may be better placed to conduct the audits instead of the private firms.⁸⁷ Two examples are the German Partnership for Sustainable Textile and the Dutch Agreement on Sustainable Garments and Textile. But the problem is that the enforcement of these state initiatives has been weak.⁸⁸ It is important that the state does not privatise human rights due diligence by outsourcing this important task to social auditors. After

⁸⁶ Liability of Social Auditors in the Textile Industry, Carolijn Terwindt and Miriam Saage-Maass, Friedrich-Ebert-Stiftung, Dec 2016) at [6.1], [6.4].

⁸⁷ Carolijn Terwindt and Miriam Saage-Maass, Liability of Social Auditors in the Textile Industry (Friedrich-Ebert-Stiftung, Dec 2016) at [3].

⁸⁸ Klinger, Remo, Constantin Hartmann and David Krebs (2015): Vom Blauen Engel zum Bekleidungsengel? Umweltsiegel als Vorbild staatlicher Zertifizierungen in der Textilindustrie, in: ZUR Vol. 5/2015, 270 - 277.

all, social auditors are for-profit actors who are afflicted with conflicts of interests. It may be said that financial auditors (professional accountants) who audit financial statements also suffer from conflicts of interest as they are paid by the company and they may have existing or prospective business relationships with the company. For example, PwC is both the financial auditor of the company and is also advising the company on a mergers and acquisitions transaction. The key difference is that professional accountants are subject to stringent statutory rules governing their audits and other conduct. But social auditors are not subject to statutory rules governing their audits. In sum, there are two approaches. The first is for the state to assume the role of auditing suppliers. The second is that should social auditors be allowed to continue to operate, the state should consider regulating the social audit industry.

Finally, the law should require the audit reports of companies of certain size to be made publicly available to promote transparency and accountability and eradicate audit fraud. There should be substantive and meaningful engagement of workers in the audit process. There should also be harmonisation of methodologies deployed in the audits.

4. Conclusion

As HRDD regulations are increasingly adopted by governments around the world, the demand for intermediaries has risen at an exponential rate. These intermediaries perform important tasks within the HRDD process, such as collating and analysing HRDD-related data from suppliers and contractors. One general characteristic observed among the intermediaries, including public-interest NGOs is that they do not operate purely for a public or social purpose. Their motives are mixed. Additionally, we observed that intermediaries occupy the murky space between large companies and other stakeholders, including suppliers, investors, and consumers and despite their claims to be acting in the public interest to uphold sustainability and human rights, they often act as a buffer and facilitate the commercial goals of the large multinationals that pay for their services. Thus, intermediaries working in HRDD have dual purposes, and the nature of their activities are both public and private. Intermediaries try to, but usually cannot be objective. The private nature of the intermediaries' activities can have significant and as-yet unforeseeable effects on the practice and integrity of HRDD.

Given that intermediaries are generally not (yet) regulated, their methodologies are not subject to scrutiny and therefore lack accountability. There is slow but steady recognition of the importance of intermediaries and the impact of their advice, outputs and the seemingly neutral statistics they produce, as reflected in the EU's regulation of ESG ratings providers. However, as we noted in this chapter, intermediaries come in a myriad of forms, and perform a range of services. This hybridity can make them difficult to identify and regulate, therefore, it is important to observe and study their activities and evolution as the ESG and HRDD industry matures. For businesses to be persuaded and to ensure that HRDD is performed with integrity and robustly, the intermediaries must walk the delicate balance of public interest and private gain. How to do so will be a matter of market accountability, legal enforcement and industry consensus. This is an area of promising research and evolution – this chapter contributes to the beginning of this work and we believe it is important to watch this space.