

Technical Seminar 16

Integrating Human Rights Due Diligence into Supplier Contracts: A Discussion on Supplier Model Contract Clauses (SMCs)"

29 November 2023

The Sustainable Terms of Trade White Paper in 2022 highlighted unfair contracting practices impacting human rights in the garment sector. A call for collaborative efforts to draft model contract clauses to protect suppliers and share responsibility for addressing human rights risks. The Responsible Contracting Project (RCP) collaborated with industry stakeholders to develop Supplier Model Contract Clauses (SMCs).

Summary

In 2022, the Sustainable Terms of Trade White Paper exposed the urgency of addressing unfair contracting practices that impact human rights in our industry. This issue calls for collaborative efforts to draft model contract clauses that can enhance supplier protection by sharing responsibility with buyers to address human rights risks.

These Supplier Model Contract Clauses (SMCs) have been developed through the Responsible Contracting Project (RCP), in collaboration with suppliers and manufacturing associations participating in the Sustainable Terms of Trade Initiative, with support from GIZ and pro bono counsel from Linklaters LLP.

In this technical seminar, we explored the SMCs, built upon the principles of human rights due diligence (HRDD) which provide a framework for shared responsibility between buyers and suppliers. We also addressed some key points to the SMCs, including the use of proper contracting methods, specifying contractual terms, incorporating environmental considerations, and guidance on implementation.



Sarah Dadush

Director, Responsible Contracting Project

Contracts play a pivotal role as legal connectors within the supply chain, serving as crucial tools for implementing human rights policies. However, their use can present challenges that undermine trust with suppliers, particularly when they shift risks without effectively managing them. Problematic contract practices often penalize suppliers through termination without addressing underlying human rights issues.

The advent of Human Rights and Environmental Due Diligence (HREDD) marks a transition from voluntary to mandatory measures, fundamentally altering the effectiveness of contracts in preventing human rights violations and adverse impacts. This shift in approach highlights the evolving role of contracts in ensuring responsible business practices and mitigating potential harm within supply chains.

Sarah's takeaways:

- For HRE issues, risk-shifting is not the same thing as risk management
- Ignore buyers' responsibility to avoid "contributing" to HRE risks, inc. in purchasing practices: low prices, short lead times, last minute changes to design or quantity, cost-shifting, no assistance
- Now is an important time for suppliers to see how they can improve their contracts with buyers



Daniel Schönfelder

European Legal Advisor, Responsible Contracting Project

The utmost priority lies in adhering to legal obligations and implementing suitable contracting measures. The mere transfer of the Human Rights and Environmental Due Diligence (HREDD) act to suppliers isn't sufficient; there must be a shared responsibility for due diligence.

Effective preventive measures are crucial, defined by their ability to be reasonably likely to work and proportionate to the scale and severity of risks, considering the company's leverage and influence. Contracts that prove ineffective, such as traditional risk-shifting contracts, fail to meet these criteria and fall short in ensuring adequate protection to workers and due diligence.

Daniel's takeaways:

- Contract terms must be fair and non-discriminatory
- Purchasing practices: (e.g., price) are a part of HREDD – price must be sufficient to cover a living wage or min wage, whichever is higher
- Exit as last resort so “cut & run” termination provisions should be avoided, and remediation of adverse impacts should be provided as matter of priority



Fatima Zohra-Alaoui

Independent Expert

Expressing concerns as a supplier to buyers often involves facing the fear of potential retaliation, a challenge that underscores the significance of groups like Sustainable Terms of Trade Initiative (STTI). This consortium, comprising organizations globally impacted by COVID, offers a collective platform where suppliers find comfort in voicing their concerns together– finding strength in unity, or as the saying goes, 'safety in numbers'.

However, a prevalent issue lies in the absence of contracts between buyers and manufacturers, who frequently lack robust internal legal teams. This results in an inherent power imbalance, where a brand's legal leverage far surpasses that of a manufacturer. To address this disparity, STTI devised standard clauses empowering manufacturers to mitigate this power asymmetry. One key clause aims to prevent buyers from expecting suppliers to bear financial responsibility without paying the equitable premiums, discouraging undue pressure to lower prices.

Fatima's takeaways:

- European legislation needs to make sure they protect human rights in the industry
- Worry that this legislation does not shove this regulation down to suppliers and expect them to abide on their own
- Collaboration between brands and suppliers is key for the whole value chain to comply.

To learn more, watch the [recording of Technical Seminar 16](#). The slides presented in this seminar are attached below. For more online seminars on similar topics, check out the [Asian Dialogues Series](#).

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FABRIC Asia
No. 27, Street 302, Boeung Keng Kang 1
Phnom Penh, Cambodia

lisa.ramershoven@giz.de
www.giz.de

Author: Rakesh Vazirani
GIZ is responsible for the content of this publication.

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Responsible
Contracting
Project

Brief Intro to RCP

- ABA Working Group “spinoff”
- MCCs 2.0 (2021) “Google translate” UNGPs + OECD Due Diligence Guidance
- RCP tasked with uptake and implementation of new approach (2022)

Contracts matter for human rights and environmental risk management

- Legal links of the supply chain
- Operational manual for supplier-buyer relationship that can be used to **build trust, or undermine it**
- Make human rights and environmental (HRE) policies **binding** across supply chain
- Critical for implementing human rights and environmental due diligence (HREDD), which is becoming mandatory

Contracts matter for human rights and environmental risk management

- Most used tool for managing supply chain risks **but** often ***mis-used* to manage human rights and environmental (HRE) risk**
- Designed to manage *company* risk, not *human rights* risk → **risk shifting**
- For HRE issues, **risk-shifting is not the same thing as risk management**

Contracting-as-usual doesn't work

1. Rely on one-sided **supplier** promises of compliance (**tick-box**):
unrealistic and dangerous
2. Ignore **buyers' responsibility** to avoid “**contributing**” to HRE risks, inc.
in purchasing practices: low prices, short lead times, last minute
changes to design or quantity, cost-shifting, no assistance
“gold standards and not even bronze prices”
3. Prioritize traditional remedies between the parties over **remediation for
victims → the people actually harmed by breach**

Traditional contracting is not effective and effectiveness is now a legal requirement

Not just a nice-to-have, but a must have

Until now effectiveness of HRE policies has been **voluntary**

but it's **becoming mandatory**

→ new **HREDD** and **trade sanctions** laws

We need a new approach rooted in **shared-responsibility** rather than risk-shifting



3 core principles of responsible contracting

- 1) Shared commitment to **cooperating on HREDD** (v. guaranties)
- 2) Buyer commitment to **responsible purchasing practices** that support effective HREDD + supplier's human rights performance
- 3) **Prioritize human rights remediation** over traditional remedies, e.g., suspension of payment, termination, and damages

Conventional Contracts

Static, Supplier-only Reps & Warranties of compliance

Supplier is solely responsible for human rights:

- only Supplier can be in “social breach”;
- Supplier has no right to cure;
- Buyer can terminate immediately

Remedies for social breach flow from Supplier to Buyer + neither party has obligation to provide remedy to victims

HRDD-Aligned Contracts (MCCs)

Joint obligation to carry out on-going, risk-based HREDD

Shared responsibility for human rights:

- Buyer commits to responsible purchasing practices as part of its HREDD, including:
- Responsible pricing
- Providing reasonable assistance to supplier
- Responsible change orders & modifications
- Responsible exit (COVID)

HRE remediation *before or in conjunction with* traditional contract remedies -- provided *jointly if Buyer contributed* to the adverse impact

The Supplier Model Clauses – SMCs (2023)

- 3 core responsible contracting principles drive the SMCs, which follow on the MCCs and the Responsible Purchaser Code of Conduct (Buyer Code)
- Covid-19 highlighted need for **apparel sector-specific clauses** to address industry dynamics, **especially purchasing practices (cancelations + discounts)**
- At suppliers' request (through STTI), with GIZ support, RCP drafted new clauses **specifically for apparel suppliers**
- SMCs take EU legislative backdrop into account and are aligned with German law and draft CS3D
- Published in September 2023 on RCP website – **open access**



Main Points on mHREDD and Due Diligence Aligned Contracts

mHREDD and Due Diligence Aligned Contracts

- LkSG and CS3D talk about contracts as **preventive measure** to prevent adverse impacts
- But simply including clauses in contracts on HRE won't cut it – **you can't contract your way out of HREDD responsibility.**
- Preventive measures have to be **effective** (reasonably likely to work) and **appropriate** (proportionate to size and severity of risk and company's leverage/influence)
- Contracts that are ineffective, like traditional risk-shifting contracts, fall short
- **In scope companies must not transfer their HREDD responsibility, or the costs of HREDD, to other actors in supply chain, contractually or otherwise**

mHREDD and Due Diligence Aligned Contracts

- **Contract terms must be fair and non-discriminatory**
- In scope companies are **required to support/assist SMEs**, inc. via cost-sharing
- **Purchasing practices: (e.g., price) are a part of HREDD** – price must be sufficient to cover a living wage or min wage, whichever is higher
- **Exit as last resort** so “cut & run” termination provisions should be avoided, and remediation of adverse impacts should be provided as matter of priority

mHREDD and Due Diligence Aligned Contracts

- Remember, HREDD **does not expect perfection and certainly not overnight**
- It's not about outlawing imperfection, it's about **ACCOMMODATING IMPERFECTION, preventing it where possible and being set up to provide remedy to victims when bad things happen**
- HREDD is a “**continuous improvement**” model – not a **perfect compliance or strict liability model**
- **Contracts that outlaw imperfection are out of sync and need to be revamped – this will enable better prevention, remediation, and compliance**
- Education and practical tools, like the SMCs, are needed to make this shift
- Suppliers and buyers should view mHREDD as an **opportunity to negotiate fairer terms and more cooperation** to achieve shared value, long-term

1. Definitions

2. Shared Responsibility to Carry Out HREDD

3. Buyer Obligations

- 3.1 Responsible Purchasing Practices
- 3.2 Forecasting
- 3.3 Production Capacity
- 3.4 **Samples**
- 3.5 Deadlines
- 3.6 **Pricing**
- 3.7 Commercial Terms (Payment and Delivery)
- 3.8 Input Cost Increases
- 3.9 Order Changes
- 3.10 **Reasonable Assistance**
- 3.11 Positive Incentives for Supplier
- 3.12 Charges, Penalties and the Like
- 3.13 **Recognition**
- 3.14 Obligation of Good Faith

4. Supplier Obligations

- 4.1 Subcontracting Approvals and Cascading Responsibilities to Subcontractors
- 4.2 **Supplier's Responsibilities as Buyer**

5. Adverse Impacts and Remediation Plan

- 5.1 Actual Adverse Impacts and Notice
- 5.2 Remediation Plan
- 5.3 Failure to Remediate
- 5.4 Disputes

6. HREDD-Related Default and Corrective Action Plan

- 6.1 HREDD-Related Default and Notice of HREDD-Related Default
- 6.2 Corrective Action Plan
- 6.3 Failure to Prepare or Implement CAP
- 6.4 Dispute

7. No Benefits from Default or Breach Related to HREDD

8. Dispute Resolution

9. Responsible Exit

2) Shared Responsibility to Carry Out HREDD

***Buyer* covenants to establish and maintain a human rights and environmental due diligence (“HREDD”) process appropriate to its size and circumstances to identify, prevent, mitigate and account for how Buyer addresses the direct and indirect Adverse Impacts of its activities on the human rights of individuals affected by its supply chains. *Supplier* covenants to participate and cooperate in Buyer’s HREDD process as requested and instructed in detail by Buyer. Buyer further covenants to support Supplier in carrying out such HREDD processes as necessary.** Such HREDD shall be consistent with the 2011 United Nations Guiding Principles on Business and Human Rights (UNGP) and the Organisation for Economic Co-operation and Development OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector 2018. Failure by either party to comply with this Clause 2 shall be a HREDD-Related Default.

3.4 Samples

Samples, whether produced as part of the style development process or after the style has been adopted, as well as the processes related to samples, shall be managed by both parties to minimise the financial burdens on Buyer and Supplier. Digital samples shall be used where appropriate. Buyer shall not request more than [] samples (style or otherwise), and any samples shall be requested to be provided within a reasonable timeframe. **If the parties agree to samples beyond such number, Supplier shall have the right to request that Buyer pay for them.** Buyer shall provide prompt feedback on all samples, and the parties shall agree expeditiously on design and related matters to enable Supplier to begin manufacture. The parties shall manage samples and the processes related to them to **maximise the conversion of samples into goods that will be furnished and accepted as part of the order**, and Buyer shall set out clear criteria to determine how samples will be selected by Buyer for conversion into goods. Failure to comply with this Clause 3.4 shall be a HREDD-Related Default.



3.6 Pricing.

Buyer and Supplier shall **collaborate to agree on a price**, taking into account the scope and size of the contract, **that accommodates the costs associated with upholding responsible business conduct, including the payment of a Living Wage to workers.** If the payment of a Living Wage is not required by law and is not immediately feasible, then Buyer and Supplier shall commit to developing a pricing schedule to pay such wages within a reasonable time. **Supplier shall ensure that the funds corresponding to the payment of the Living Wage are used solely for that purpose.** Supplier shall document that the funds are being used as agreed, and **in the absence of satisfactory documentation, such funds shall be returned to Buyer.** If necessary, Buyer may set off any unreturned funds against any amount that Buyer owes Supplier. [Where possible and to the extent permissible under competition laws, Buyer and Supplier shall cooperate to utilise open costing approaches to determining price.] Failure to comply with this Clause [3.6] shall be a HREDD-Related Default.

3.10 Reasonable Assistance.

If, through the HREDD process carried out in accordance with this Agreement, either party determines that Supplier requires reasonable assistance to comply with the Supplier Code of Conduct, Buyer shall provide such assistance. Reasonable assistance may include Supplier **training**, upgrading facilities, **cost-sharing**, and strengthening management systems. Failure by Buyer to provide the necessary reasonable assistance, or failure by Supplier to comply with the Supplier Code of Conduct after receiving such assistance, shall constitute a HREDD-Related Default.

3.13 Recognition

Where Buyer seeks to employ due diligence measures such as, but not limited to, **questionnaires, audits, and scorecards** in its HREDD processes, **Supplier may provide Buyer with a recent equivalent document** (e.g., questionnaires completed for another buyer or audit reports prepared by a reputable third-party) provided that the respective document does not contain competitively-sensitive information **regarding supply relationships with other customers** (including, among other things, the identity of other buyers should not be disclosed), and **Buyer shall accept such equivalent document [or a portion of the equivalent document to the extent that it meets the Buyer's minimum standards], unless it reasonably considers that such equivalent document [entirely] fails to satisfy Buyer's minimum standards.** At the request of Supplier, Buyer shall, to the extent permissible under competition laws, coordinate with Supplier and other buyers publicly known to source from the respective Supplier to minimise inconsistencies between various due diligence measures employed. Failure to comply with this Clause [3.13] shall be a HREDD-Related Default.

4.2 Supplier Responsibility

When Supplier acts as a buyer or in a similar capacity in its contracts with subsuppliers or subcontractors, **Supplier shall ensure that it complies with all of the buyer responsibilities stated in this Agreement.** Such responsibilities include, without limitation, sharing responsibility for HREDD, responsible purchasing practices, responsible pricing, providing reasonable assistance, establishing clear and reasonable deadlines, fair labour practices, and responsible exit. Failure to comply with this Clause [4.2] shall be a HREDD-Related Default.

9. Responsible Exit

In any termination of this Agreement by either party, whether due to a failure by the other party to comply with this Agreement or for any other reason (including the occurrence of a force majeure event or any other event that lies beyond the control of the parties), **the terminating party shall (a) consider the Adverse Impacts; (b) collaborate with the other party to address such Adverse Impacts and employ reasonable efforts to avoid or mitigate them; and (c) provide reasonable notice to the other party of its intent to terminate this Agreement** [which notice shall be shared promptly with affected stakeholders]. Termination of this Agreement shall be without prejudice to any rights or obligations under this Agreement arising prior to termination, including, without limitation, **payment that is due for invoices submitted by Supplier pursuant to Buyer's purchase orders prior to termination, including for partially or completely manufactured conforming goods.**

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