Independent Experts Initial Report: Recommendations

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Background

Morningstar committed in October 2022[1] to take a series of specific actions designed to address concerns of anti-Israel bias in Sustainalytics' ESG research. Among these commitments, Morningstar undertook to seek advice regarding its assumptions, sources, and internal use of language from independent, recognized experts in international law, including international human rights law. The experts were expected to be well-versed in the policy, security, history, religious and legal context of the Israel-Palestinian dispute. These commitments flowed from Morningstar's sustained engagement with representatives of the Jewish Federations of North America, the ADL, the American Jewish Committee, JLens, the Foundation for Defense of Democracies, and the Louis D. Brandeis Center for Human Rights Under Law. They followed the findings of the law firm White & Case, LLP in its independent investigative counsel report dated May 11, 2022.[2]

Morningstar engaged us as Independent Experts to review Sustainalytics' models, methods, and assumptions in order to provide actionable recommendations to address concerns of anti-Israel bias in Sustainalytics' research and products. This initial report by Professor Michael Newton and Ambassador (Ret.) Alejandro Wolff constitutes the first of two products commissioned by Morningstar in partial fulfillment of its commitments of October 2022.[3] We want to thank Morningstar for its support and the array of assistance provided to complete this review. Leadership at all levels has been generous with their time and our access to employees. Morningstar was also responsive to all our requests for information and/or clarification. We want to acknowledge the staff and employees of Sustainalytics for their support and diligence in response to our many queries. We were granted access to the Global Access database, which proved to be an invaluable source of autonomous inquiry. Combined with our research and

[1] *See* the public statement at https://newsroom.morningstar.com/newsroom/news-archive/press-release-details/2022/Morningstar-Announces-Steps-to-Address-Anti-Israel-Bias-Concerns-in-ESG-Research/default.aspx (within which Morningstar leadership thanked a range of organizations for "bringing their deep expertise on Israel and antisemitism and our Sustainalytics team for providing extensive background and analysis to have these important, meaningful discussions and help find common ground.")

[2] The full White and Case Report is *available at* https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blt14225aa50ae4fa4d/2022-05-11_Report_of_Independent_Investigative_Counsel_(Final).pdf [hereinafter White and Case].

[3] The experts have committed to writing a follow-up report assessing the implementation of these Recommendations.

analysis, that access permitted us to examine the full range of corporate practices, products, policies, assumptions, and conclusions relevant to our inquiry. To supplement our research, we conducted wide-ranging interviews within Sustainalytics staff and reviewed various privileged materials. We also reviewed a variety of public sources to supplement our efforts, and we sought and received perspectives from informed third parties. All of this work informed the Recommendations that follow regarding the assumptions, sources, and language that Sustainalytics uses for its rating.

Morningstar strives to demonstrate transparency and data-driven analysis as a core operating tenet. It is a market leader by those metrics with highly professional processes and an impressive array of products. This report represents our independent effort to evaluate Sustainalytics' processes and policies against public perceptions of bias with respect to assessing corporate practices related to Israel. During preparation of this report, Morningstar and Sustainalytics employees with whom we spoke expressed unreserved commitment to excellence in analysis based on impartial and apolitical evaluative criteria. They also expressed commitment to innovation and incremental improvements in the ongoing quest to provide better information that helps clients make informed investment decisions.

Executive Summary

The ongoing conflict between Israel and the Palestinians remains among the most complex and controversial disputes in today's world. Due to its contentious nature, it remains heavily scrutinized and highly litigated. Business entities that choose to operate in this area understand that this is an intensely political dispute with weighty historical baggage. They must operate under difficult circumstances and under great scrutiny based on differing legal and policy judgments. They should nevertheless be held to the same standards of corporate responsibility and action as any other companies operating anywhere else in the world.

History suggests that resolution of such conflicts can only be achieved through negotiations between the parties directly involved. Therefore, the ultimate disposition of these territories may look different than the *status quo ante*. In the interim, companies should be assessed with

methodological consistency, analytical rigor, and objectivity based on the highest professional standards. Morningstar stands by that goal and we have seen no evidence to question its commitment in that regard.

Sustainalytics employees are guided by the overarching affirmation from the June 2, 2022 memorandum that "neither Morningstar nor Sustainalytics supports the anti-Israel BDS Campaign."[4] The White and Case report commissioned by Morningstar found that Sustainalytics' screening included the presumption that "in occupied territories where human rights are being systematically violated, any business activity in that region is connected to the violations in some direct or indirect way."[5] The White and Case report identified certain areas of concern within the Sustainalytics model that raised the potential for anti-Israel bias at the time of their analysis. Our recommendations are intended to enhance Morningstar's efforts to address and mitigate potential for implicit or confirmation bias.

The White and Case Report provides a detailed description of Sustainalytics' processes and the concerns expressed about Sustainalytics' research and ratings models. The concerns, as cited in that report, revolve around whether the research was either biased against Israel or violative of U.S. anti-Boycott, Disinvestment, and Sanctions (BDS) regulations.[6] In preparing this report, we reviewed a range of documentation and interviewed key leadership, management, and analysts involved in the research and rating of companies. Our Recommendations are intended to address concerns of actual or perceived anti-Israel bias in Sustainalytics' research and products, focusing on the assumptions that currently underpin Sustainalytics' assessment of business activities conducted within the context of the Israel/Palestinian conflict area (IPCA).[7]

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[4] *See* A Letter from Joe Mansueto and Kunal Kapoor, June 2, 2022, https://www.morningstar.com/company/esg-research-integrity (Addressed To our Morningstar community and acknowledging that while Morningstar considers "bias unacceptable in any form" the concerns raised by external observers "warranted a thorough, independent review."

[5] White and Case Report, note 2.

[6] White and Case Report, note 2, p. 3. The Office of Antiboycott Compliance, Bureau of Industry and Security, United States Department of Commerce, https://www.bis.doc.gov/index.php/enforcement/oac, monitors compliance with the provisions of the Anti-Boycott Act of 2018 and the antiboycott provisions set forth in Part 760 of the Export Administration Regulations, 15 CFR parts 730-774 (EAR).

[7] Sustainalytics currently defines the IPCA to include the West Bank, East Jerusalem, the Golan Heights, and the Gaza Strip. We note that the Golan Heights is disputed territory between Israel and Syria.

We want to be explicit that our conclusions and resulting Recommendations were the product of independent inquiry and analysis conducted after the White and Case Report. Our recommendations complement the White and Case effort from our informed and independent perspectives. We did not confer with White and Case for any aspect of our research and analysis.

As the cornerstone of our Recommendations, we conclude that Sustainalytics should eliminate the 'Occupied Territories/Disputed Regions' incident type. Doing so would fortify Sustainalytics' ESG research and controversy ratings against concerns of anti-Israel bias. This subordinate tag, which falls under the umbrella Society – Human Rights event indicator, is neither statistically meaningful nor analytically necessary to assess a company's engagement in human rights violations. In fact, the share of Controversy Ratings attributable to the Israel-Palestinian conflict based on this incident type represents only 1.6 % of all Society - Human Rights Incidents and only 0.1% of all Incidents. In our view, focus on the affected companies and the emotive issues associated with the IPCA viewed primarily through the lens of 'occupation' or 'dispute' renders this incident type particularly susceptible to actual or perceived bias.

At the same time, elimination of the incident type would support the goal of strengthening analysis intended to buttress compliance with human rights regardless of geography. The geographic focus of that incident type adds little to this effort, while potentially detracting from Sustainalytics' goal to provide objectivity and consistency when examining corporate respect for human rights as a factor in assessing a company's material risks. This incident type is also the only geographically based tag in Sustainalytics' methodology. Every other tag is based on functional sub-categories.

In our review of Sustainalytics' methodology, we found that any demonstrable human rights concern that might be captured under this tag could also be identified under the general Society – Human Rights event indicator using internationally accepted best practices. The UN Global Compact is particularly relevant to our inquiry, though each of its Principles is reflected in various other aspects of Sustainalytics' analysis and reporting.[8] We therefore conclude that the

[8] Human Rights (Principles 1 and 2), Labour (Principles 3 to 6), Environment (Principles 7 to 9), and Anti-Corruption (Principle 10).

'Occupied Territories/Disputed Regions' tag is superfluous, while creating an analytic lens that raises risks of internal inconsistency, susceptibility to bias, or the perception of bias against Israel.

Sustainalytics offers expertise intended to provide clients with objective apolitical assessments. We agree with the Sustainalytics view that human rights are universal and should be applied in a nondiscriminatory manner. Our Recommendations are interconnected and mutually reinforcing, yet modular in the sense that each resulted from separate strands of independent inquiry. Taken as a whole, our Recommendations represent improvements and innovations related to the assumptions, sources, and language used in the relevant ratings, and are designed to enhance Sustainalytics' efforts to monitor corporate respect for and adherence to fundamental human rights. In addition to fortifying Sustainalytics against allegations of anti-Israel bias, we believe that our Recommendations would reinforce the credibility, consistency, and objectivity of Sustainalytics' assessments of corporate human rights practices. This report also describes the reason for these Recommendations.

At the time of this writing, the following assumptions guided Sustainalytics' analysis of whether business activities in the context of the IPCA create material ESG risk:

- The IPCA is the scene of an ongoing conflict between the Israeli Security forces and Palestinian armed groups and civilians.
- The IPCA is occupied by the State of Israel.
- The Israeli settlement within the IPCA and the separation wall built by Israel between Israel and some parts of the IPCA have human rights implications.
- The settlements and separation wall creating the human rights implications do not fall within Israel's official borders.

In conducting its analysis, Sustainalytics evaluates whether a company's reported business activities contribute to negative impacts and the degree to which those activities create material risk for the company. In the context of the IPCA, those activities might include the following according to Sustainalytics:

- Developing or expanding settlement activity in the IPCA.
- Providing services to infrastructure run by the Israeli security forces within the IPCA.

- Providing products and materials that are used by armed forces to assert control over the civilian Palestinian population.

Summary of Recommendations

1. Repeal the 'Occupied Territories/Disputed Regions' incident type along with accompanying guidance;
2. Adopt appropriate guidance related to the Society – Human Rights event indicator;
3. Refine procedures for assessing the Materiality and Impact of incident reporting to minimize risk of anti-Israel bias;
4. Mandate that Controversy Ratings be based on defined human rights violations, including enhancement of internal Sustainalytics processes;
5. Incorporate additional legal expertise, including consideration of appointing a designated legal expert under the authority of Morningstar's Chief Legal Officer, to advise analysts and Oversight Committees on relevant human rights law, legal aspects of corporate human rights compliance, and jurisprudence;
6. Guidance Documents should prohibit reference to countries not implicated in a particular event or incident in narrative descriptions or rating justifications; and,
7. Enhance guidance and quality oversight to ensure consistency and accuracy of ratings assumptions and language within and across Sustainalytics product lines.

Recommendations

Recommendation 1 -- Repeal the 'Occupied Territories/Disputed Regions' incident type along with accompanying guidance

Corporate obligations to protect against human rights abuses cannot be reduced to simple geographic parameters. The 'Occupied Territories/Disputed Regions' incident type shifts analytical focus onto geographic circumstances rather than functional evaluation of corporate human rights practices. Moreover, this incident type remains susceptible to manipulation and inconsistent application across disparate geographic areas and conflict zones. As a corollary, each of the 'Occupied Territories/Disputed Regions' around the world has unique characteristics, geopolitical influences, and historical circumstances. Conflicts necessarily involve a complex amalgam of state obligations to comply with often overlapping human rights and international humanitarian law norms. This entails a sophisticated blend of sovereign rights and collateral duties designed to help protect innocent persons and property. Therefore, business entities should

not be held responsible for human rights consequences simply by virtue of presence in a specific area.

Disputed regions and/or occupied territories exist due to unresolved conflicts or disagreements over the borders and sovereignty of specific geographic areas. Resolution of disputes requires negotiated political settlements among the contending parties. In the case of the IPCA and Israel-Syria disputes, for example, final borders are yet to be agreed among the parties.[9] Our recommended deletion of this incident type stems from careful review of Sustainalytics' practices under the 'Occupied Territories/Disputed Regions' tag related to the IPCA. This geographic demarcation provides a potential entry point for injecting political judgments into what should be apolitical and objective assessments of corporate human rights actions.

We note that there is no occupied territory or disputed region that has garnered more attention and media coverage over the past decades than the Israel-Palestinian dispute. The ongoing political dynamic remains tense and unpredictable. Because media mentions of incidents related to the IPCA are far more numerous over time, Sustainalytics' screening process risks picking up a disproportionate measure of IPCA actions within this incident type. The very existence of the incident type also raises the possibility that occupation or territorial disputes could be weaponized by third parties which could influence Sustainalytics' assessment of financial risks associated with business activities.

We believe that screening and assessing a company's behavior in the IPCA based on the geographic designator alone creates unnecessary complications for ESG analysts. It stands to reason that such a dispute would also tax the ability of most analysts to accurately assess a company's complicity in alleged human rights violations. We found that media reports and other accounts risk equating a company's business activities in occupied or disputed areas with human rights violations. In addition, the category creates inherent perceptual barriers in the effort to conduct apolitical and rigorous analysis based on methodological consistency rather than preconceived preferences or judgments of analysts.

[9] As potentially modified by the correlative *lex specialis* embodied in the Oslo Accords and any future agreements between the parties.

Sustainalytics personnel often mentioned that they had no intention of allowing their independence to be manipulated to serve third party objectives. Nevertheless, companies flagged by Sustainalytics for controversies within this incident type risk being downgraded based on actions of external actors rather than their own business activities.[10] By relying on third party allegations, Sustainalytics risks allowing its processes to serve the political interests of external parties. In making normative judgments without specific evidence of business activities that contribute to, facilitate, or perpetuate human rights violations, Sustainalytics exposes itself to allegations or perceptions of anti-Israel bias. Sustainalytics should be careful not to consider activities on sovereign Israeli territory outside occupied territory as violative of international standards because of presumed effects within the IPCA.

The distinctive incident type 'Occupied Territories/Disputed Regions' within Sustainalytics' methodology presents the potential for embedding actual or perceived bias against Israel within the larger Society - Human Rights event indicator. Disputed areas (which by definition include occupations governed by the applicable norms of international humanitarian law) provide the setting for complex commingling of disparate legal frameworks. Human rights law and the express principles drawn from international humanitarian law operate with very different presumptions, burdens of proof, substantive standards, and contextual circumstances. We describe the complex mosaic of interacting norms in more detail within the rationale for Recommendations 2 and 4 below.

Adjudicating disputes within the IPCA has required courts around the world to sift through an evolving combination of Israeli domestic provisions, interpretations derived from the Fourth Geneva Convention of 1949 (which has a number of specific provisions focused on rights and duties of an occupant *vis-à-vis* the civilian population, movable and immovable property, and the temporarily displaced sovereign authority),[11] and the thickets of relevant human rights

[10] This fact is important in the context of Recommendation 3 below as well as the caution expressed in the UN Global Compact that corporate complicity must be precisely framed based on facts rather than perception or advocacy.

[11] Geneva Convention Relative to the Protection of Civilians in Time of War, *opened for signature* 12 Aug 1949, 75 UNTS 287, 6 UST 3516 (hereinafter Fourth Geneva Convention).

obligations drawn from both treaty bodies and state practice. They must also apply the *lex specialis*[12] of the Oslo Accords or of other international conventions when relevant.

Military and civilian decision makers, as well as courts and external analysts, are faced with ever-shifting relationships between valid considerations of self-defense, military necessity, public order and safety, and conservation of the legal and political order preceding the occupation to the greatest degree possible.[13] As discussed in more detail under the rationale for Recommendation 2 below, the Geneva Conventions are clear that the baseline obligation under occupation is for the occupant to retain domestic laws affecting the civilian population subject to narrowly construed and explicitly stated exceptions.[14] These imperatives must balance in every instance the appropriate and ever-present concerns for safety of civilians and the occupant, humanitarian interests, public welfare, and fundamental freedoms.[15] These represent constantly shifting considerations in the real world.

It would be inappropriate from our informed perspective for analysts and Oversight Committees to conduct time-consuming and legally intensive deconstruction of the litigation positions of various parties to conflicts or political disputes. It would be equally inappropriate for them to side with either party to the dispute and use Sustainalytics ratings as a tool to advance that position. We believe that it would be unduly speculative to presume that territory currently deemed occupied and/or within a 'Disputed Region' will have the same borders as would result from a negotiated settlement. Sustainalytics risks being perceived to be supportive of one side or another by applying its ratings based on the assumption that borders in these areas are fixed and immutable. The existence of this tag raises the potential for analysts and Oversight Committees

[12] Conclusions of the work of the Study Group on the Fragmentation of International Law: Difficulties arising from the Diversification and Expansion of International Law, Report of the International Law Commission on the Work of its 58th Session, adopted in U.N. Doc. A/61/10, para. 251 *available at* https://legal.un.org/ilc/documentation/english/reports/a_61_10.pdf (noting that international law is a system of systems, which necessarily entails "meaningful analysis" of international norms that function at "higher and lower hierarchical levels" and have "meaningful relationships between them.")

[13] This is one reason why some disputes within the IPCA are settled by reference to Jordanian law in accordance with the Fourth Geneva Convention.

[14] Fourth Geneva Convention, arts. 64-68.

[15] This report explains many of the provisions of the Fourth Geneva Convention in more detail across its various sections and recommendations.

to inject subjective assumptions in their rating in ways that could be perceived as financial leverage to affect ongoing disputes or occupations.

The IPCA remains one of the most contentious and complex business environments on the planet. We understand from Sustainalytics employees that, despite the challenges, analysts are not consumed by the IPCA in day-to-day work. However, while the 'Occupied Territories/ Disputed Regions' incident type is used in a number of regions around the world, our analysis revealed that the IPCA remains prominent within the group of issuers flagged for controversies by virtue of their geographic scope of business. At the same time, this incident type represents a statistically negligible subset of the broader set of Controversy and GSS assessments. We nevertheless believe that entities conducting business activities of any sort within disputed regions, whether in the IPCA or elsewhere, should be treated identically to all other companies doing business in non-disputed regions.

Business entities should be evaluated based on their human rights actions and policies rather than the locale of their activities. They must often make business decisions based on incomplete or inaccurate information. Their responsibility to respect human rights should not substitute for nor exceed those attributable to sovereign states. Similar to the *jus in bello* obligation to take "all feasible precautions" to minimize damage to civilian lives and property during the conduct of military operations in conflicts, corporate actors should take actions that are practicable under the circumstances prevailing in the particular context.[16] This symmetry is reflected in various international treaties[17] and in state practice[18] as well as the relevant business guidelines.

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[16] International Committee of the Red Cross (ICRC), Customary International Humanitarian Law, Rule 15, Volume I: Rules, *available at* https://ihl-databases.icrc.org/en/customary-ihl/v1.

[17] Protocol on Prohibitions or Restrictions on the Use of Mines, Booby Traps and Other Devices (1980 Protocol II to the Convention on Certain Conventional Weapons), art. 3(4); Protocol on Prohibitions or Restrictions on the Use of Incendiary Weapons (1980 Protocol III to the Convention on Certain Conventional Weapons), art.1(5); Amended Protocol II to the Convention on Certain Conventional Weapons, art. 3(10).

[18] Like other NATO nations, who are bound by the treaty based authority of the 1977 Additional Protocols, the United Kingdom took a reservation upon ratification of Protocol I Additional to the 1949 Geneva Conventions that states as follows: The United Kingdom understands the term "feasible" as used in the Protocol to mean that which is practicable or practically possible, taking into account all circumstances ruling at the time, including humanitarian and military considerations. *available at* https://ihl-databases.icrc.org/en/ihl-treaties/api-1977/state-parties/gb?activeTab=default.

The United States accepts similar formulations as a matter of accepted customary international law notwithstanding the fact that it has never ratified the full Protocol. U.S. Department of Defense, *Law of War Manual*

The ‘Occupied Territories/Disputed Regions’ incident type is tendentious in the sense that it could be understood to support the premise that an occupant or a Party to a conflict should be subjected to normative disfavor on that basis alone. Sustainalytics analysts rely on internationally recommended human rights best practices for business entities such as the OECD Guidelines for Multinational Enterprises, the Global Compact, and the UN Guiding Principles on Business and Human Rights, among others. Yet, none of these guidelines substitute geographic assumptions for detailed human rights analysis. Neither is a company’s presence in ‘Occupied Territories/ Disputed Regions’ deemed to be dispositive. Activities by a company operating in an occupied territory, including activities that third parties may deem to facilitate occupation, should be judged by the same human rights criteria applicable to areas not under occupation or in dispute.

Elimination of the ‘Occupied Territories/Disputed Regions’ incident type should also prevent misalignment between the Sustainalytics methodology and the accepted precepts of public international law.[19] International law establishes objective premises in this field. As only one example, international humanitarian law applies to “all cases of declared war or of any other armed conflict which may arise between two or more High Contracting Parties, even if the state of war is not recognized by one of them.”[20] The intentional byproduct of this embedded objectivity creates the disaggregated approach to considering *jus ad bellum* and *jus in bello* under completely different standards and presumptions.[21] In our view, this legal divide lends itself to objective and apolitical analysis of business activities based on demonstrable human rights effects or other legal violations. The laws and customs of war apply equally to all parties to conflicts without regard to whether participants are committing aggression or exercising lawful

(June 2015, Updated July 2023), para. 5.5.3 (noting that the law of war “does not forestall commanders and other decision-makers from making decisions and taking actions at the speed of relevance, including in high-intensity conflict, based on their good faith assessment of the information that is available to them at the time.”)

[19] Within which we include the well accepted framework of *jus ad bellum*, *jus in bello*, international human rights law, international humanitarian regimes, and the prohibition on aggression under Article 2(4) of the United Nations Charter as balanced against the sovereign prerogatives of self-defense and defense of national interests.

[20] International Committee of the Red Cross, *Commentary on the Third Geneva Convention, Convention (III) Relative to the Treatment of Prisoners of War*, Vol. 1, paras. 225-384 (Cambridge University Press, 2021).

[21] Michael A. Newton, ‘Jus Post Bellum and Proportionality,’ in *The Justice of Peace and Jus Post Bellum* 79 (Carsten Stahn and Jens Iverson eds., Oxford University Press, 2020), *available at* https://ssrn.com/abstract=4052030.

self-defense.[22] By extension, business entities are not complicit in human rights abuses simply because they are present in either occupied territories or disputed regions.

Elimination of the 'Occupied Territories/Disputed Regions' incident type should help ensure that analysis avoids the risk of normative predispositions and remains objective and apolitical based on facts relevant to the particular case. This in turn will help focus narrative evaluations and Oversight Committee reviews evaluating compliance with specific and demonstrable human rights violations.

Finally, the incident type is fraught with normative baggage based on the subjectivity of media reporting and the political views of interested third parties. All areas within the 'Occupied Territories/Disputed Regions' tag represent contested fault lines. Its elimination would increase consistency between Controversy Ratings and overall GSS analysis by eliminating an avenue for selectivity and undue subjectivity. Firms with business activities in the IPCA, or any other regions, should be assessed for demonstrable human rights violations and material ESG controversy and risk using the same standards for any company operating anywhere else in the world. We believe strict application of consistent standards would reinforce the reliability and credibility of Sustainalytics' ESG rating model.

Our research also found that the current scope of the incident type is both overinclusive and underinclusive. For example, Israel has affirmative rights and duties within Area C that derive from both the Fourth Geneva Convention and the Oslo Accords.[23] The Israeli Supreme Court sitting as the High Court of Justice has issued opinions that constrain Israeli authorities and business entities operating in the IPCA. By extension, international law permits a range of business activities that might appear to erode human rights yet are expressly authorized under Occupation Law, the Oslo Accords, or the rights of sovereign self-defense. Companies

[22] The Authors accept the premise that the duties incumbent upon participants in conflict or that derive from the role of occupant are, and should be, independent of the conduct by the opposing party or even its acceptance of established international norms. Individuals covered by international humanitarian law remain autonomous actors who are subject to individual accountability for their decisions and actions. In like manner, the Preamble to 1977 Additional Protocol I stipulates that its provisions along with the 1949 Geneva Conventions apply "in all circumstances to all persons who are protected by those instruments, without any adverse distinction based on the nature or origin of the armed conflict or on the causes espoused by or attributed to the Parties to the conflict."
[23] This set of obligations is described in more detail in Recommendation 2.

complying with those state derived rights could be penalized under the current incident type simply by virtue of geographic fortuity. Their only remedy would be to cease doing business despite the fact that their compliance structures and actual human rights related standards are fully compatible with accepted international norms. Elimination of the 'Occupied Territories/ Disputed Regions' incident type would help ensure that companies are not downgraded by virtue of their locale, but rather due to business activities that demonstrably affected the human rights of the local population.

It is also difficult to apply the 'Occupied Territories/Disputed Regions' incident type without doing so in an underinclusive and subjective manner. For example, 'Occupied Territories/ Disputed Regions' could include Crimea, Kashmir, Northern Cyprus, Abkhazia, South Ossetia, the Essequibo region, Tibet, Ethiopia-Eritrea, Nagorno Karabakh, and numerous other areas. Given the difficulties of creating an accurate list of such regions, the incident type raises risk of perceptions of anti-Israel bias since other areas considered occupied or disputed with larger populations or potentially greater human rights implications do not appear to be covered by Sustainalytics with the same degree of scrutiny.

Neither did we find that all companies doing business in and around 'Occupied Areas/Disputed Regions' were subjected to negative analysis or narrative commentary. The incident type is underinclusive in the sense that its metric is internally inconsistent. Companies that are building windfarms in Western Sahara might get credit for their Environmental stewardship under ESG metrics. Some might escape identification within the incident type merely by describing their business as being based in Morocco. Companies might not be mentioned at all, despite the fact that they are doing business within 'Occupied Territories/Disputed Regions,' based on subjective assessments of the range of human rights affected. Others might close their business in the geographic zone but not see a corresponding realignment of their rating.

We believe that this incident type offers no analytical advantage to Sustainalytics. Any actual deviations from accepted corporate best practices or internationally accepted compliance procedures would be captured by robust review under the Society - Human Rights event indicator. Hence, the incident type is redundant in our view.

We conclude that while the incident type's utility is *de minimis*, its potential effects are corrosive to the objectivity and rigor that Sustainalytics seeks in its analytical products. Retention of this incident type and its related assumptions presents the possibility that some observers could interpret the category as either empty virtue signaling or antipathy to Israel. Our overall objective is to better align Sustainalytics' methodology with applicable international and domestic law. We recommend that this specific incident type be discontinued against the backdrop of revitalized processes for assessing corporate compliance with human rights responsibilities under the Society - Human Rights event indicator.

Recommendation 2 – Adopt appropriate guidance related to the Society – Human Rights event indicator

We conclude that promulgation of appropriate and authoritative guidance related to analysis within the Society – Human Rights event indicator would enhance the ability of analysts and Oversight Committees to describe the effects of corporate activities in the human rights space. From our observations, current practices are too broadly framed to ensure consistency and avoid risks of bias.

Revisions suggested within this Recommendation would refine human rights analysis to reflect prevailing views of international law. Guidance adopted under the Society - Human Rights event indicator should assist analysts in making precise and informed ratings judgments. Analysis of corporate actions, compliance structures, and management within conflict zones involves complex commingling of disparate legal and policy frameworks. Guidance should assist analysts in discerning the relevance of key facts when juxtaposed against the complex intersection of human rights law and the tenets of international humanitarian law. To that end, guidance should be apolitical and adhere to best practices to maximize objective analysis of corporate activities.

We reject the perspectives of those who argue that international humanitarian law serves as *lex specialis* that should automatically override all considerations or application of human rights

principles.[24] Our conclusion in this regard comports with the vast majority of courts and commentators.[25] The application of the law is a question of fact rather than subjective argumentation. Our review of relevant documents and practices indicates that Sustainalytics shares this view. We support the proposition that in conflict-affected areas, including areas under military occupation, international human rights law and international humanitarian law are each applicable by virtue of the exercise of effective control.[26] The nuances of these related legal regimes remain complex.

However, human rights norms and the express principles and prohibitions drawn from international humanitarian law operate with very different presumptions, burdens of proof, substantive standards, and contextual duties. Full explication of these themes is far beyond the scope of this effort and would be an unnecessary digression from our analysis. One need only examine the jurisprudential differences between the principle of proportionality as embodied in human rights law and that derived from humanitarian law to grasp the importance of fine-grained distinctions that are an enduring feature of litigation related to the IPCA.[27]

For our purposes it is sufficient to note that we adopt the view that neither body of law extinguishes consideration of the other. They operate in "close, but complex, proximity."[28] That

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[24] Geoffrey Corn, 'Mixing Apples and Hand Grenades The Logical Limit of Applying Human Rights Norms to Armed Conflict,' *Journal of International Humanitarian Legal Studies*, 2010 1(1), pp 52-94.

[25] ICJ, *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion, 2004, paras. 106-113.

[26] The jurisprudential, academic, and human rights organizational literature on this topic is abundant. Among the many books and articles, see Bill Schabas, 'Lex Specialis? Belt and Suspenders? The Parallel Operation of Human Rights Law and the Law of Armed Conflict, and the Conundrum of Jus Ad Bellum,' 40 *Israel Law Review* 592 (2007); Beth Van Schaak, 'The United States' Position on the Extraterritorial Application of Human Rights Obligations: Now is the Time for Change,' 90 *International Legal Studies* 20 (2014) *available at* https://digital-commons.usnwc.edu/cgi/viewcontent.cgi?article=1011&context=ils.

[27] *Rashed Marar v. IDF Commander in Judaea and Samaria,* Israel Law Reports [2006] (2) Israel Law Reports 56 HCJ 9593/04 (holding in favor of Palestinian farmers protesting decisions of the military commander in Area C and ordering the military commander to improve law enforcement practices to permit Palestinian farmers to safely access their lands without interference); David Kretzmer and Yaël Ronen, *The Occupation of Justice: The Supreme Court of Israel and the Occupied Territories* (Oxford University Press 2nd ed. 2021) 271 (noting that the Court's use of proportionality "enables it to restrain the acts of military authorities"), 317, 401-405.

[28] Conor McCarthy, 'Legal Conclusion or Interpretive Process? Lex Specialis and the Applicability of International Human Rights Standards, in Roberta Arnold and Noëlle Quénivet, eds. *International Humanitarian Law and Human Rights Law* (Martinuss Nijhoff, 2008) 101 (concluding that "it is true, to the point of tautology, to state that the laws of war are appropriately applied *lex specialis* in situations where they are applicable. However, conclusory forms of *lex specialis* would see this fact, in itself, as being dispositive of questions of applicability and as dispensing with the need for further interpretation and argumentation.")

relationship is especially important when assessing the appropriate scope of corporate responsibility to protect human rights within their scope of operations. While the primary obligations to respect, protect, and promote fundamental human freedoms lie with sovereign states, business enterprises have an important but subordinate role in implementing international human rights norms.

The application of occupation law (alongside the larger principles of *jus in bello*) depends upon the objective reality of conflict, conquest, or sustained hostilities between state and/or non-state actors. Occupation law in particular applies when the following circumstances prevail on the ground: first, that the existing governmental structures have been rendered incapable of exercising their normal authority; and second that the occupant is in a position to carry out the normal functions of government over the affected area.[29] Exercise of effective control on the ground by virtue of temporarily displacing the sovereign authority is the cornerstone for contextual application of human rights law alongside applicable principles of international humanitarian law.[30]

Article 42 of the Hague Regulations of 1907, which is an integral component of accepted customary international law applicable to any occupant, is logically consistent by virtue of its accepted premise that "Territory is considered occupied when it is actually placed under. the authority of the hostile army. The occupation extends only to the territory where such authority has been established and can be exercised."

Moreover, the duty of the occupant to establish structures for governance during the displacement of the sovereign authority is a pragmatic necessity based on objective reality on the ground. The opening phraseology of Article 43 of the 1907 Hague Regulations makes this plain by noting that it is the fact of occupation that makes it necessary to establish governance structures until the return of control to the legitimate authority. Our research indicates that Sustainalytics analysts would accept these well-established treaty norms as authoritative

[29] UK Ministry of Defence *The Manual of the Law of Armed Conflict* (Oxford University Press Oxford 2004) 275, para. 11.3.
[30] *Al Skeini and others v. United Kingdom*, App. No. 55721/07 (Grand Chamber, July 7, 2011), paras. 138-149.

guidance. This law applies to all instances whereby the Occupying Power meets this objective standard.

The Israeli High Court of Justice has repeatedly affirmed that the provisions of the Hague Regulations apply in the IPCA as a matter of law. Article 43 of the Hague Regulations captures the bedrock principle of occupation as follows (emphasis added):

> The authority of the legitimate power having in fact passed into the hands of the occupant, the latter shall take **all** the measures in his power to restore, and ensure, as far as possible, public order and safety, while respecting, unless absolutely prevented, the laws in force in the country.

The English word 'safety' falls far short of the actual meaning of the text. In the authoritative French, the occupier must preserve 'l'ordre et la vie publics' (better translated as public order and life'). This authentic language is far broader than the more commonly referenced English. The occupant is subject to legal imperatives designed to ensure the overall welfare of the population, and the Geneva Conventions mandate a variety of areas where this humanitarian concern becomes manifest in specific legal obligations. Article 64 of the 1949 Geneva Convention Relative to the Protection of Civilian Persons in Time of War extends this tenet to permit changes to local laws designed to fulfill the occupant's "obligations under the present Convention, to maintain the orderly government of the territory, and to ensure the security of the Occupying Power."[31] The High Court of Justice has referred to role of the military commander during occupation in balancing legitimate military and security interests against the welfare of the civilian population as a "quasi-constitutional duty."[32]

In this light, the prevailing opinion of courts and commentators is that during occupation or armed conflict, states have an affirmative obligation to establish administrative mechanisms designed to facilitate human rights on behalf of the civilian population. These duties are overarching and nontransferable. At a minimum, this entails provision of basic public utilities such as electricity, establishment and maintenance of communications infrastructure,

[31] This provision includes the provision of various treaty obligations that affect the human rights of the population, *inter alia* the provision of medical care (Articles 56,57), labor rights (Article 52), freedom of religion (Article 58), and the care for children (Article 50).
[32] *Yesh Din v. IDF Commander in Judea and Samaria*, HCJ 2164/09 (26 Dec 2011), para. 8.

transportation, law enforcement, functional courts and administrative bodies, and other accoutrements of 21st century life.

Based on pure pragmatism, Article 6 of the Fourth Geneva Convention permits the application of a broader range of specific treaty provisions "for the duration of the occupation, to the extent that such Power exercises the functions of government in such territory." The occupier must do everything feasible to protect the human rights of civilians derived from the Fourth Geneva Convention, even in instances of purported annexation.[33] The High Court of Justice summarized these duties as encompassing "regular administration, with all the branches accepted in our times in a well-ordered state, including security, health, education, welfare, as well as the quality of life and transportation"[34] These duties include the right to "take such measures of control and security in regard to protected persons as may be necessary as a result of the war" even as they provide a wide range of rights to the civilians caught up in hostilities.[35]

Sustainalytics analysts evaluating the corporate roles for sustaining human rights must do so in light of the reality that basic principles of human rights are often refracted through the prism of relevant *jus in bello* provisions and considerations. They should help clients understand the Controversy and Compliance standards in the context of different sets of norms that never fully extinguish each other. As the International Law Commission observed, the concept of *lex specialis* does little more than "indicate that, while it might have been desirable to apply only human rights, such a solution would have been too idealistic, bearing in mind the speciality and persistence of armed conflict."[36]

We urge Sustainalytics to adopt Human Rights Guidance in a manner that balances the reality of armed conflicts and concomitant occupation with corporate human rights responsibilities. Just as

[33] Fourth Geneva Convention, art. 47.
[34] *Tabeeb v. Minister of Defense*, HCJ 202/81 (31 Dec 1981) PD 36(2), para. 629.
[35] Fourth Geneva Convention, art 27 (providing in part that "Protected persons are entitled, in all circumstances, to respect for their persons, their honour, their family rights, their religious convictions and practices, and their manners and customs. They shall at all times be humanely treated, and shall be protected especially against all acts of violence or threats thereof and against insults and public curiosity.).
[36] Report of the Study Group of the International Law Commission, finalized by Mr. Martti Koskenniemi Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Doc. No. A/CN.4/L.682 and Add.1 (13 April 2006) para 106, *available at* https://legal.un.org/ilc/documentation/english/a_cn_1682.pdf.

sovereign states are entitled to ensure their survival while mindful of relevant constraints under modern international law, corporate entities are entitled to conduct their affairs while balancing appropriate commitments to human rights norms.

We suggest the following elements be included within that Guidance:

1. Simple recitation of international humanitarian law as *lex specialis* does not obviate consideration of human rights norms during armed conflicts or occupations. We deem the reverse proposition equally unsustainable in the real world. Guidance should provide a convenient template for analysts that also aids thorough reflection of the interrelated nature of applicable norms. It seems incongruous from our vantage point to critique companies that are operating pursuant to contracts with sovereign states that endeavor to achieve the humanitarian goals drawn from international humanitarian law. This approach superimposes human rights considerations above countervailing considerations.

   A range of important human rights are affected by the interrelationship between these bodies of law, such as the right to be free of arbitrary detentions, the right to life, some aspects of due process, freedom of speech and assembly, and the right to travel among others. We therefore recommend that Guidance related to the Society - Human Rights event indicator include the premise that business enterprises should be governed by a standard designed to "interpret human rights norms in light of relevant humanitarian law provisions and considerations."[37]

2. Guidance related to the Society - Human Rights event indicator should recognize the premise that business relationships involving disputed or occupied territories are not inherently blameworthy. As noted elsewhere in our Report, this assumption would depart from the language and spirit of the UN Global Compact. To be sure, litigation risks might be tangible in some contexts from a variety of sources, but a company's involvement in disputed or occupied territories should be assessed in light of the countervailing language from relevant law. As one example, corporate contracts could lawfully enable the

[37] *Hassan v United Kingdom*, 2014 VI Eur. Ct. H.R. 1, paras 102-107.

government to restrict people's movement during armed conflict or occupation. Guidance should clarify that adverse human rights during conflict are tempered by the right of occupants to prevent persons "who may desire to leave the territory" if their departure would be "contrary to the national interests of the State."[38] Protected persons may be restricted to "assigned residence or internment"[39] if "the security of the Detaining Power makes it absolutely necessary."[40] There are many other provisions that could impact human rights norms yet are subject to conditions drawn from international humanitarian law. Provision of food and medical supplies and health services are not absolute duties because they must be done only to the "fullest extent possible."

International humanitarian law contains a litany of pragmatic caveats such as requiring action "as far as military considerations allow,"[41] taking measures of control and security that "are necessary as a result of the war,"[42] effecting total or partial evacuation of an area "if the security of the population or imperative military reasons so demand,"[43] destroying real or personal property when "rendered absolutely necessary by military operations,"[44] These provisions, among many others, are integral aspects of international humanitarian law, despite the fact that they might affect rights-bearing civilians. As such, they are conceptually distinct from the treaty-based limitations on derogations under human rights law as exceptional deviations in response to extraordinary circumstances. Broadly drafted Guidance would be insufficient to balance the pursuit of human rights against lawful or legitimate business activities in conflict zones or occupation. The text should provide a listing of relevant contextual circumstances to bring clarity and minimize opportunities for selectivity or perceived bias that might color Controversy or other evaluations.

3. Guidance should include criteria to aid analysts in determining the corporate measures that constitute due diligence in conflict zones or occupation. The concept of heightened

[38] Fourth Geneva Convention, art. 35.
[39] Fourth Geneva Convention, art. 41.
[40] Fourth Geneva Convention, art. 42.
[41] Fourth Geneva Convention, art. 16.
[42] Fourth Geneva Convention, art. 27.
[43] Fourth Geneva Convention, art. 49.
[44] Fourth Geneva Convention, art. 53 (which provision seems reminiscent of the language of the 1907 Hague Regulations, art. 23(g) permitting conduct when "imperatively demanded by the necessities of war.")

due diligence is critical to assessing corporate activities within conflict zones or disputed areas as they relate to human rights. International best practice is clear that business enterprises may operate in conflict zones or occupations subject to specific actions aimed at fulfilling heightened due diligence in those circumstances.[45] Guidance should express these best practices with some precision in order to guide assessments of incidents or litigation risk. The following language (drawn from ongoing intergovernmental negotiations related to the role of transnational corporations and other business entities in protecting fundamental human rights) provides a representative sample:

> Human rights due diligence shall mean the processes by which business enterprises identify, prevent, mitigate and account for adverse human rights impacts. While these processes will vary in complexity with the size of a business enterprise, the risk of severe adverse human rights impacts, and the nature and context of the operations of that business enterprise, these processes will generally comprise the following elements:
>
> a) identifying and assessing adverse human rights impacts with which the business enterprise may be involved through its own activities or as a result of its business relationships;
> b) taking appropriate measures to prevent and mitigate such adverse human rights impacts;
> c) monitoring the effectiveness of its measures to address such adverse human rights impacts; and
> d) communicating how the relevant business enterprise addresses such adverse human rights impacts to interested stakeholders

4. Finally, use of the phrase 'directly and indirectly' is too imprecise in our view when referring to the contributions of corporate activities within conflict zones. Guidance should make clear the scope of corporate activity that creates real risk of human rights abuses must be based on activities that have a substantial effect on those violations. For example, merely paying taxes to a government would be insufficient. The concept of corporate 'benefits' should be consistently applied as inconsistencies could create the perception of bias. Forcing companies to withdraw from 'Occupied Territories/Disputed Regions' based on the broad assertion that they are 'directly or indirectly' cooperating with any government would not align with current international law as noted above.

[45] *Guidance on Responsible business in conflict-affected and High Rish Areas: A Resource for Companies and Investors*, A joint UN Global Compact – PRI publication (2010).

Recommendation 3 -- Refine procedures for assessing the Materiality and Impact of incident reporting to minimize risk of anti-Israel bias

Reliance on credible sources does not necessarily equate to credible information that should drive objective risk analysis. Interested parties or non-governmental actors can generate media reporting to advance their own objectives by besmirching legitimate business activities in the IPCA. A Controversy methodology with an 'Occupied Territory/Disputed Regions' incident type that includes the IPCA will be inherently vulnerable to manipulation by external parties or activists. We therefore recommend that Sustainalytics establish more rigorous procedures for assessing the underlying facts contained in media reports, regardless of the purported reliability of the media entity.

Sustainalytics should ensure that Incidents used to justify rating decisions are based on credible accounts of relevant underlying business activities. Narratives for each 'issuer' should be linked to demonstrable human rights violations rather than presumed effects from media reporting alone. Analysts and Oversight Committees should be guided by criteria focused on material risk to a company attributable to its own activities rather than assumed reputational or material risk due to unfavorable media or other reporting that may be inaccurate.

We recognize that Sustainalytics has sought to minimize bias and subjectivity in its methodology through adoption, among other things, of the recommendations presented in the White and Case report. Sustainalytics instituted a series of innovations designed to eliminate actual or perceived bias. We believe that there are further opportunities to reduce the potential for actual or perceived anti-Israel bias or subjectivity in evaluating business activities in Israel or the IPCA.

Sustainalytics scores companies using Controversy Ratings, Global Standards Screening (GSS) compliance assessments, and ESG risk ratings. All of these processes rely on a small and dedicated Incidents team, which in turn relies on a third-party provider that screens media outlets for coverage with a negative tilt towards individual companies. Such media reports may include business activities alleged by third parties to have had a human rights impact. They seldom recount detailed evaluations of the merits of the human rights allegations or assess the third

party's credibility or motivations. Incidents identified by Sustainalytics' incidents team are assessed and ranked for severity by specialized sector analysts or by an analyst on a dedicated controversies research team. Controversy Ratings scored as 4 (serious) or 5 (severe) receive higher-level review by the Events Oversight Committee. Changes to GSS compliance assessments receive higher-level review by the Global Standards Oversight Committee. We deem imperative that evaluations be based on the truth and demonstrable human rights consequences rather than magnification of media accounts that may or may not have actual impact on company risk. News -- even fake news -- can torque this process away from the facts of corporate activities or the actual material business risk associated with the incident.

Sustainalytics' Controversy research was described to us as being "disciplined and structured" and based on a detailed set of event indicators. The overarching goal is to identify companies involved in incidents and events that may pose unintended and/or undesired negative business or reputation risks due to the potential impact on stakeholders or the environment. Sustainalytics bases its methodology on the identification of individual 'incidents' which, when combined with other related 'incidents,' form an 'event.' Incidents are typically drawn from reports in the media, by NGOs, or the subject enterprise itself through its public reporting. Events are evaluated for potential material financial, social, or reputational risk to an enterprise.

The Controversy Rating methodology relies on reports from sources deemed credible by Sustainalytics. Current practice raises the risk that uncorroborated allegations could be attributed the same degree of credibility as demonstrable violations of applicable human rights standards. Focusing on the reliability of the media source rather than distinguishing between allegations and facts that may affect corporate value creates a risk that mis- or disinformation may distort the related analysis.

Without the resources on the ground to verify the facts surrounding an alleged activity by a company, Sustainalytics is forced to rely on the media outlet or NGO that publicizes the allegation. However, in our view, reliance on credible reporting sources does not equate to credible activities that should drive objective analysis. Reports by reliable outlets may or may not correspond to credible information that a company has demonstrably engaged in the

activities affecting human rights. For example, credible source reporting of incidents organized by third parties, such as demonstrations occurring outside Israel that are intended to pressure companies to curtail activities opposed by those groups should have no weight in Controversy analysis absent a demonstrable connection to human rights violations. Guidance should not adopt the underlying assertion by third parties and advocacy groups that business activities within Israel or the IPCA abet occupation and are therefore synonymous with human rights violations. This perspective does not align with the actual state of either customary or treaty-based international law or the Global Compact and other relevant standards.

Political activism targeting a company is not necessarily sufficient to impute material risk to corporate value. We have found that such activism often impugns business activities without foundation. Incidents may have no discernible effects on corporate value or reputation if justified by other contextual factors such as relevant humanitarian law principles, legality, or self-defense. Neither should analytic objectivity and rigor be held hostage to external actors with their own agendas that target business enterprises simply by virtue of their activities within or with Israel. In our view, equating unsubstantiated media allegations with "reputational risk" that affects corporate value would deviate from the desired objectivity and rigor.

We recognize that requiring Sustainalytics to develop its own capacity to confirm the accuracy and evaluate the context of allegations for every relevant incident reported in the media is unrealistic. At the same time, the potential for attributing inaccurate or unmerited material risk to a company for incidents or allegations that do not pose actual reputational or financial risk could undermine Sustainalytics' effort to ensure consistency in its coverage for companies with business activities in Israel or the IPCA. Basing ratings decisions on incidents derived solely from reliable media sources without further evaluating the credibility of the underlying allegations raises a risk of contributing to the very reputational risk for a company that Sustainalytics seeks to assess.

Given the inherent difficulty of validating every media source along with the resource constraints of a small Incidents team, we believe that Sustainalytics should refine its definition of corporate complicity as the lynchpin for assessing incident materiality and risk. The concept of complicity

is ambiguous and difficult for analysts to apply in practice. NGO actors or other outside groups often rely on blanket allegations of corporate 'complicity' in human rights violations to condemn business entities.

We could not discern a stated policy that would help analysts assess the concept of complicity as it relates to evaluating whether media reports of incidents represent a material risk to the company. The simplest approach would align with that taken by the Commentary to the UN Guiding Principles which notes that the "weight of international criminal law jurisprudence indicates that the relevant standard for aiding and abetting is knowingly providing practical assistance or encouragement that has a substantial effect on the commission of a crime."[46]

Relevant jurisprudence in the field of international criminal law makes it plain that a purportedly complicit act must have a "substantial effect" on the commission of the violation itself by virtue of either affirmative acts or omissions despite some legal duty to act. This substantial-effect requirement is well-established across relevant international criminal law institutions provided that the perpetrator has some demonstrable knowledge of the underlying offenses.[47] Principal 2 of the Global Compact opines that complicity entails two essential components: 1. "an act or omission (failure to act) by a company, or individual representing a company, that "helps" (facilitates, legitimizes, assists, encourages, etc.) another, in some way, to carry out a human rights abuse," and 2. "knowledge by the company that its act or omission could provide such help."[48]

[46] Office of the High Commissioner for Human Rights, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect, and Remedy Framework," p. 19, *available at* https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf; Business and Human Rights Compliance, *Conducting Business during Armed Conflict*, (Global Rights Compliance, 2022), pp. 8,9.

[47] *Prosecutor v. Stanisic and Simatovic*, MICT-15-96-A, Judgement (Int'l Residual Mechanism for Crim. Trib. May 31, 2023)(the International Residual Mechanism for Courts and Tribunals), paras. 268-69; *Prosecutor v. Karadzic*, IT-95-5/18-T, Public Redacted Version of Judgement (Int'l Trib. for the Prosecution of Pers. Responsible for Serious Violations of Int'l Humanitarian Law Committed in the Territory of the former Yugoslavia since 1991, Mar. 24, 2016), paras. 575-576; *Prosecutor v. Taylor*, Case No. SCSL-03-01-A, Judgement, paras. 365-72 (Sep. 26, 2013)(Special Court for Sierra Leone), paras. 365-372; *Prosecutor v. Nyiramasuhuko et al*., Case No. ICTR-98-42-A, Judgement (Dec. 14, 2015), para. 3332.

[48] https://unglobalcompact.org/what-is-gc/mission/principles/principle-2

Corporate actions should be considered in light of the substantial-effects test. The Global Compact is clear that companies must be linked to actual human rights abuses. Any other approach may lead analysts into unwarranted subjectivity which can be perceived as bias against companies associated with the IPCA (or, for that matter, entities operating in any 'Occupied Territory/Disputed Region').[49]

We would suggest that Sustainalytics adopt a standard that focuses analysts and Oversight Committees on actual human rights impacts associated with corporate activities that either deliberately facilitate the violation or provide direct assistance to such violations. Assessments of media reporting should identify corporate involvement in demonstrable human rights violations arising from some aspect of corporate management or conduct. Corporate activities in general or solely due to their presence in the IPCA (or other areas of conflict around the world) do not provide sufficient basis for meeting the substantial effects test.

In this light, we commend the conclusions found in the Commentary to the Global Compact on this issue. The authors identified similar concerns to those we described above and noted as follows (emphasis added):[50]

> However, allegations of complicity are not confined to situations in which a company could be held legally liable for its involvement in the human rights abuse committed by another. The media, civil society organizations, trade unions and others may allege complicity in a far broader range of circumstances, such as where a business may appear to benefit from another actor's abuse of human rights, and may lobby the company to play an advocacy role. **The better view is that the presence of a company in an area and payment of taxes where egregious and systematic human rights abuses are occurring, without more, is not enough to make the organization complicit in those abuses.** However, some societal actors take a different view and may lobby business to play an advocacy role in such circumstances.

We urge Sustainalytics adhere to this "better view" by linking corporate action to actual human rights violations as the basis of Controversy findings. We believe that media or NGO reports

[49] See the Rational for Recommendation 1 above.
[50] https://unglobalcompact.org/what-is-gc/mission/principles/principle-2

sourced to advocacy groups should be reviewed to ensure adequate corroboration of actual human rights violations. We recommend that reports of actions that are uncorroborated should be not considered in ratings decisions. This would fortify Sustainalytics' efforts to avoid anti-Israel bias or the perception of bias. This Recommendation is closely linked to Recommendation 4 below.

Recommendation 4 -- Mandate that Controversy Ratings be based on defined human rights violations, including enhancement of internal Sustainalytics processes

Sustainalytics' human rights-related ratings should be linked in all cases to specified, not speculative, human rights impacts. The GSS product assesses a company's compliance with internationally accepted human rights standards under three categories: Compliant, Watchlist, or Non Compliant. Its analytical metrics focus on foreseeable impacts of corporate actions. In contrast, the Controversies product rates companies on a scale of 5 levels of controversy, ranging from 1 (low) to 5 (severe). Its analytical metrics focus on material financial risks to the value of the business enterprise, and thus all five controversy levels can affect a company's ESG risk rating. Controversies ranked 4 (serious) or 5 (severe) require additional review by the Events Oversight Committee. Controversies ranked 1 (low), 2 (moderate), or 3 (significant) are independently assigned by analysts following peer review, but without higher-level review by the Events Oversight Committee, thereby enhancing the risk that analysts might apply such scores in an inconsistent manner.[51]

The review process for a level 4 or 5 rating helps ensure consistency across industries and companies. We believe, based on our review, that there is a greater likelihood of inconsistency and internal contradictions in the assessments of controversies not subject to oversight. Analysts could impute a Controversy Rating less than 4 without appropriate grounds despite the potential adverse effects on issuers.

[51] Category 3 events do receive some scrutiny from the Oversight Committee when a ratings change is being proposed from Category 4 or 5 to Category 3 or the reverse (*i.e.*, Category 3 to Category 4 or 5).

We believe that adverse ratings without demonstrable linkages between company activities and defined human rights violations may result in inconsistency. Such inconsistencies include divergent criteria for assessing lower Controversy Ratings across sectors and companies. They may also result in internal confusion in the ratings of individual companies, such as those receiving level 2 (moderate) score, but whose capsule summary justifies the rating due to its "significant" impact — which descriptor would correspond to a level 3 (significant) score.

By linking **all** controversy scores to demonstrable human rights violations attributable to company business activities, and requiring identification of the defined human right affected, Sustainalytics' products would be based on more rigor and consistency. This would assist uniform implementation of internationally accepted guidelines. Core documents outlining globally accepted human rights standards from which Sustainalytics draws include the UN Compact (primarily Principles 1 and 2), the UN Guiding Principles on Business and Human Rights, and the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct. These documents provide detailed guidance for companies without regard to geography. They are rights focused rather than media driven. We urge Sustainalytics to require analysts to make specific reference to the rights applicable to companies (and attributable to their actions) by describing the defined violation of relevant international law binding on the business. These include regional human rights Conventions, the Universal Declaration of Human Rights, and The International Covenants. The guidance in these documents can be informed by accepted law and precedent applicable to unique circumstances such as conflict areas and occupation.

Sustainalytics should ensure that evaluations of a company's material risk and compliance are tied to the specific company responsibilities and international best practices as delineated within applicable sources. Allegations of human rights violations or impacts should be tied to credible and specific examples of corporate human rights deficiencies and should not derive primarily from the fact that a company's activities involved disputed or occupied territories.

Implementation of this Recommendation would better align Sustainalytics practice with applicable international standards. One leader told us that Sustainalytics' standards are clear "that it's not where the company is operating; we are looking for specific activities that connect a

company to potential human rights violations." We also heard that "it's not presence, the company has to do something." This Recommendation helps ensure that analysts and Oversight Committees adhere to this approach for all Controversy Ratings.

Current practice risks handing protestors a 'squawkers veto' whether or not the underlying action of the company comports with international standards and identifiable human rights or poses genuine material risk to the company. Implementation of this Recommendation would also minimize the possibility of confusion between responsibilities of governments and companies, or the potential for giving undue weight to reports of allegations or complaints against a company for activities over which it is not involved or responsible. For example, demonstrations by employees or third parties against a company's activities with which they disagree — even if such activities are caused by reasonable, legal, and acceptable business practices that accord with corporate human rights principles and applicable law — could be treated under Sustainalytics' current methodology as relevant incidents affecting a company's reputation.

Under current standards, any negative reference to a company, such as demonstrations targeting legitimate business decisions that comport with the UN Compact and other guidelines, could be deemed to pose abstract reputational risk. In such situations, it is conceivable that the only remediation to ensure an end to demonstrations would be acquiescence to the demonstrators demands which could include the cessation of all business activities in 'Occupied Territories/ Disputed Regions.' We have observed this activist goal as a feature of online fundraising by some advocacy groups.

Current practice risks undue influence by external actors which would undermine Sustainalytics' goals of independence and objectivity. Furthermore, receipt of a Controversy Rating for unspecified human rights related incidents/events obliges 'issuers' to disprove allegations that may have no substantive merit. Without anchoring all adverse ratings in specific human rights

abuses, Sustainalytics compels business entities either to prove the (presumed) negative or simply withdraw from business activities in order to satiate activists or external actors.[52]

This recommendation is designed to ensure more rigorous and objective internal practices. Sustainalytics should aim to ensure that its methodology does not take a myopic view on human rights concepts that inadequately accounts for other relevant factors.

We believe that every Controversy should be linked to specific human rights violations regardless of its numerical score. This could be accomplished through a number of mechanisms. For example, creating a drop-down menu of human rights considerations for controversy/incident reporting would capture the impressions of analysts from the outset based on the underlying incident. Development and fielding of a set of dropdown boxes for use by analysts could more precisely frame assessments while helping ensure that every Controversy is grounded in actual human rights effects. A mechanism of this type, or something similar, could aid analysts by increasing precision and grounding reviews in fuller awareness of the relevant considerations. It could also facilitate management in compiling consistent (and searchable) data across industries and regions as an additional measure of quality control. Such data would be an important tool in addressing allegations of bias or perceived bias with respect to companies or regions or subindustries.

International practice is clear that States must comply with their international humanitarian law obligations in all circumstances. However, a Drop-Down menu at the first step of analysis, or some other similar mechanism, would help systematize Sustainalytics' process and create consistency across regions. Such a tool for analysts would enhance objectivity and consistency across sectors and companies regardless of geographical or political considerations. Sustainalytics would thus avoid another possible source of actual or perceived anti-Israel bias. Furthermore, Oversight Committees would have ready reference to the selections of the analysts

[52] We note in passing that this Recommendation could well apply to other areas of Controversy within the E or G sectors, or within specific subindustries. The same cautions might well apply to other areas beyond the human rights framework.

from the Drop-Down menu as a way of organizing their own deliberations while highlighting potential gaps and residual assumptions.

As a tentative model, we envision the following non-exhaustive components for Drop-Down menus:

1. *Analysts would specify the affected human right/rights and fundamental freedoms*. This would be specifically done by reference to the range of relevant international obligations delineated by right and article. These include identification of the relevant provisions drawn from international human rights law such as: The Universal Declaration of Human Rights (1948), The International Covenant on Civil and Political Rights (1966), The International Covenant on Economic, Social and Cultural Rights (1966), The Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (1984); The Convention on the Prevention and Punishment of the Crime of Genocide (1948), the International Convention on the Elimination of All Forms of Racial Discrimination (1965), the Convention on the Elimination of All Forms of Discrimination against Women (1979), the Convention on the Rights of the Child (1989) and the Convention on the Rights of Persons with Disabilities (2006), relevant Conventions adopted by the International Labour Organization, among others. This could also include an additional checkbox if the company should be cognizant of an additional overlay drawn from a regional human rights Convention. Specific identification would provide the typology of rights that can inform assessments of materiality and impact for Sustainalytics.
2. *Specific identification of the perceived nexus to business activities*. This identification instantiates the linkage between corporate actions and 'substantial effects' on demonstrable human rights violations. Ordinary commercial or contractual transactions, without more, do not violate international human rights norms or the Global Compact. This menu would include identification of any or all relevant verbs by which corporate action could be linked to human rights violations. The list could include, *inter alia*, such terms: contributed, caused, required, directed, exacerbated, sustained, supported, intimidated, coerced, prevented, supervised, arranged, funded, etc.

3. *Do the human rights consequences impede the rights of human rights defenders, journalists, members of indigenous peoples, or laborers?*
4. *Was the corporate action passive, negligent, or active?*
5. *Is the analyst aware of relevant jurisprudence that might affect the analysis of this human rights situation?* We imagine this a simple yes/no checkbox, that would inform both the Oversight Committees and also serve as a potential flag to the legal expert envisioned in Recommendation 5 below.
6. *Did the business entity have an affirmative duty to act based on other legal or regulatory guidance?*
7. *Do the human rights consequences entail immediate or long-term material impact on business activities?*
8. *Is there evidence of discriminatory intent or effect in the actions undertaken by the business enterprise?*
9. *How many people were affected?*
10. *Is there information to indicate special circumstances warranting a finding that the alleged human rights abuse are of a peculiar gravity and nature?*

Recommendation 5 -- Incorporate additional legal expertise, including consideration of appointing a designated legal expert under the authority of Morningstar's Chief Legal Officer, to advise analysts and Oversight Committees on relevant human rights law, legal aspects of corporate human rights compliance, and jurisprudence

We recommend that Morningstar incorporate additional legal expertise into Sustainalytics' operations under the authority of the Chief Legal Officer. One way to do this is to appoint a designated Human Rights Focal Point. This expertise should provide an accessible resource for Sustainalytics' analysts or management. A dedicated legal expert would also provide consistency across functional areas of the company in addition to generating nuanced insights and information drawn from ongoing developments to support the decision-making of analysts and Oversight Committees.

Current guidance makes plain that analysts and Oversight Committees should consider relevant jurisprudence. However, the process would benefit from legal expertise to access analysts' efforts

when considering the relevance of various facts necessary to assess Events or Incidents. Analysts or Oversight Committees should not be expected to remain current on all the complexities of human rights, disparate treaty regimes, current litigation around the world, ongoing treaty and intergovernmental debates, and impending regulatory structures. We have identified many relevant cases from a variety of jurisdictions in addition to an array of current developments that should inform decisions in this space. A dedicated Focal Point could help distill the myriad of external developments as a resource to augment the efforts of internal experts.

Careful legal analysis and consideration of current litigation results may or may not be dispositive to particular Controversy or GSS assessments and analysts who need assistance in avoiding overly broad or imprecise human rights formulations have no such resource available at present. Appointment of a dedicated Human Rights Focal Point could help provide pragmatic support for analysts and Oversight Committees. As a logical extension, the Human Rights Focal Point would serve, in our conception, as an *ex officio* member of Oversight Committees that would serve their needs upon request. This would provide a degree of granularity and legal nuance that would help mitigate concerns of either actual or perceived anti-Israel bias.

Recommendation 6 -- Guidance Documents should prohibit reference to countries not implicated in a particular event or incident in narrative descriptions or rating justifications

Sustainalytics' narratives provide important background, context, and justification to its Controversy, GSS, and ESG ratings. Such narratives also imply what actions a company should consider taking in order to redress concerns deemed relevant to its material risks. Sustainalytics risks being perceived as demonstrating anti-Israel bias simply by virtue of narratives that refer or allude to Israel (or indeed companies with business operations associated with Israel) in circumstances where such companies or Israel are not directly implicated in the particular Event or Incident cited in the narrative.

Sustainalytics should implement controls so that narratives do not include references to companies or countries based on unsubstantiated or unrelated allegations of activities not tied to the specific Incident/Event. If Sustainalytics were to color its narratives with such broad strokes,

it would risk undermining its goal of providing documented justification for its ratings. If such narratives gratuitously reference or allude to Israel, the objective and apolitical process would become susceptible to allegations of bias or perception of bias against Israel or companies with business activities there. We therefore recommend that Sustainalytics prohibit references to countries or business activities not directly implicated in a particular Event or Incident.

Recommendation 7 -- Enhance guidance and quality oversight to ensure consistency and accuracy of ratings assumptions and language within and across Sustainalytics product lines

Sustainalytics applies numerical ranks to and narrative assessments for its Controversy Ratings. The former suggest methodological rigor whereas the latter might draw on subjective interpretations or speculation. Sustainalytics should take steps to reduce the risk of internal contradictions between the numerical scores and the narrative descriptors that help justify those scores. For example, the numerical scale ranks controversies according to risk categories: 0 = none, 1 = low, 2 = moderate, 3 = significant, 4 = high, 5 = severe.

Per Sustainalytics' current approach gleaned from our research, these categories are scored according to the following criteria:

> Category 0 indicates that there are no incidents associated with the company;
> Category 1 is considered to reflect low impact and risk;
> Category 2 is also considered to reflect low impact and risk;
> Category 3 ranges from low to medium impact and risk;
> Category 4 ranges from moderate to high impact and risk, and potentially irreversible;
> Category 5 is considered to reflect high impact and moderate to high risk.

All incidents receiving category 1-5 ratings should be based on verifiable allegations in which the verification is of the alleged activities themselves rather than merely based on the source.

We believe there is an inherent risk of subjectivity embedded within the overlapping and possibly contradictory categories and criteria. For example, while Category 2 rating corresponds to "moderate" risk, the criteria for this category are defined as indicating low impact and risk, which would also correspond to Category 1. Similarly, we found examples where a Category 2

“moderate” risk rating is defined in the accompanying narrative as being based on an event level assessment of impact and risk as “significant”.

For example, Sustainalytics gave a Controversy rating of 2 (Moderate) to a company under the Tag ‘Occupied Territories/Dispute Regions,’ based on two “incidents” cited in its narrative for the company. The capsule summary for the company states that “based on our event level assessment of impact and risk as significant, the company has been assigned an overall controversy assessment of category 2.” We note that risk level 2 in Sustainalytics ratings corresponds by its definition to “moderate” risk; “significant” risk would correspond to level 3. This discrepancy suggests internally inconsistent assessment within the Controversy Rating, and potential inconsistency with the GSS Society - Human Rights “compliant” rating for the same company.

Sustainalytics’ Global Standards Screening (GSS) assessment reviews a company’s adherence to international human rights principles drawn from, among other things, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights. The Human Rights component of the Global Compact encompasses two “Principles”: 1) Businesses should support and respect the protection of internationally proclaimed human rights, and 2) Businesses should make sure that they are not complicit in human rights abuses. Companies are assessed as Compliant, Watchlist, or Non Compliant within each evaluative category. Hence, Sustainalytics could deem a company to be compliant in adherence to human rights principles in its GSS rating, yet the Controversy assessment for the same company could rank it as Category 3 for significant risk based on allegations linking the company to human rights violations.

Sustainalytics staff point out that Controversy Ratings and GSS categories consider different matters, namely potential for reputational or financial risk versus impact. We conclude that, at a minimum, these apparent contradictions within and across ratings risk confusion. Enhancing consistency would minimize susceptibility to subjectivity, including anti-Israel bias or perceived bias in Sustainalytics ratings.

Expert Affirmations

The experts herewith confirm that this Recommendations Report was executed consistent with the terms of our confidential Agreement with Morningstar. No one interfered with our ability to conduct the Work as specified in our contractual arrangement. In accordance with our expectations at the outset, Morningstar demonstrated a notably superior level of cooperation throughout preparation of this initial expert report. The views expressed in this Report represent our independent assessments, opinions, and judgments. Our efforts have been fully independent of Morningstar and no employee or agent attempted to influence or suppress our conclusions. The Recommendations above reflect our shared views and provide the framework for our Supplemental Report on Implementation.