“Sustainable Contracts”

Taking Multinational Corporate Codes of Conduct to the next level

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Abstract

Are sustainable goals and contract law compatible? The article discusses whether Sustainability Contractual Clauses (SCCs) may contribute in overcoming the limitations the provisions about sustainable development provided for by the Codes of Conduct of multinational enterprises. The article specifically analyses the case of the inclusion by multinational enterprises of SCCs in supply chain contracts. It discusses, in particular, the contractualisation of sustainability goals, the regulatory effects of these clauses over third parties, and the remedies for the breach of such peculiar obligations.
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1. Setting the scene

We witness companies increasingly engage under the imperative of corporate social responsibility (CSR), often by adopting Codes of Conduct, in the promotion of social and environmental standards, an activity that was traditionally in the sole responsibility of States.

Private actors are developing new tools implementing CSR into daily business operations. Many of these tools (such as CSR policies, reporting or labelling) and their legal regulation have been widely discussed by legal scholars. This article examines one of the CSR tools that has received much less attention, although the practice confirms it is increasingly adopted by companies: it specifically analyses Sustainability Contractual Clauses (SCCs) negotiated by private companies in international supply chain agreements (ISCAs).

The most relevant studies published in this field are focusing primarily on investments contracts.¹

A first question arises: why legal scholars have generally not focused on ISCAs as tools to promote sustainability. There are both theoretical and practical reasons to explain the limited academic interest on the subject.

Legal scholarship have dedicated a limited attention to private contracts used for achieving public goals, such as in the case of SCCs, ‘because they do not fall neatly into the domain of public or private law scholars’.²

From a more practical perspective, supply chain contracts are drafted with the sole purpose to regulate behaviour regarding the exchange of goods and money between two parties. However, they have gradually included an increasing number of provisions whose aim is to protect third parties’ interests rather than economic interests of the contracting parties. Indeed, these provisions do not directly relate to the subject matter of a contract,

which in the case of supply chain contracts means the tangible quality of the delivered products. In addition, supply chain contracts are bilateral instruments. They are private documents and, thus, a non-disclosure provision protects their confidentiality. Thus, although hundreds of contracts are concluded every day, it may be difficult for a researcher to register their existence, monitor their compliance, and eventually enforce the sustainability requirements therein.

In consideration of the existing gaps in the exploration of this subject, new studies have recently been published on the subject³, and the article aim to contribute to the discussion by focusing on two directions. It questions whether SCCs are justifiable according to contract theory, and if they may help to overcome the regulatory gap in relation to global sustainability in international contracts. In other word, are these contractual clauses enforceable?

Before entering the topic, it is necessary to consider the role of sustainability in Corporate social responsibility and, particularly, in the Codes of conduct of Multi-national enterprises.

2. The contractualisation of sustainability

2.1 Defining sustainability

Unless terminologically imprecise the expression “sustainable contractual clause” results from the implementation of the concept of sustainable development in international contracts. The same concept appears in the Codes of conduct of Multi-national enterprises. Sustainable development is broadly defined as

“the policy imperative to balance economic, social and environmental considerations so as to meet the needs of today’s generation without compromising the ability of future generations to meet their own needs”⁴.

And

“... [It] includes two key components: The concept of needs, in particular the essential needs of the world's poor; and the idea of limitations that are imposed by technology and society on the environment to meet those needs. Sustainable development is best understood as a process of change”.

This definition develops the idea proposed in 1987 by the Bruntland Report, which first institutionalised the concept of sustainable development (World Commission on Environment and Development, 1987).\(^5\)

Sustainability is usually thought to focus on environmental issues, and sustainability advocates seek to intertwine environmental concerns with agricultural land development and industrial practices. Nevertheless, there is also some element of social justice to sustainability efforts: they are focusing on developing local agriculture in third-world communities as well as giving workers more of a voice in their employment. In its current form, the concept is designed to have three dimensions: environmental, economic and social.

The report also adopted an optimistic approach to growth believing that human creativity would find ways to surmount the limitations imposed by non-renewable resources in particular, for instance by finding substitutes. However, available substitutes are limited and renewable resources follow specific replacement cycles. Perhaps sustainability should be qualified as entailing re-harmonisation of human activities with the cycles of the ecosystem and of human cycles with each other (i.e. reproduction, education, production recycling, technological and institutional change, etc.). In other words, we would have to reinvent development and economic growth in particular.

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\(^5\) The report identified a broad range of measures, grouped under seven strategic imperatives for sustainable development: Reviving growth; Making economic growth less energy-intensive and more equitable in its social impact; Meeting the essential needs of an expanding population in the developing world for employment, food, energy, water, sanitation and health care; Ensuring a sustainable and stabilised population level; Conserving and enhancing the resource base; Reorienting technology and managing risk; Merging environmental and economic concerns in decision-making.
2.2. The contractualisation of sustainability

Sustainability proponents argue that MNEs should be tasked of integrating these principles internally into their organizations -by using the self-regulation tool represented by the Code of conducts to answer to the calls for corporate social responsibility - as well as externally including them into their relationship with suppliers and contractors (contractualisation).

Legal scholars have noted the limitations of the Codes of Conduct, mainly consisting in their low effectiveness and soft nature. Proponents of CSR as well as subjects influenced by ethically tainted behaviour have tried to find creative ways to ensure that companies keep to what they pledge.

This article discusses whether SCCs, in consideration of their nature of contractual obligations between MNS and their suppliers, may overcome the heavily criticized softness of Codes of conduct and, therefore, contribute in fostering a sustainable development.

In particular, the United Nations Global Compact (UNGC), ⁶ requests its participants to extend their influence in the areas of child labour and environmental protection throughout their supply chains. The UNGC practical guide on supply chain sustainability advises companies to clearly formulate their CSR expectations towards their suppliers in a Code of Conductand subsequently implement the code through its “integration (…) into supplier contracts”. ⁷

Similar proposals emerge from the OECD Guidelines for Multinational Enterprises (2011) stating that ‘enterprises can also influence suppliers through contractual arrangements’. ⁸ Also interesting in this respect ISO 26000 Guidance on social responsibility (ISO 26000) that expects companies not to contract with risky partners and to influence supplier by imposing SSCs upon them. For instance, ISO 26000 states that:

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⁶ UNGC, Commentary to Principle 5 and Principle 8.
“To promote social responsibility in its value chain, an organization should: integrate ethical, social, and environmental and gender equality criteria, and health and safety, in its purchasing, distribution and contracting”.

It is worth noting that, with respect to supply contracts, this statement represents a fundamental change with respect to the past: supply chain contracts were traditionally drafted with the sole purpose to regulate behaviour regarding the exchange of goods and money between two parties. However, they have gradually included an increasing number of provisions whose aim is to protect third parties’ interests rather than economic interests of the contracting parties. These provisions do not directly relate to the subject matter of a contract, which in the case of supply chain contracts means the tangible quality of the delivered products.

In the light of the above, sustainability contractual clauses (SCCs) may be defined as “provisions in business contracts that cover social and environmental issues, which are not directly connected to the subject matter of the specific contract”.

Some empirical studies have been conducted overtime with respect to the increasing presence of SCCs in international contracts. For example, four years ago, a study has evidenced the rapid increase of these contractual practices. It shows that almost 80% of the sample companies (companies representing various industries from North America, Middle East, Africa, Europe, Asia and Pacific) stated that they had imposed sustainability related requirements upon their business partners and approximately 70% of them considered including sustainability clauses in their contracts as highly or very important.

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9 ISO 26000, par. 6.6.6.2.
11 K. P. Mitkidis supra.
12 M.P. Vandenbergh, “The New Wal-Mart Effect: The Role of Private Contracting in Global Governance”, UCLA Law Review, vol.54, ed. 4, 2007, 913-970. Vandenbergh studied contractual practices in relation to environmental issues of companies from eight retail and industrial sectors and found that over 50% of companies include some type of environmental requirements into their business contracts.
Sustainability contractual clauses appear in different forms, as an expressed contractual provision or a reference to another document, such as standard terms and conditions, a code of conduct, another internal policy, a global CSR initiative, or a separate agreement. Frequently, these clauses will integrate corporate codes of conduct in order to give the codes the form of binding commitments.\textsuperscript{14}

They also have different contents, most often related to environmental standards, employment conditions, health and safety standards, human rights and business ethics issues. Their scope of applicability varies largely; many of them extend beyond a bilateral agreement and impose or drive the obligations to further members of the supply chain.\textsuperscript{15}

This means that they do not specify the physical quality of the delivered goods, but rather prescribe how the parties should generally behave when conducting business.\textsuperscript{16} When a supplier does not follow these standards, the product delivered may not suffer from any physical damage in the sense of lower usability or functionality, but may still have a lower market value.\textsuperscript{17}

Their scope of applicability varies largely; many of them extend beyond a bilateral agreement and impose or drive the obligations to further members of the supply chain. In addition, MNEs also established different monitoring and enforcing mechanisms, ranging from soft relational tools to hard contractual sanctions.\textsuperscript{18}


\textsuperscript{15} Peterkova Katerina, Sustainability Clauses in International Supply Chain Contracts: Regulation, Enforceability and Effects of Ethical Requirements (June 22, 2014). Nordic Journal of Commercial Law, Issue 1#2014.

\textsuperscript{16} Li-Wen Lin, ‘Legal Transplants through Private Contracting: Codes of Vendor Conduct in Global Supply Chains as an Example’ (2009) 57 Am.J.Comp.L. 711, 725.


\textsuperscript{18} Telecom Italia Group implements a full range of monitoring and enforcement tools during both pre-contractual and contractual phase. These tools include, inclusion of CSR criteria into suppliers’ selection process, suppliers’ self-assessments, on-site audits (both internal and external), corrective plans, and contractual sanctions (penalties, reduction of supply volumes and
2.3. From Codes of conduct to suppliers’ contracts

Code of conducts appear in many different forms and they differ by their content by the monitoring mechanism they may or may not include, and by the level (the individual company, the sector, the country or group of countries) at which they are drafted and proposed for adoption. They appears on company’s websites and in annual reports.¹⁹

The private Code of Conduct experienced in the last 15 years a great diffusion. Levi-Strauss is usually credited as the first to establish a code with comprehensive principles regarding its global sourcing and operations, in 1991. Nike followed later the same year. In May 2001, the OECD published a review of 246 codes of conduct.²⁰ In 2003, the World Bank estimated them to be around 1,000.²¹ The reason for the rise of such codes is not only that their implementation may confer competitive benefit to the MNEs helping them in establishing the so-called “social legitimacy” and to clean their image. It also consists in the fact that they are felt as a necessary private tool to fill the gaps where states regulation are present only to a small degree and the solutions provided at international level are undermined by different national interest.²²

Generally, the or Code of ethics is drafted in compliance with the principle established by International Institutions and Conventions (within the framework of the United Nations Universal Declaration of Human Rights, the OECD Guidelines for Multinational Enterprises). It also relies on the suggestions provided by local authorities such category associations and trade union representatives concerning fair employment practices, freedom of association, rejection of any form of discrimination, of forced labour, child


labour while safeguarding dignity, health and workplace safety, have been so far mainly addressed internally to MNEs own employees.

The obligation to comply to the above in addition to their general duties of loyalty, impartiality and compliance in good faith with their employment contract, is usually incorporated into the employment contract. It is hence imposed to employees the duty to comply with company rules and the prescriptions of the Code of conduct, whose compliance is required pursuant to and within the meaning of the relevant labour laws.  

In recent time, the scope of the Codes of conduct has broaden to include also MNEs supply chains, with more concerns in terms of their enforceability and related monitoring procedures arising thereto. In fact, control and monitoring procedures although diverse and varied, have as common feature the fact that they (so far) do not rely on legal and judicial mechanisms, but on mechanism set by the same companies. Difficulties are also due to the fact that MNEs use complex supply chains. This makes it harder and harder to control each of potentially hundreds of global contractors, subcontractors and suppliers.

Companies impose such principles by including them as a supplier’s obligation in corresponding commercial contracts. These principles are usually incorporated into agreements with suppliers, partners, consultants, agents, dealers, distributors contractors, and any other parties with whom the company has a long-term relationships to be followed by the supplier in different ways:

(i) they can be ethical values that supplier commit to through representation and warranties;
(ii) they may require a supplier to perform obligations in compliance with stated principle or
(iii) they may provide environmental practices for the supplier to follow.

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23 Usually a specific clause is inserted in the employment agreement stating as follows: “Violation of the provisions of the Code of Conduct constitutes a breach of discipline and of employment contract and, as such, sanctions may be imposed. The Company defines disciplinary actions on ascertainment of violations of the Code of Conduct in accordance with the provisions of the applicable Collective Bargaining Agreement or of the individual contract.”

When the terms of a Code of Conduct are incorporated into a contract with a supplier, they become legally binding as \textit{de facto} any other obligations contained in the agreement. However, since most of the terms of a Code of Conduct reflects broad value or principle and mostly show a very high level of abstraction, it is difficult to determine whether a supplier has actually failed to comply with them. Examples of drafted general clauses to be incorporated in the commercial agreement related to the recognition of, and adherence to the fundamental principle of a Code of conduct, could be:

\textbf{“Code of conduct:} The Supplier declares to be aware of Company’s Code of conduct made available to him and agrees to comply with such code of conduct in all respects while performing its obligations under the Agreement. The Parties agree that the violation of these prohibitions or obligations is deemed as fundamental and hence entails the immediate termination of the Agreement, without prejudice to damages.”

\textit{Or}

\textbf{“Enforceability of Code of conduct:} In order to ensure that this Code of conduct is applied, suppliers must acknowledge in writing that they have read, understood and accepted this Supplier Code of conduct. Suppliers hereby commit to perform their business activities with the highest level of integrity and compliance within the terms of the Supplier Code of conduct among their staff and throughout their supply chain”.

In order to face the practicability problem, a strategy is to incorporate (by reference) such Codes of conduct into business (supply) contracts to make them formally enforceable, and (as it is commonly provided for) to have the legal right to terminate the contract in case of non-compliance.

Contractual parties are free to agree on the contractual content that becomes the “law” of the relationship and can be enforced through formal proceedings. However, courts do not enforce all contractual provisions for example vague clauses from which no specific right or obligation can be deduced will not be enforced under the international laws of contracts. If an obligation is not clearly stipulated, there may be no breach.

Moreover, traditional remedies under contract law are not suitable for the purposes behind social and environmental provisions, namely reputational protection and risk management.
Because the most common and probably the most detrimental consequence of suppliers’ breach is the buyer's damaged reputation, specific performance is inconsequential, because the buyer cannot recover the loss suffered. Claiming damages might be more helpful for the buyer, but establishing a link between the supplier's breach and any loss suffered by the buyer may be difficult. Furthermore, calculating damages is problematic. Damages often include non-monetary damage such as future loss of profit due to harmed reputation.

Contract termination is the most suitable remedy. Nevertheless, even here some concerns occur. In fact, terminating the relationship although appearing as the suitable legal tools against supplier’s violation for principles embedded in the codes of conduct could be detrimental for the company, which will lose the investments into the relationship and needs to build a new one. Moreover, terminating the agreement does not help to recover the damages for bad reputation. Finally, should the supplier contest the termination, it may be difficult to prove that a breach of a Sustainability contractual provision constituted a fundamental breach of the contract.

As emerged by the OECD survey\(^2\), in practice most of the codes contain no real sanction for non-compliance. The survey found few examples of codes where non-compliance would lead to a serious penalty, such as a financial sanction or even termination of a contract. The response to code violations is more likely to be the maintenance of the relationship and attempts to remedy the breach, rather than imposing a penalty on the offending supplier.

3. The challenge to contract theory

3.1. Contracts to promote sustainable development

SCCs do not promote only the private interests of the contractual parties, but also a more general interest, i.e. sustainable development.

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In this respect, it becomes clearer that these clauses pose a challenge to traditional contract theory. Actually, this does not correspond to the common understanding of a contract as a framework for a private transaction stipulating the rights and obligations of the parties to facilitate a specific exchange.26

At the same time, Contract Law has changed dramatically since the heyday of free contract ideology. The false conflict in the cases and literature between facilitation of market transactions and regulation to achieve social aims has been transcended, largely due to the realization that social aims are behind all of contract law.27

The skeptical reader might protest that contract doctrine does not look all that different today than it did in the late nineteenth century. Judicial opinions abound in contemporary reports that appear to rest exclusively on freedom of contract ideology. It is difficult, in fact, to find cases that explicitly discuss the values providing the foundation for modern contract law.

It is therefore true that, while free contract ideology still plays an important role in contract law and that, many contemporary decisions are explainable only as resting on adherence to notions of free contract; other values have been incorporated in free contract thinking and, thus, finally changed it. The goal of sustainability may thus find a place in this set of values.

3.2 Contracts as relational tools

In addition, the use of contracts for other than private exchange related purposes shifts the notion of contract as such. From enforceable exchange of promises, contracts are becoming relational tools: from frameworks of private transactions, they move towards regulatory tools.28

Indeed, they usually address out-of-contractual subjects: the first tier suppliers, on one hand, and the third parties whose rights fall under SCCs (we think, for example, to the company’s employees), on the other hand. 29

Implementation of CSR issues into international supply contracts is a positive step towards global sustainability; however, it may lead nowhere if the provisions are not enforced throughout the whole supply chain. 30 This remains a major issue in CSR, since buyers may force compliance on their direct suppliers, but face difficulties in achieving compliance of further supply chain tiers with whom they have no direct legal relationship. Private international law is not very useful in this respect. 31

However, as SCCs do not influence the tangible quality of goods, they can hardly create such claims. Moreover, although the extension of implied warranties to subsequent buyers is well established in some jurisdictions, it is still unknown in others. Hence a question arises as to which law is applicable to decide the admissibility of the claim. 32 If we take international contract law and in particular the CISG as the applicable legal framework, such claim would not most probably be admissible. 33

Second, focusing on third parties, the contractual parties must intend to confer such a right. The intention can be either expressed or implied in the contract. 34 Normally, a third party’s right will not be found if a third party benefitted from the contract only incidentally. It has been argued that this cannot happen in the CSR area as the essential goal of buyers’ codes is to benefit workers, or other parties such as people living near suppliers’ factories.

31 UPICC ch 5 s 2; PECL art 6:110; CESL art 78. CISG does not provide for third party beneficiaries’ rights, see art 4. Cf Schwenzer and Schmidt, supra note 93, at 114.
However, some also claim that the right can only arise from promissory obligations to benefit others and not from obligations not to harm others, which is relevant especially in relation to environmental and anti-corruption issues.  

Furthermore, the conferred right must be specific. If there is no clear right, for example because vague language is used, there can be no breach. Lastly, the third party must be identified with adequate certainty, at least as a member of a specific group. This requirement can be especially complicated in relation to breaches of a contractual duty of care where there is an indefinite number of third party beneficiaries.

While the various third parties’ strategies have not hitherto been successful at Courts, they have not been entirely rejected either. In practice, the success of such claims will largely depend on the formulations of SCCs. Companies are aware of this ‘open door’ and try to minimize the possible risks by the inclusion of disclaimers in their contract.

4. The enforceability of SCCs obligations in suppliers’ contracts

Sustainability clauses must become a valid part of a contract in order to been forced. Companies and their suppliers should be aware that CSR standards might become an integral part of a contract not only by their direct implementation into the contractual text, but also by reference to another document, such as a Code of Conduct or a soft law instrument. While express provisions do not pose any formal problems, the incorporation by reference can sometimes raise concerns as to whether the referenced document becomes validly a part of the contract.

For example, a Code of Conduct or any other CSR document may qualify as standard terms and conditions, if one party only in advance of the contract drafts it and intended for general and repeated use. In any case, in order to establish if a referenced document became a part of a contract we have to look into the form and content of the reference. International contract law does not provide any specific rules in this respect; therefore,

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36 UPICC art 2.1.19; PECL art 2.209 (3); CESL art 2 (b); the CISG does not contain a special provision on standard terms and conditions.
the general rules on interpretation of the parties’ intentions will apply. The reference must be made in such a form and language that a reasonable person would comprehend that the mentioned document is intended to form part of the contract. It does not need to be in writing or signed. Furthermore, it does not need to be placed directly in the contractual text, but it can be for example made clear during pre-contractual negotiations. Thus, signing a Code of Conduct by a supplier in the pre-contractual phase, which states that the buyer intends to cooperate only with suppliers fulfilling therein-stipulated requirements, may be interpreted as incorporation of the code as standard terms and conditions into the contract.

The supplier should be aware of the referenced CSR documents. A mere statement that a supplier must fulfil requirements stipulated in a Code of Conduct is not sufficient; he must be also able to access the text. Except for express provisions or incorporation by reference, some authors argued that sustainability requirements become part of international contracts impliedly, without the necessity of contractual parties expressly acknowledging them. This may happen through the concepts of practices that the parties have established between themselves or international trade usages.

Parties are also bound by trade usages that are widely known and regularly observed by traders involved in the particular trade and of which the parties knew or ought to have known. Some authors suggest that observance of ethical standards constitutes such an international trade usage. However, we note, the scope of CSR obligations that would fall under the usage is not clearly established and thus this would not be sufficient for the enforceability of such clauses.

Should the CSR make reference by incorporation to the Codes of conduct, the neoliberal private-law oriented ideas of freedom and self-organization lead to the recognition of private regulation (such as a Codes of Conduct) as a source of law (of national or international level) having legal effects.

The potential legal effect deriving thereto can be distinguished between:

1. Those legal effects that concern only the authors of private rules (i.e. company

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and suppliers entering into a contract embedding Sustainability clauses).

It is true that companies by describing their behavior in Code of Conducts, although potentially addressed to a very broad public, tend to create confidence or expectations on those actors, which interact with the company (i.e suppliers). Those actors tend to trust the company’s compliance with such promises. Therefore, those actors can rely on the legal protection of legitimate expectations in the compliance with promises, an institute common in contract law and/or in the law on misleading advertising (usually forming part of competition and antitrust law).

Concerning contract law, there exist in almost all jurisdiction the principle of party autonomy which allow contracting parties to regulate the terms and conditions of their relationship in full autonomy safe for the so called mandatory rules and talking about contracts until the agreement is neither illegal nor immoral.

It derives from the above that companies are legitimate to make those promises concerning its own behaviors by establishing or signing a Code of Conduct, but the problem of the enforcement of said contractual promises and related litigation for breach of promises is yet to be evaluated and to be balanced with specific limits set by national contract law found applicable to the breach of claim.

2. Those legal effects that are binding on a whole group of corporations, including outsiders, by determining what constitutes fair business conduct (by introducing higher safety standards in the market). This is for example the roles played by provisions set out by professional bodies to their members.

3. Those legal effects that are binding on third parties setting standards for all producers of the same category.

4.1. Contractual remedies

It should also be noted that contract termination plays an important role: a refusal to source from a supplier is considered as the most severe punishment. Although contract termination is a remedy provided to a buyer under all international contract law instruments, it is most often executed outside of any formal enforcement proceedings; a company may simply stop placing orders to the supplier. If it comes to a formal disagreement about the right to terminate, the court would have to establish whether the
breach in question amounted to a fundamental breach. This is easy if the contract states that non-compliance with SCCs constitutes a fundamental breach, but much more difficult if it does not. Usually, a fundamental breach is found when the main obligation under a contract is not fulfilled. A breach of ancillary obligations can also result in a fundamental breach, but most probably not if those obligations were not connected to the goods’ non-conformity.

A fundamental breach must also be foreseeable according to the general rules on contract interpretation. The main aspect to examine in this respect will once again be the language of the SCCs and/or the manner in which the supplier was informed of the buyer’s CSR standards. Therefore, it can be concluded that the possibility of contract termination plays an important role in the use of SCCs, but the role relates more to the deterrence function of such a provision than its actual use. In this sense, underlying contract law is crucial in allowing multinational buyers to exert legal pressure over their suppliers.

A brief note should address the other two typical contractual remedies next to contract termination - specific performance and damages - although they are not used in the enforcement practice of SCCs. Specific performance actually cannot be used in relation to SCCs, since these requirements do not relate to the physical product quality. The courts have been reluctant to recognize CSR production method-related requirements as product characteristics in consumer cases, and it can be expected that the same would happen in business cases as well.

In order to claim damages under international contract law the buyer then has to prove a breach, damage that was foreseeable and a causal relationship between the two. All may pose problems in relation to SCCs. Firstly, a breach can occur only where there is a binding obligation. As discussed earlier, the binding nature of SCCs is dependent on the relevant provision’s form and specificity. Secondly, if an SCC is breached, most likely a non-pecuniary damage occurs, usually a reputational harm. Whereas UPICC and PECL expressly provide for the possibility of recovering non-pecuniary loss, the same is the subject of an academic discussion and contradicting court decisions under CISG and it is expressly excluded in relation to reputational loss by CESL.  

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39 UPICC art 7.4.2(2); PECL art 9:501(2)(a).
Finally, the causal relationship between breach of an SCC and relevant damage will often be a controversial matter and it will be even harder if a buyer claims a future loss, which must be proved with reasonable certainty. It may be impossible to reach reasonable certainty, unless the buyer for example faces litigation by third parties due to the breach in question and expects to lose it.41

4.2. Relational enforcement tools

Given their nature of relation tools, SCCs’ enforcement is primarily based on relational enforcement tools.

First of all, monitoring, because non-compliance is not detectable after the goods are delivered. For example, we cannot see from the goods’ appearance that children were used to produce it.

The majority of companies use suppliers’ self-assessment to start with. It is often required during the suppliers’ selection process as a part of risk assessment and due diligence as well as during the contractual term. As a cheap although highly subjective alternative, self-assessments can be conducted often and commonly serve as detecting ‘red flag’ issues, which are then further followed up by suppliers’ audits. A variety of audits exists, including internal and external, announced and unannounced audits on site, audits coordinated among groups of firms and according to different audit standards. Each type has some associated positives and negatives, but all of them face a common criticism pointing towards unreliable and subjective results and corruption practices.

In response to the criticism, companies are becoming more transparent about the audit results. This information, despite its possible incompleteness, is essential for implementing any practical change in suppliers’ behaviour through various soft and hard remedial strategies. If non-compliance is discovered, the buyer will usually work with the supplier to find solutions.

For example, the most common tool that companies use is a so-called corrective action plan, under which the parties agree what the supplier must do to remedy the breach. Sometimes, the buyer will even provide a supplier with capacity building resources, such

41 Schlechtriem, supra, at 94.
as training or assistance. The aim of these relational strategies is to secure compliance with sustainability requirements in a collaborative manner and avoid disputes. It is common that buyers expect a certain level of non-compliance among their suppliers and thus do not break off cooperation if a supplier is willing to improve.

In addition to the positive relational enforcement tools, companies may also rely on name-and-shame strategies. An increasing number of CSR initiatives establish a database of compliant suppliers. Members of the specific initiative can no longer use a supplier, who is erased from such a database or, worse still, listed as noncompliant.

Relational enforcement tools are essential for the effectiveness of SCCs as they aim to actually change behavioural patterns in supply chains. However, although neither companies nor regulators stress it, the effectiveness of the relational tools is grounded in the threat of formal legal sanctions. This reliance on the indirect enforcement power of formal legal sanctions is evident from the frequent reservation of the right to terminate a contract if the supplier’s non-compliance is not remedied.

4.3 Case studies

Some companies and third parties have tried to enforce suppliers’ breach to comply with SCC - in order to respond to the lack of internal sanctions for code breach - indirectly using the tools of consumer law (misleading advertising)\textsuperscript{42}, labour law or contract law. However, no case (so far) against a company for breach of a code has reached trial on the substantive issues. Most, such as the Nike case (described below), settled the disputes before entering into the substantive claims. This seems to confirm that MNEs more often use the relational remedies (see before) in case of non-compliance of their suppliers. Moreover, in term of enforceability, it is worth to mention that the wording of the codes does not always give clear answer to the question whether they will prevail over local law.

\textsuperscript{42} For reference to certain case-studies involving German law please refer to Eva Kocher, “Codes of Conduct and Framework Agreements on Social minimum Standards. Private regulations?” in Responsible Business Oxford and Portland Oregon (2008), 67. They refer to cases where the company promotes its products on the basis that they were produced in compliance with certain minimum social standards arising in Misleading advertising in violation of section 5(1)(2) of the German Act against Unfair Competition.
or practice at the place of production, or if the interpretation of national law will rather determine the interpretation of the standards.

As pointed out by other author\textsuperscript{43}, the evaluation of the effectiveness of codes of conducts is not yet been exploited in a consistent way primarily due to lack of empirical studies. The codes of conduct private instruments and therefore little transparency in their development and implementation make only those been brought to the attention of the public following the attack or criticism by the media bringing to negative publicity and consumer boycotts (as Nike case shows\textsuperscript{44}). Moreover legal actions arising therefrom (especially in the US in the form of a class action) ends with settlement agreements which do not include any admission of liability by the companies.\textsuperscript{45}

Good example of legal actions ending with no liability since the cases were settled before the final judgment is represented by three separate lawsuits filed in 1999 in Califormian state and federal courts and in a US federal court on the West Pacific island of Saipan against a number of US clothes retailers and against garment contractors based in Saipan. Saipan is exempt from US immigration and minimum wage laws. The legal actions were brought by NGOs and a class of some 30,000 foreign textile workers, most of whom had been brought from China and the Philippines by apparel companies to work in their factories in Saipan. Some workers were forced to pay recruitment fees in their home countries. These fees effectively tied people to their employers in Saipan to pay back the debt. A first legal action alleged breaches of Californian state law on unfair business practices on the basis that the defendant companies had falsely advertised their goods as sweatshop free, and aided and abetted violations by their contractors in Saipan of laws against involuntary servitude as well as other misleading labelling and advertising practices. A second action was based on federal laws: the Alien Tort Claims Act, the Anti-Peonage Act, which prohibits use of forced labour, and RICO – the Racketeer Influenced and Corrupt Organizations Act. To state a claim, plaintiffs must allege unlawful conduct of an enterprise through a pattern of racketeering activity violating specified ‘predicate acts,’ which include involuntary servitude and indentured labour. RICO broadly defines

\textsuperscript{43} Fiona McLEAY, cited above, 224.
\textsuperscript{44} See for example \textit{Kasky v. Nike}, 45 P.3d 243 (Cal. 2002), where Nike has been challenged for accountability not only for the activities carried out by the manufacturers but also for their suppliers’ and subcontracted factories.
\textsuperscript{45} H. WARD, cited above 17-18.
‘enterprise’ to include ‘any union or group of individuals associated, in fact, although not a legal entity.’ The plaintiffs’ alleged that the defendants’ behaviour amounted to a pattern of racketeering activity, which exists when a person commits or aids and abets two or more specified acts that have sufficient continuity and relationship so as to pose a threat of continued criminal activity. The substantive legal principles at stake in the case have not been tested, since settlement talks began early in the action. In light of the above, below reference is made to the literature available on case studies. The cases of Nike Inc., SKF, Ocean Trawlers and Ikea deserve attention.\(^{46}\)

**Nike**\(^{47}\)

The Kasky v. Nike case, probably the most known case study, originates from the lawsuits brought by the environmental activist Marc Kasky claiming that the statements - made by Nike in response to alleged non ethical labour practises in its supply chain - to instead work worldwide in accordance with a strict code of conduct, free from sweated labour, were false or misleading, and that they should be censured under California’s unfair competition legislation and false advertising\(^ {48}\).

The action challenges the accuracy of the report commissioned by Nike on compliance with its corporate code by suppliers\(^ {49}\).

Nike cited the US constitution’s First Amendment, which enshrines freedom of speech. Notwithstanding the fact that initially, the San Francisco Superior Court and the California Court of Appeal dismissed the action, agreeing with Nike that the company’s statements were indeed protected by the First Amendment, in May 2002, the California Supreme Court stated that the company statements amounted to “commercial speech” because they were directed by a commercial speaker to a commercial audience


\(^{48}\) Kasky v. Nike, 45 P.3d 243 (Cal. 2002). Overturning decisions of lower courts, the Supreme Court of California held that since Nike's statements were representations of fact about the company's commercial operations, they were commercial speech, and thus not protected by the First Amendment.

\(^{49}\) The Nike code of conduct: a report on conditions in international manufacturing facilities for Nike, Inc. (1998). The Report was produced by GoodWorks International, LLC, a consulting group chaired by Andrew J. Young, based on Mr. Young's investigations.
(consumers of Nike products), making representations of fact about Nike’s business operations ‘for the purpose of promoting sales of its products’. Commercial speech is not subject to the same level of protection as ‘political speech’ under the First Amendment. As a consequence, the commercial statements would be subject to the stricter standard of truth required by advertising law. The case was thereafter settled where Nike was to pay $1.5 million to the Fair Labor Association (FLA) to be used for worker development programs and hence no ruling on the found of evidence of illegal or unsafe working conditions at Nike factories in China, Vietnam, and Indonesia has been given. Notwithstanding the above, from such lawsuits Nike adopted a rather hard-line approach towards suppliers, drawing a sharp line on how much non-compliance will be tolerated before the supplier’s contract will be terminated. In general, Nike accepts a maximum limit of three non-conformances before terminating a contract and forever excluding the supplier from their sourcing. This strategy has been criticized as being more about protecting a brand name rather than the supplier’s workforce.

**SKF**

SKF is viewed as one of the most successful company’s Code of Conduct because it implements social and environmental activities into its core business plan and recognizes Sustainability projects as one of the corporations’ key business drivers. The SKF’s *Code of Conduct* 50, introduced in 2002, in order to “enable systematic compliance assessment and risk identification” is applicable to all of the SKF Group’s operations worldwide and has also been used as a reference to establish other documents such as the SKF Code of Conduct for Suppliers and Sub-contractors, and the SKF Code of Conduct for Distributors, demanding similar high levels of commitment from their business partners.

**Ocean Trawlers**

In 2004 and 2006 Ocean Trawlers (market leader in supplying and processing cod and haddock from the Barents Sea and a leading distributor to Europe, Asia and the U.S.) was involved in a Norwegian and a Swedish TV documentary which accused the corporation of illegal fishing. Although media information turned out to be false, the case shows the

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importance of traceability and transparency in order to respond to public demands being more prepared to identify risks and respond to allegations.

**Ikea**

In the early 1990s a Swedish documentary discovered brutal production methods among several suppliers in Pakistan linked to IKEA and a German documentary raised the issue of child labour. Together with other companies IKEA was cited as a customer of wicker suppliers employing children, causing the corporation to review their supply-chain.

IKEA’s current Code of Conduct, *The IKEA Way on Purchasing Home Furnishing Products*, was officially launched in 2000 to secure their sourcing in developing countries such as China in order to better face failure in monitoring its supply-chain processes and therefore increase traceability in the business.

For an analysis of the impact of codes limited to “employee rights” it is interesting to read the conclusion reached by Fiona McLEAY\(^{51}\) reporting on the “Schrange report”\(^{52}\) which analyzes four cases related to **manufacturing sector in China**, demonstrating that according to the context the outcomes of the implementation of the same Code of conducts can vary significantly.

**Adidas-Salomon**

The analysis involves two factories in China having both implemented the *adidas-Salomon* Code of Conduct used to encompass the activities of the Adidas supply chain. Contractors and companies who contract with Adidas-Salomon sign terms of engagement that require them to uphold the Code of Conducts. This is accompanied by educational tools (handbooks and posters) to educate the workers in the factories about the terms of the codes and about the mechanism for bringing complaints for their violation. Responsibility for controlling their implementation is left to the Adidas-Salomon Social and environmental Affairs department, which carries out regular visits to supplier to check adherence and to assist in resolving compliance problem.

Notwithstanding the same set of instruments, factory A showed better application of the Code of Conduct and performed also better than factory B, including demonstrating better levels of pay and health and safety, and lower labour turnover, while in factory B the code

\(^{51}\) Fiona McLEAY, cited above.

\(^{52}\) E. SCHRANGE, “Promoting International Worker Rights Through Private Voluntary Initiatives: Public relations or Public Policy?”, report to US Department of State in behalf of the University of IOWA Center for Human Rights, January 2004.
has been see as one of the conditions needed to be satisfied to continue to do business with Adidas, but the code did not become an integral part of factory’s business operation: simpler compliance approach. The better success in factory A can be explained by A’s management having successfully interpreted and implemented the Adidas code of labour practice as a collaborative relationships.

5. Conclusions

Sustainability contractual clauses (SCCs) may be compatible with our current broad understanding of the theory of contract and they are enforceable, unless primarily through relational enforcement tools given the shortcomings of traditional contract remedies in this particular respect. The article argues that a meaningful shift to sustainability will require significant changes to the definition of the rights and obligations of individuals, corporations and government, and a transformation in the interactions between all societal actors. Given the role that contracts play in defining rights and obligations, they represent a central mechanism to effecting this transformation and they may contribute to make CRS polices and Codes of Conduct more effective. On such basis, structuring contracts to maximise sustainable outcomes recognises that, profit maximisation is not an end in itself, but a means to an end. The ultimate goal is to improve living conditions and enable people to have greater control over their lives, whilst respecting the environment.