

***The Enforcement of Corporate Social Responsibility  
Through Contractual Terms in Business to Business  
Contracts Through the Supply Chain***

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*Human and labour rights abuses are endemic in the manufacturing industry and have become a global issue through the out-sourcing of the production of goods to countries with cheap and abundant labour. The movement to highlight and address human and labour rights issues in global supply chains was born in the 1990s with the media exposure of sweatshop factories linked to the supply chains of major Western companies, such as Nike. These issues persist to this day and are arguably becoming more acute. Currently, there is a lacuna in the law on the enforcement of human and labour rights standards in global supply chains as national and international state actors have not developed a comprehensive regulatory system. The responsibility is now being shifted to the corporate sector and is known as supply chain Corporate Social Responsibility (CSR). This article examines the feasibility and effectiveness of fulfilling a company's supply chain CSR through incorporating a CSR Code of Conduct into supply contracts between purchasing companies and their suppliers. The article demonstrates that the proposed solution is feasible under New Zealand contract law and explores four different ways in which a CSR Code of Conduct could be incorporated into a supply contract. This article then presents a proposed contractual solution and identifies its potential positive and negative aspects. The overall conclusion of this comparison is that the solution is an effective means for a company to fulfil its supply chain CSR obligations.*

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## I INTRODUCTION

The peoples of the earth have ... entered in varying degrees into a universal community, and it has developed to the point where a violation of rights in one part of world is felt everywhere.

— Immanuel Kant<sup>1</sup>

In the 20th century, companies took advantage of globalisation and economic capitalism by out-sourcing the manufacture of their products to countries with cheap and abundant labour.<sup>2</sup> Consequently, 21st century human and labour rights issues endemic in the manufacturing industry have multiplied and spread through global supply chains that involve some 18,000,000–20,000,000 employees.<sup>3</sup>

Traditionally, breaches of human and labour rights are within the realm of national law enforcement.<sup>4</sup> However, the globalisation of supply chains challenges the effectiveness of this traditional approach, as often these manufacturing factories operate in countries where there are weak protections for human and labour rights.<sup>5</sup> The natural alternative would be enforcement through international actors. These fundamental universal rights are, after all, enshrined in instruments such as the United Nations' *Universal Declaration of Human Rights (UDHR)*<sup>6</sup> and the International Labour Organisation's *Declaration on Fundamental Principles and Rights at Work*.<sup>7</sup> However, the instruments adopted in response to global supply chain issues are soft law. That is, the nation states are not bound to replicate the content of these instruments in their national law. As a result, companies (whether manufacturer or purchaser), are also not bound.

The truth is that there is no comprehensive legal system for regulating supply chain practices affecting the labour and human rights of millions

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- 1 Immanuel Kant *Zum ewigen Frieden. Ein philosophischer Entwurf* (Friedrich Nicolovius, Königsberg, 1795) (translated ed: HB Nisbet (translator) Immanuel Kant "Perpetual Peace: A Philosophical Sketch" in Hans Reiss (ed) *Kant's Political Writings* (Cambridge University Press, London, 1970)) at 107–108.
  - 2 Radu Mares *The Dynamics of Corporate Social Responsibilities* (Martinus Nijhoff, Leiden (Netherlands), 2008) at 98.
  - 3 Miriam Saage-Maaß "Labour Conditions in the Global Supply Chain: What Is the Extent and Implications of German Corporate Responsibility?" (Research Paper, Friedrich Ebert Stiftung, 2011) at 2.
  - 4 For example, after a fire at the Triangle Shirtwaist Factory in New York led to the death of almost 150 garment workers, a state commission was set up to investigate the safety of buildings in other garment factories. The findings of that commission eventually led to the adoption of new labour laws. Anna Beckers *Enforcing Corporate Social Responsibility Codes: On Global Self-Regulation and National Private Law* (Hart Publishing, Oxford, 2015) at 1–2; and Richard A Greenwald *The Triangle Fire, the Protocols of Peace, and Industrial Democracy in Progressive Era New York* (Temple University Press, Philadelphia, 2005) at 127–129.
  - 5 Julia Patrizia Rotter, Peppi-Emilia Airike and Cecilia Mark-Herbert "Exploring Political Corporate Social Responsibility in Global Supply Chains" (2014) 125 *J Bus Ethics* 581 at 582; and Michael Kerr, Richard Janda and Chip Pitts *Corporate Social Responsibility: A Legal Analysis* (LexisNexis, Markham (Canada), 2009) at 481.
  - 6 *Universal Declaration of Human Rights* GA Res 217/A, A/Res/3/217A (1948) [*UDHR*].
  - 7 International Labour Organization *Declaration on Fundamental Principles and Rights at Work* 37 ILM 1233 (1998), CIT/1998/PR20A [*ILO Principles and Rights at Work*].

of people globally. Without state and international regulation of supply chain practices, the purchasing companies at the top of the supply chains have come under increasing pressure from non-governmental organisations (NGOs), the media and the general public to accept that regulating human rights and labour standards throughout their supply chains is a part of their CSR obligations.

Part II of this article examines the human and labour rights issues found in supply factories and why the corporate sector is now expected to take responsibility for supply chain practices, filling the gap in the law. Part III presents a proposed solution to addressing a company's supply chain CSR: incorporating a code of conduct into the supply contract between the purchasing company and its suppliers. It also explores the concept of a code, its content, the relevant law and how it may be incorporated into the contract. Part IV is a critical analysis of the proposal, identifying the potential strengths and weaknesses. It concludes that the refinement of the proposed solution overcomes most of the potential issues.

## II CORPORATE RESPONSIBILITY FOR SOCIAL STANDARDS IN THE SUPPLY CHAIN

Corporations are increasingly being held responsible for the promotion of social standards in their supply chains by NGOs, consumers, the media and the general public as a part of their CSR obligations. The preliminary definition of CSR for most theorists is Archie B Carroll's: "economic, legal, ethical and discretionary expectations that society has of organizations".<sup>8</sup> CSR fits into R Edward Freeman's theory that a company's social activities can have an impact on economic activities; therefore, firms must adopt a stakeholder perspective and satisfy the interests of the owners, stakeholders, community, the public and the employees.<sup>9</sup> In the context of supply chain CSR, "[a] modern day company has the responsibility to ensure that every member of its labour supply-chain across the world is afforded universal human rights."<sup>10</sup>

### Human Rights and Labour Rights Issues in Supplier Factories

Virtually all corporations out-source the production of their goods to countries with cheap and abundant labour — particularly in Southeast Asia and Central

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8 Archie B Carroll "A Three-Dimensional Conceptual Model of Corporate Performance" (1979) 4 *AMR* 497 at 500.

9 R Edward Freeman *Strategic Management: A Stakeholder Approach* (Pitman Publishing, Marshfield (Mass), 1984) as cited in Joyce Falkenberg and Petter Brunsæl "Corporate Social Responsibility: A Strategic Advantage or a Strategic Necessity?" (2011) 99 *J Bus Ethics* 9 at 10.

10 Aaron Bernstein and Larry Beeferman "Supply-Chain Labour and Human Rights" (Research Paper, Harvard Law School, 2011) at 3.

America — through widespread and far-reaching supply chains.<sup>11</sup> Some 18,000,000–20,000,000 employees are involved in global supply chains with the money generated making up to 15 percent of some countries' gross domestic product.<sup>12</sup>

The movement to highlight and address human and labour rights issues in supply chains was born in the 1990s with the media exposure of sweatshop factories linked to major Western companies, such as Nike. Some of Nike's Vietnamese, Chinese and Indonesian suppliers were exposed as using child labour, imposing long work hours, and paying their employees below even the local statutory minimum wage.<sup>13</sup> The strong media and NGO attention on Nike's supply chain issues increased interest amongst consumers and the general public in "ethical production".<sup>14</sup>

The issues in global supply chains identified in the 1990s persist to this day and are arguably more acute. For instance, in April 2013, the Rana Plaza factory building in Savar, Bangladesh collapsed, causing 2,500 injuries and 1,100 deaths. In the aftermath, consumers accused international purchasing companies of tolerating the poor working conditions in the factory.<sup>15</sup> NGOs demanded that they take responsibility by contributing to the long-term compensation of victims and their families.<sup>16</sup> In response, several clothing retailers and textile brands signed the Accord on Fire and Safety in Bangladesh with international trade unions,<sup>17</sup> obliging them to "take an active organisational and financial role in improving working conditions in garment factories in Bangladesh".<sup>18</sup>

### The Case for Corporations' Social Responsibility for Their Supply Chains

There are several arguments in favour of corporations' social responsibility for their supply chain. First, while there was a growth in interest in human and labour rights in supply chains in the 1990s, there is still not a comprehensive and effective response. For example, principle 2 of the United Nations Global Compact states that businesses should "make sure that

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11 Mares, above n 2, at 98; and OECD Roundtable on Corporate Responsibility *Supply Chains and the OECD Guidelines for Multinational Enterprises: Discussion Paper on Supply Chain Management* (Business and Industry Advisory Committee, 2002) at 2.

12 Saage-Maaß, above n 3, at 2.

13 Doreen McBarnet "Corporate social responsibility beyond law, through law, for law: the new corporate accountability" in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds) *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press, Cambridge, 2007) 9 at 15.

14 Simon Birch "How activism forced Nike to change its ethical game" *The Guardian* (online ed, London, 6 July 2012); and McBarnet, above n 13, at 16.

15 Emily Jane Fox "Shoppers lash out at stores over Bangladesh" (2 May 2013) CNN Money <[www.money.cnn.com](http://www.money.cnn.com)>.

16 Liana Foxvog and others *Still Waiting: Six months after history's deadliest apparel industry disaster, workers continue to fight for compensation* (Clean Clothes Campaign, 4 October 2013).

17 Accord on Fire and Building Safety in Bangladesh (signed 15 May 2013).

18 Beckers, above n 4, at 3.

they are not complicit in human rights abuses”.<sup>19</sup> The United Nations’ *Guiding Principles on Business and Human Rights* outlines principles such as principle 13(b):<sup>20</sup>

... seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts

Principle 17 adds: “carry out human rights due diligence”.<sup>21</sup> However, whilst these principles demonstrate international recognition, they are soft law instruments. Therefore, nation states are not bound to adopt a comprehensive system for enforcement, and indeed they have not.

There have been limited national efforts at addressing specific supply chain issues. For instance, the Modern Slavery Act 2015 (UK) and the California Transparency in Supply Chains Act of 2010 focus on slavery in supply chains.<sup>22</sup> However, the broad but non-binding international principles and the binding but narrow national instruments do not collectively create a comprehensive regulatory system for addressing human rights and labour issues in supply chains. In the meantime, disasters such as the Rana Plaza Incident occur. The public and NGOs seem to have decided that corporations are responsible for filling the regulatory void, as no other actor is in a more advantageous position to disseminate CSR principles through supply chains.

The second argument is that since many businesses’ suppliers are operating in countries where the local government is either unable or unwilling to enforce fundamental human rights standards, this creates the opportunity for supplier firms to exploit employees and abuse their rights.<sup>23</sup> However, a purchasing company should not feign ignorance of human rights abuses as it would be unconscionable for them “to remain aloof and prosperous while the surrounding communities decline and decay”.<sup>24</sup> This is “globalization’s Catch-22”: instead of simply enjoying the advantages of cheap and abundant labour, purchasing companies are being called upon to directly deal with the underlying social issues.<sup>25</sup> This is justified on the basis that corporations should not sidestep responsibility for human rights abuses occurring within their supply structures — they are, after all, primarily responsible for developing those structures.<sup>26</sup>

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19 “The Ten Principles of the UN Global Compact” United Nations Global Compact <[www.unglobalcompact.org](http://www.unglobalcompact.org)>.

20 *Guiding Principles on Business and Human Rights* HR/PUB/11/04 (2011) at 14.

21 At 17.

22 Modern Slavery Act 2015 (UK); and California Transparency in Supply Chains Act of 2010 CA Civ Code § 1714.43.

23 Rotter, Airike and Mark-Herbert, above n 5, at 582; and Kerr, Janda and Pitts, above n 5, at 481.

24 John F Welch Jr “What Corporate Social Responsibility Means to Me: Wanted: Teachers and Leaders” (Spring 1992) 81 *Business and Society Review* 87 at 88.

25 Matthew J Hirschland *Corporate Social Responsibility and the Shaping of Global Public Policy* (Palgrave Macmillan, New York, 2006) at 20.

26 Saage-Maaf, above n 3, at 16.

The third argument is that it might be in the purchasing companies' interests to adopt responsibility for the social standards of their supply chains as a part of their corporate governance duties. Corporations in New Zealand are bound by several obligations to their stakeholders, captured in the *NZX Corporate Governance Code 2017*.<sup>27</sup> Although CSR in the supply chain is not an express obligation, it can be implied into the other principles of the *Corporate Governance Code*. For instance, Principle 4 requires that the board annually reports and discloses its financial and non-financial activities, "including considering material exposure to environmental, economic and *social sustainability* risks and other key risks".<sup>28</sup> Principle 6 requires the directors to understand and manage the risks associated with its business,<sup>29</sup> and Principle 8 requires the board to have "sufficient channels for transparent and accountable, periodic engagement and reporting on environmental, *social* and governance issues" with its shareholders.<sup>30</sup> There are considerable reputational and financial costs associated with being exposed as a purchaser of unethically produced goods. A company may be subject to boycotts, NGO-led campaigns<sup>31</sup> and loss of customer loyalty.<sup>32</sup> Therefore, on a risk-based analysis, a company arguably must enforce CSR standards in their supply chains as a part of "good corporate governance".

### The Extent of Corporations' Responsibility for Supply Chain Issues

Society has at least two expectations of companies. First, companies will not be socially irresponsible.<sup>33</sup> In the context of CSR in supply chain management, this means companies cannot participate in, or turn a blind eye to labour exploitation or human rights abuses. This is because many of the relevant social problems have become more acute<sup>34</sup> and society will no longer tolerate purely profit maximising business practice.<sup>35</sup> Secondly, companies should respond to the society's needs by engaging in positive CSR efforts.<sup>36</sup> It is acknowledged that "[n]o business can solve all of society's problems or bear the cost of doing so."<sup>37</sup> Further, a business' foremost duty is to its shareholders and profit maximisation.<sup>38</sup> Companies should engage in "strategic corporate

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27 *NZX Corporate Governance Code 2017* (New Zealand Stock Exchange, 10 May 2017).

28 At 19 (emphasis added).

29 At 24–25.

30 At 28 (emphasis added).

31 Birch, above n 14; and Kerr, Janda and Pitts, above n 5, at 46.

32 Longinos Marin, Salvador Ruiz and Alicio Rubio "The Role of Identity Salience in the Effects of Corporate Social Responsibility on Consumer Behavior" (2009) 84 *J Bus Ethics* 65.

33 J Scott Armstrong and Kesten C Green "Effects of corporate social responsibility and irresponsibility policies" (2013) 66 *J Bus Res* 1922 at 1925.

34 Lee Burke and Jeanne M Logsdon "How Corporate Social Responsibility Pays Off" (1996) 29 *Long Range Planning* 495 at 499.

35 Welch Jr, above n 24, at 88.

36 Michael E Porter and Mark R Kramer "Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility" (2006) 84 *Harv Bus Rev* 78 at 91–92.

37 Porter and Kramer, above n 36, at 84.

38 Milton Friedman "A Friedman doctrine – The Social Responsibility Of Business Is to Increase Its Profits" *New York Times* (13 September 1970); and Margaret Lindorff, Elizabeth Prior Jonson and

social responsibility<sup>39</sup> by committing themselves to social initiatives within their field of influence that will simultaneously profit maximise and solve a societal problem.<sup>40</sup>

Most organisations seem to recognise that supply chain management and practices are relevant CSR concerns for corporations.<sup>41</sup> However, it appears that companies are unsure of how to implement CSR obligations effectively through the supply chain. Corporations occasionally argue that the organisation and surveillance of all of their subsidiaries and suppliers is in practice a legally impossible task.<sup>42</sup>

### III THE PROPOSED SOLUTION: INCORPORATING A CSR CODE OF CONDUCT INTO THE SUPPLY CONTRACT

This article's proposed solution for supply chain CSR is incorporating a code of conduct into the supply contract between the purchasing company and the supplier company.

#### What is a Code of Conduct?

Codes of conduct can be described as broad policy statements covering topics associated with CSR, such as sustainability, human rights and labour standards, and environmental responsibility.<sup>43</sup> They are an effective means of internal and external communication of a corporation's CSR commitments.<sup>44</sup> A company may adopt a recommended code of conduct such as the *Guiding Principles on Business and Human Rights* or Amnesty International's Human Rights Principles for Companies.<sup>45</sup> In this case, it is recommended that the purchasing company develops a specific supplier code of conduct tailored to the nature of the supply chain.<sup>46</sup>

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Linda McGuire "Strategic Corporate Social Responsibility in Controversial Industry Sectors: The Social Value of Harm Minimisation" (2012) 110 J Bus Ethics 457 at 463.

39 Burke and Logsdon, above n 34, at 499.

40 Porter and Kramer, above n 36, at 91–92.

41 See, for example, Australian Centre for Corporate Social Responsibility "The State of CSR in Australia and New Zealand Annual Review 2015: Initiators, Integrators, and Innovators" (Report, 2015) at 18; and Australian Centre for Corporate Social Responsibility "Annual Review of the State of CSR in Australia and New Zealand 2016: Pathways to the Sustainable Development Goals" (2016) at 14.

42 Saage-Maaß, above n 3, at 16.

43 Beckers, above n 4, at 23–24.

44 Jacqueline Cramer *Corporate Social Responsibility and Globalisation: An Action Plan for Business* (Greenleaf Publishing, Sheffield, 2006) at 40–41.

45 *Guiding Principles on Business and Human Rights*, above n 20; and Beckers, above n 4, at 21.

46 See, for example, *Supplier Code of Conduct* (Air New Zealand).

## The Content of Codes of Conduct in Supply Contracts

Supplier codes tend to focus on labour and human rights issues, since they have captured the media's focus,<sup>47</sup> such as with Nike's "sweatshop" exposé.<sup>48</sup> These issues are within the purchasing company's scope of influence as they concern the wellbeing of employees at supplier factories who are producing the goods of the contract.

The International Labour Organisation's *Declaration on Fundamental Principles and Rights to Work* are a good set of "fundamental" principles for a supplier code of conduct. They concern:<sup>49</sup>

1. freedom of association and the effective recognition of the right to collective bargaining;
2. elimination of forced labour;
3. abolition of child labour; and
4. elimination of employment and occupation discrimination.

The *UDHR* is a source of more general human rights such as respect for human dignity, and freedom from cruel, harsh and inhumane treatment.<sup>50</sup>

A supplier code could reinforce the existing standards by requiring suppliers to adhere to their own national law as "99 per cent or even 100 per cent of [requirements in the Code] are legal requirements that should be observed anyway".<sup>51</sup> Where domestic law falls below international standards, it may be preferable to hold the suppliers to the higher standard of the supply contract.<sup>52</sup> This has particularly featured in contracts of purchasing companies that have faced backlash over a particular issue such as child labour (for example, H&M, Nike and Gap).<sup>53</sup>

## Enforcement Provisions

In order to ensure a supply contract's CSR obligations are enforceable in a New Zealand court, the purchasing company should establish the exclusive jurisdiction of New Zealand.<sup>54</sup> This means that if the manufacturing company breaches the contract's CSR obligations, the dispute may only be brought in New Zealand before a New Zealand court.<sup>55</sup> The purchasing company should

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47 Doreen McBarnet and Marina Kurkchiyan "Corporate social responsibility through contractual control? Global supply chains and 'other-regulation'" in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds) *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press, Cambridge, 2007) 59 at 65; and Birch, above n 14.

48 McBarnet, above n 13, at 15.

49 *ILO Principles and Rights at Work*, above n 7.

50 *UDHR*, above n 6.

51 McBarnet and Kurkchiyan, above n 47, at 67.

52 At 67.

53 Mette Andersen and Tage Skjoett-Larsen "Corporate social responsibility in global supply chains" (2009) 14 *Supply Chain Management: An International Journal* 75 at 77; Birch, above n 14; and Larry Catá Backer "Multinational Corporations as Objects and Sources of Transnational Regulation" (2007–2008) 14 *ILSA J Int'l & Comp L* 499 at 512–513.

54 High Court Rules 2016, r 6.27(2)(k).

55 Peter Whiteside and Anthony Willy *District Courts Practice (Civil) (NZ)* (online looseleaf ed, LexisNexis) at [DCR3.38.1.05].

also ensure that New Zealand law will govern the contract.<sup>56</sup> The purchasing company and the New Zealand courts are most familiar with the New Zealand law, so any case should just be a fairly straightforward application of the law to the facts.<sup>57</sup> In a supply relationship, the symmetry of power is likely to be significantly distorted to the purchasing company such that they may reasonably insist on such terms in the contract.<sup>58</sup>

## The Relevant Law

All relevant New Zealand commercial legislation has recently become consolidated in the Contract and Commercial Law Act 2017 (CCLA),<sup>59</sup> which entered into force on 1 September 2017.<sup>60</sup>

Part 3 of the CCLA is the primary statutory law on supply contracts involving a sale of goods.<sup>61</sup> Unless the provisions are explicitly contracted out of, pt 3 of the CCLA acts as a set of default rules.<sup>62</sup> Although pt 3 of the CCLA is “largely a codification of the common law”,<sup>63</sup> s 201(2) provides room for the continual application of the common law so long as it is not inconsistent with the provisions of the CCLA. Part 2 of the CCLA may be relevant to an international supply contract and the application of CSR, particularly subpart 1 on contractual privity. The Fair Trading Act 1986 may also apply. The United Nations’ Convention on Contracts for International Sale of Goods (CISG), found at pt 3, subpart 7 of the CCLA, applies.<sup>64</sup>

- (1) ... to contracts of sale of goods between parties whose places of business are in different States:
  - (a) when the States are Contracting States; or
  - (b) when the rules of private international law lead to the application of the law of a Contracting State.

For the purpose of this proposal, it is assumed that the parties expressly contract out of the CISG such that New Zealand law has primary application.<sup>65</sup>

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56 High Court Rules 2016, r 6.27(2)(b)(iv).

57 *Laws of New Zealand* Conflict of Laws: Choice of Law (online ed) at [117].

58 McBarnet and Kurkchian, above n 47, at 86; and Andreas Rühmkorf *Corporate Social Responsibility, Private Law and Global Supply Chains* (Edward Elgar Publishing, Cheltenham (UK), 2015) at 85.

59 Contract and Commercial Law Act 2017 [CCLA], s 345(1).

60 Section 2.

61 Cynthia Hawes “Scope of the Sale of Goods Act 1908” in Henry Holderness (ed) *Introduction to Commercial Law* (5th ed, LexisNexis, Wellington, 2016) 227 at 228.

62 CCLA, s 197.

63 Hawes, above n 61, at 228.

64 United Nations Convention on Contracts for the International Sale of Goods 1489 UNTS 3 (opened for signature 11 April 1980, entered into force 1 January 1988) [CISG], art 1.

65 Article 6; and Debra Wilson “Export Trade Contracts” in Henry Holderness (ed) *Introduction to Commercial Law* (5th ed, LexisNexis, Wellington, 2016), at 344.

## How can the Code of Conduct be Incorporated into the Supply Contract?

There are four methods of incorporating a code of conduct into a supply contract focused on in this article. These involve incorporation through:

1. an expressly negotiated contract;
2. the buyer's general terms and conditions;
3. the buyer's invitations to tender; or
4. a contractual requirement that the supplier sign up to the code of conduct.

Each method will now be discussed in turn.

### 1 Expressly Negotiated Contract

There is no legal limitation preventing companies from committing to ethical or social obligations through a contract under New Zealand law.<sup>66</sup> So long as the essential features of a valid contract are present — an agreement as to terms, an intention to create legal relations, consideration, and capacity to contract — the rights, obligations and terms of the contract defined by the parties will be binding in law.<sup>67</sup>

The code of conduct may be incorporated into supply contracts as a reference (for example, “the supplier agrees to adhere to the Code of Conduct annexed to this Agreement”) or as an express term (for example, “the supplier agrees not to engage in child labour”). The terms of a CSR code of conduct tend to be distinct from the “traditional” obligations in a supply of goods contract such as product description, quality and fitness for purpose.<sup>68</sup> An example of this method of incorporation is Gap's Code of Vendor Conduct, which is included in all of its supply contracts.<sup>69</sup> The Code “applies to all facilities that produce goods for Gap Inc. or any of its subsidiaries, divisions, affiliates or agents” and “sets forth the basic requirements that all facilities must meet in order to do business with Gap Inc”.<sup>70</sup>

While an expressly negotiated contract is the most legally certain way of incorporating a CSR code of conduct, the reality of business practice is that it is often impractical for companies to expressly negotiate contracts with each one of their suppliers.<sup>71</sup> Louise Vyoptil conducted a study of CSR supply chain codes of conduct in the Netherlands. She found that “[u]sing a CSR clause in a contract was the least popular option” among the 14 companies

66 Jeremy Finn and Stephen Todd “Introduction: The Nature of Contract” in Henry Holderness (ed) *Introduction to Commercial Law* (5th ed, LexisNexis, Wellington, 2016) 11 at 11–12.

67 John Shijian Mo *International Commercial Law* (4th ed, LexisNexis, Chatswood (NSW), 2009) at 37; and Finn and Todd “The Nature of Contract”, above n 66, at 12. See also CISG, arts 14–24.

68 McBarnet and Kurkchian, above n 47, at 65; and Beckers, above n 4, at 43.

69 *Code of Vendor Conduct* (Gap Inc, June 2016). See also Backer, above n 53, at 512.

70 *Code of Vendor Conduct*, above n 69.

71 McBarnet and Kurkchian, above n 47, at 68.

sampled.<sup>72</sup> Those companies that did include CSR clauses indicated that they only did so when the risk of CSR violations was high and extra attention was needed to be drawn to the CSR issues.<sup>73</sup>

## 2 *In the Buyer's General Terms and Conditions*

Incorporating CSR obligations through the buyer's terms and conditions is popular and the most common mechanism of incorporation.<sup>74</sup> It prevents wasting time in party negotiations for every order, and the buyer can easily include terms in their favour.<sup>75</sup> The reality of fast-paced industries (such as manufacturing) is that most supply chains are based on "soft contracts".<sup>76</sup> A "soft contract" is where the actual contract is short and minimalistic,<sup>77</sup> being later supplemented by email exchanges and a separate document containing standard form terms and conditions.<sup>78</sup>

New Zealand contract law recognises that a contract may comprise more than one document<sup>79</sup> and that the express obligations of the parties will be interpreted by the courts objectively, in consideration of the matrix of fact and common sense.<sup>80</sup> The buyer's general terms and conditions may be incorporated into the contract through various methods, including: reference to the terms and conditions, giving them to the other party at the formation of the contract, or even by implication from previous dealings between the same parties.<sup>81</sup>

A potential issue that could arise is known as the "battle of the forms", a situation where each party has their own set of contractual terms which provide for different legal obligations.<sup>82</sup> New Zealand law recognises only the last set of contractual terms proffered,<sup>83</sup> as the introduction of a party's own terms in response to the other party's terms is not an acceptance, but a counter-offer.<sup>84</sup> In order to ensure that the purchasing company does not become a "victim" to this battle of forms, the purchasing company must expressly receive the supplier's acceptance of the CSR Code of Conduct and their obligations under it.<sup>85</sup>

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72 Louise Vytopil "Contractual Control and Labour-Related CSR Norms in the Supply Chain: Dutch Best Practices" (2012) 8 *Utrecht Law Review* 155 at 167.

73 At 167.

74 Rühmkorf, above n 58, at 88; and McBarnet and Kurkchiyan, above n 47, at 69.

75 Rühmkorf, above n 58, at 88.

76 McBarnet and Kurkchiyan, above n 47, at 69.

77 At 69.

78 At 68.

79 Jeremy Finn and Stephen Todd "The Terms of the Contract" in Henry Holderness (ed) *Introduction to Commercial Law* (5th ed, LexisNexis, Wellington, 2016) 53 at 54.

80 At 56; and *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) at 912–913.

81 Beckers, above n 4, at 53.

82 At 54.

83 Jeremy Finn "The phenomena of agreement" in Jeremy Finn, Stephen Todd and Matthew Barber (eds) *Burrows, Finn and Todd on the Law of Contract in New Zealand* (6th ed, LexisNexis, Wellington, 2018), 37 at 60–61.

84 Finn and Todd "The Nature of Contract", above n 66, at 25.

85 Vytopil, above n 72, at 167.

### 3 *In the Buyer's Invitation to Tender*

Before entering into a contractual relationship with a supplier, a purchasing company may 'feel out' the potential supply pool through an invitation to tender. The purchasing company may wish to gauge the level of the potential supplier's commitment to CSR objectives by including the code of conduct into the invitation.<sup>86</sup> A potential method of determining this is through a questionnaire in which suppliers are required to complete, assessing how their current operations meet the purchasing company's standards in the code.<sup>87</sup> This may be particularly advantageous for companies that have previously suffered reputational damage and are sensitive to repeat occasions, such as H&M, Nike, and Gap on child labour issues.<sup>88</sup>

Incorporating the CSR code into the invitation to tender does not necessarily make it enforceable by the purchasing company against the supplier company. British Telecom has a practice of inviting potential suppliers to complete a questionnaire on "Sourcing with Human Dignity" to evaluate their current CSR practices and standards, and to adopt an appropriate approach to address areas that the supplier is found lacking under British Telecom's Sourcing with Human Dignity standards.<sup>89</sup> The responses can become part of the contract through either an expressly negotiated contract or the buyer's general terms and conditions.<sup>90</sup>

### 4 *As a Contractual Requirement for the Supplier to Sign Up to the Buyer's Code of Conduct*

The supplier could be asked to sign up to the buyer's code of conduct, which may be a general code or a supplier-specific one.<sup>91</sup> This method overcomes some of the issues identified above with (1) an expressly negotiated contract and (2) the buyer's general terms and conditions. It is a relatively easy method of incorporation given the fast-paced and often informal nature of business relations in a supply chain.<sup>92</sup> There is also no risk of a "battle of the forms" since the supplier company lacks the opportunity to proffer their own code of conduct. The study conducted by Louise Vytopil of Dutch companies found that almost all the companies preferred their supply partners to sign up to their codes of conduct.<sup>93</sup> A study conducted of small and medium-sized enterprises in Italy produced similar results.<sup>94</sup>

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86 Rühmkorf, above n 58, at 88.

87 McBarnet and Kurkchiyan, above n 47, at 69–70.

88 At 69–70.

89 *Generic Standard 18: Sourcing with Human Dignity* (BT Group, August 2017).

90 Rühmkorf, above n 58, at 88–89.

91 At 89.

92 McBarnet and Kurkchiyan, above n 47, at 68.

93 Vytopil, above n 72, at 166.

94 Francesco Ciliberti, Pierpaolo Pontrandolfo and Barbara Scozzi "Investigating corporate social responsibility in supply chains: a SME perspective" (2008) 16 *Journal of Cleaner Production* 1579 at 1585.

The only potential issue with this method of incorporation is that it does not per se incorporate the buyer's code into the supply contract.<sup>95</sup> A code of conduct is inherently a voluntary and general statement of principle without a corollary legal effect.<sup>96</sup> The purchasing company would need to be explicit that signing up to the code of conduct makes its content legally enforceable in the contract.<sup>97</sup>

## IV CRITICAL ANALYSIS OF THE PROPOSED SOLUTION

### The Strengths of the Proposed Solution

There are several benefits to incorporating a CSR code of conduct into the supplier contract as an enforceable clause:

1. it provides a clear legal remedy for the purchasing company;
2. it avoids the alternative of implying CSR terms into the contract;
3. it gives hard law legitimacy to the soft law recommendations and guidelines on CSR in supply chains;
4. it is a strong demonstration of the purchasing company's commitment to CSR; and
5. it helps rationalise and define CSR in the supply chain.

#### *1 Providing a Clear Legal Remedy For the Purchasing Company When the Code of Conduct is Breached*

When a purchasing company's code of conduct is included in a supply contract, the code becomes a binding contractual obligation for the supplier. Contractual remedies can be invoked against the supplier if the code is breached. The purchasing company has the choice of invoking the contractually agreed upon remedies, the remedies specified in the code, or general remedies available under contractual law.<sup>98</sup>

Non-conventional remedies for breaching the code can be developed, either through the code itself or the supplier contract. This is beneficial to the contracting parties as the remedies can reflect the unique nature of the CSR contractual obligations and can cater to the nature and extent of the breach. For example, the purchasing company may require the supplier to set up an improvement plan, participate in employee and manager training, or apply penalties.<sup>99</sup> The objective of these remedies is not focused on compensation but rather on ensuring compliance with the code in the future.<sup>100</sup>

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95 Rühmkorf, above n 58, at 89.

96 S Prakash Sethi "Standards for Corporate Conduct in the International Arena: Challenges and Opportunities for Multinational Corporations" (2002) 107 *Business and Society Review* 20 at 23.

97 Vytopil, above n 72, at 164.

98 Fabrizio Cafaggi "The Regulatory Functions of Transnational Commercial Contracts: New Architectures" (2013) 36 *Fordham Int'l LJ* 1557 at 1562–1563.

99 Beckers, above n 4, at 49.

100 Cafaggi, above n 98, at 1614–1615.

The purchasing company may also revert to the general remedies under contract law: repudiation of the contract or damages. The availability of either is dependent on whether the CSR code obligations have been incorporated as conditions, warranties or innominate terms. The common law definition of a “condition” is an essential term of the contract, the breach of which would be a substantial failure to perform the contract at all.<sup>101</sup> A breach of a condition gives the non-breaching party the right to either repudiate the contract,<sup>102</sup> or elect to treat it as a breach of warranty and claim damages.<sup>103</sup> The CCLA defines a “warranty” as:<sup>104</sup>

... an agreement with reference to goods that are the subject of a contract of sale, but collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.

Innominate terms are a common law “middle ground” option, developed in recognition of situations where it cannot be determined in advance whether a breach of a term will or will not constitute a substantial failure of the contract.<sup>105</sup> Instead, the courts determine the appropriate remedy at the time of the claim, in light of the nature, gravity, and effects of the particular breach.<sup>106</sup> Whether the obligations of the code of conduct in the supply contract are a condition, warranty or innominate term is dependent on the construction of the contract.<sup>107</sup>

The remedy of terminating a contract can be valuable to the purchasing company. Its use sends a strong message to the supplier firm and the purchasing company’s stakeholders that it takes compliance with its CSR obligations very seriously.<sup>108</sup> The mere threat of using this sanction could have a disciplining effect on the supplier firms.<sup>109</sup> Given its value, a purchasing company may wish to ensure they have the option to terminate through an express remedy, either in the supply contract or the code.<sup>110</sup>

## 2 *Avoiding the Alternative of Implying CSR Terms Into the Contract*

If a purchasing company does not incorporate their code of conduct into the supply contract and a breach occurs, the purchasing company cannot seek a remedy from the supplier company. The purchasing company would need to rely on the novel argument that the code of conduct was implied into the supply contract.

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101 *Wallis, Son & Wells v Pratt & Haynes* [1910] 2 KB 1003 at 1012.

102 CCLA, s 132(1).

103 Section 133(1).

104 Section 119(1).

105 Hawes, above n 61, at 269.

106 At 269.

107 CCLA, s 132(3).

108 Backer, above n 53, at 513.

109 Beckers, above n 4, at 125.

110 At 49.

### (a) Implied by Law

Part 3 of the CCLA implies certain terms on description,<sup>111</sup> quality<sup>112</sup> and fitness for purpose of goods<sup>113</sup> into all sale of goods contracts, unless they are expressly contracted out of.<sup>114</sup> Thus, the purchasing company could argue that their CSR standards qualify their expectations on quality, description or fitness for purpose of the goods.<sup>115</sup> Therefore, practices that breach the purchasing company's code of conduct breach the implied conditions of the contract. This would give the purchasing company the right either to terminate the contract,<sup>116</sup> or to treat the breach as a breach of warranty and claim damages from the supplier company.<sup>117</sup>

This argument for CSR standards as implied terms extends the traditional interpretation of implied terms of sale of good contracts. CSR standards are about ensuring compliance with “ethical process” whereas quality, fitness for purpose and description are about the physical characteristics of the product.<sup>118</sup> These terms on quality, fitness for purpose and description are implied into sale of goods contracts because they are express legal standards for which the courts have developed and defined specific requirements.<sup>119</sup> In order for a court to entertain the argument that CSR standards are implied in a supply contract as an aspect of quality, fitness for purpose or description of the goods, the purchasing company would need to convincingly argue that these standards are so widely recognised and accepted in sale of goods contracts that extension of the conventionally accepted meaning of these implied terms is warranted. Although the idea of labour and human rights standards in supply chains has gained recognition from the corporate sector and in international law, it would be difficult to present a case for the widespread incorporation and recognition of these standards in contracts for the supply of goods.

### (b) Implied by Custom

The purchasing company may argue that CSR obligations in supply relationships are a customary practice and therefore these standards should be implied terms in the supply contract to give it business efficacy.<sup>120</sup> The leading

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111 CCLA, s 136.

112 Section 139.

113 Section 138.

114 Section 197.

115 See Beckers, above n 4, at 110–118.

116 CCLA, s 132(1).

117 Section 133(1).

118 Cafaggi, above n 98, at 1597.

119 At 1586.

120 Matthew Barber “Contents of the contract” in Jeremy Finn, Stephen Todd and Matthew Barber (eds) *Burrows, Finn and Todd on the Law of Contract in New Zealand* (6th ed, LexisNexis, Wellington, 2018) 177 at 207–209.

case in New Zealand on implication by custom is *Woods v NJ Ellingham & Co Ltd*.<sup>121</sup> Henry J stated that for a custom to be implied, it must:<sup>122</sup>

1. have acquired such notoriety that the parties must be taken to have known of it and intended it should form part of the contract;
2. be certain;
3. be reasonable;
4. be proved by clear and convincing evidence; and
5. not be inconsistent with the express contract.

These five principles demonstrate that the courts tend to take a restrictive approach. This is due to the potentially significant effect that recognition of a custom can have on future contracts in that industry. For instance, if the courts accepted the argument that CSR standards are a customary practice of supply contracts, then over time the courts may come to assume that this practice forms the foundation of all contracts made within that trade, unless expressly excluded by the parties.<sup>123</sup> This may potentially be the case in the future if supply chain CSR continues to develop. However, it would be very difficult for a purchasing company to argue that there is presently a custom of addressing human and labour standards through the supply contract. This would be especially challenging if the company does not have its own supplier code of conduct.

### (c) Implied on the Facts

A purchasing company may argue, very specifically to the facts of its case, that principles of human and labour rights are of such significance to their operations that they must be implied in order to repair an intrinsic failure of expression in the contract.<sup>124</sup> The traditional test referred to for terms implied in fact is the Privy Council's five-point test in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings*.<sup>125</sup>

... (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that "it goes without saying"; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.

Lord Hoffmann proposed a more holistic approach to the *BP Refinery* test in *Attorney General of Belize v Belize Telecom Ltd*.<sup>126</sup> His Lordship described the *BP Refinery* list of criteria "as a collection of different ways in which

121 *Woods v NJ Ellingham & Co Ltd* [1977] 1 NZLR 218 (SC).

122 At 220–221; and Barber, above n 120, at 208–209. These principles have been applied in subsequent cases, such as *Everist v McEvedy* [1996] 3 NZLR 348 (HC) and *Mullaney v Brown* HC Auckland CIV-2008-404-6364, 14 July 2009.

123 Barber, above n 120, at 209.

124 At 216–226.

125 *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266 (PC) at 283.

126 *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988.

judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means”.<sup>127</sup>

However, subsequent judgments from the New Zealand Court of Appeal, such as *White v Reserve Bank of New Zealand*<sup>128</sup> and *Manukau Golf Club Inc v Shoye Venture Ltd*,<sup>129</sup> suggest that Lord Hoffmann’s approach in *Belize* is unlikely to gain precedence as “[t]he traditional approach is too well entrenched, and too useful, to be abandoned.”<sup>130</sup>

The *BP Refinery* test is very rigorous as the Courts recognise the potential intrusive effect of implying a term into a contract.<sup>131</sup> A purchasing company may have difficulty arguing that the CSR standards are implied terms, particularly if:

1. the company does not have supporting evidence of its commitment to CSR such as a code of conduct; and
2. there is a detailed written contract (there is a presumption that the parties have recorded the whole of their agreement).<sup>132</sup>

If the relationship between the purchaser and the supplier is based on a “soft contract”,<sup>133</sup> the purchaser may have greater success at arguing that implication of the CSR terms is necessary to make the contract workable and to give effect to the parties’ contractual intentions.<sup>134</sup> The Courts have somewhat relaxed the *BP Refinery* test for informal contracts. In *McNeill v Gould*, for example, the New Zealand Court of Appeal held that a term can be implied on the facts if the “goes without saying” element of the *BP Refinery* test alone is satisfied.<sup>135</sup>

### 3 Giving Hard Law Legitimacy to the Soft Law Recommendations and Guidelines on CSR in Supply Chains

The implementation of international human rights and labour standards through supply contracts makes them binding between private parties.<sup>136</sup> It also gives hard law legitimacy to non-binding CSR proclamations such as the *Guiding Principles on Business and Human Rights*.<sup>137</sup> The incorporation of these standards into commercial contracts expands the effects of these international instruments to the relationship between private parties and increases their effectiveness through enforcement under private law.<sup>138</sup>

127 At [27].

128 *White v Reserve Bank of New Zealand* [2013] NZCA 663 at [35].

129 *Manukau Golf Club Inc v Shoye Venture Ltd* [2012] NZCA 154, (2012) 21 PRNZ 235 at [29].

130 Barber, above n 120, at 222.

131 *Philips Electronique Grand Public SA v British Sky Broadcasting Ltd* [1995] EMLR 472 (CA) at 481.

132 Barber, above n 120, at 223.

133 See the earlier discussion in Part II regarding the incorporation of codes of conduct into supply contracts through the buyer’s terms and conditions.

134 Barber, above n 120, at 223–225.

135 *McNeill v Gould* (2002) 4 NZ ConvC 193,557 (CA) at [25]. In *BP Refinery*, above n 125, all five criteria were deemed necessary.

136 Cafaggi, above n 98, at 1565.

137 Saage-Maaß, above n 3, at 3–4.

138 Cafaggi, above n 98, at 1565. See also Fabrizio Cafaggi *Enforcement of Transnational Regulation: Ensuring Compliance in a Global World* (Edward Elgar Publishing, Cheltenham (UK), 2012).

#### 4 *Demonstrating a Strong Commitment by the Purchasing Company to CSR*

Purchasing companies have been heavily criticised in the context of supply chain CSR management for not “walk[ing] the talk”.<sup>139</sup> Incorporating the code of conduct into the supply contract has two effects. First, it demonstrates to the purchasing company’s stakeholders and supplier firms that it takes compliance with its CSR obligations very seriously.<sup>140</sup> Secondly, it gives contractual legitimacy to the purchasing company’s CSR standards.

#### 5 *Helping Rationalise and Define CSR in the Supply Chain*

There is currently a multitude of CSR instruments and potentially many CSR issues relevant to supply chains.<sup>141</sup> A code of conduct in a supply contract defines and clarifies the human rights and labour standards relevant to the purchasing company’s business. In turn, this can help assure that the entire supply chain of a company adheres to consistent and principled ethical standards.<sup>142</sup> It also systemises the purchasing company’s selection and retention process of suppliers.<sup>143</sup>

### **The Potential Negative Aspects and their Solutions**

There are several potential drawbacks with the proposal:

1. it may not necessarily ensure that the CSR standards are widely enforced throughout the supply chain;
2. there is a need to commit to a monitoring system in order to implement the proposal;
3. it may not be as effective for smaller purchasing companies and other companies with less coercive power over a supplier company; and
4. it could expose the purchasing company to legal action from third parties to the contract.

Further, the proposed contractual solution raises questions of whether:

1. the purpose of the solution is to protect the purchasing company from liability or to improve standards in the supply chain;
2. there is sufficient recognition of the purchasing company’s role in inducing the supplier’s breach of its CSR standards; and
3. the purchasing company’s enforcement of human rights and labour standards through the supply contract is a form of cultural imperialism.

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139 Andersen and Skjoett-Larsen, above n 53, at 75. See also Australian Human Rights Commission, Australian Centre for Corporate Social Responsibility and Global Compact Network Australia “Human rights in supply chains: Promoting positive practice” (Melbourne, December 2015) at 14.

140 Backer, above n 53, at 513.

141 Heli Wang and others (eds) “Corporate Social Responsibility: An Overview and New Research Directions” (2016) 59 AMJ 534 at 534.

142 Phillip H Rudolph “The History, Variations, Impact and Future of Self-Regulation” in Ramon Mullerat (ed) *Corporate Social Responsibility: The Corporate Governance of the 21st Century* (2nd ed, Kluwer Law International, Alphen aan den Rijn (Netherlands), 2011) 421 at 433.

143 At 433.

### 1 Weak Assurance That the CSR Standards are Projected and Enforced Throughout the Supply Chain

Many purchasing companies' global supply chains include several tiers of supplier factories. Often the work commissioned by the purchasing company is sub-contracted from the first-tier supplier to another factory which may sub-contract this work and so on.<sup>144</sup> For the proposed contractual solution to be effective regarding CSR, "companies need all firms in their own supply chain ... to act in a socially responsible manner".<sup>145</sup> The CSR Code obligations in the supply contract are limited to the parties to the contract, the purchasing company and the first-tier supplier,<sup>146</sup> by the doctrine of privity of contract.<sup>147</sup> However, a breach of the labour and human rights standards may occur further down the company's global supply chain. The media may then make the connection between the purchasing company and the supplier firm in breach and publicise this to the public even though the supplier firm in breach is, by contract, beyond the reach of the purchasing company. For instance, an investigation conducted by Associated Press in 2015 found that shrimp peeled by slave labourers in Thailand was being sold by global supermarkets.<sup>148</sup> The CEO of Thai Union, a leading global seafood supplier, stated that "despite our best efforts ... illicitly sourced product may have fraudulently entered [our] supply chain".<sup>149</sup> The issue of sub-contracting challenges the effectiveness of promoting labour and human rights standards through the supply contract.

There are several methods which may be adopted by the purchasing company to encourage dissipation of the CSR code obligations throughout the supply chain. First, the purchasing company could include a condition in the supply contract that the supplier may not contract with companies whose practices do not comply with the standards of the code of conduct.<sup>150</sup> However, the statement made by the CEO of Thai Union after the shrimp slave labour scandal makes it evident that this is already in practice. He confirmed that a supplier "was doing business with an unregistered pre-processor *in violation of our code of conduct*".<sup>151</sup> Secondly, if the supply contract contained an obligation not to sub-contract with CSR non-compliers, the purchasing company may instead sue the first-tier supplier for breach of contract.<sup>152</sup>

It should be noted that these solutions do not give the purchasing company the right to deal with the supplier who actually commits the breach directly. Rather, the supply contract provides an avenue for positively

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144 Mares, above n 2, at 98–100.

145 Ciliberti, Pontrandolfo and Scozzi, above n 94, at 1579.

146 Cafaggi, above n 98, at 1567.

147 Stephen Todd "Privity" in Jeremy Finn, Stephen Todd and Matthew Barber (eds) *Burrows, Finn and Todd on the Law of Contract in New Zealand* (6th ed, LexisNexis, Wellington, 2018) 559 at 560–561.

148 Margie Mason and others "Shrimp sold by global supermarkets is peeled by slave labourers in Thailand" *The Guardian* (online ed, London, 14 December 2015).

149 Mason and others, above n 148.

150 Cafaggi, above n 98, at 1577.

151 Mason and others, above n 148 (emphasis added).

152 Cafaggi, above n 98, at 1567–1568.

influencing the company's supply chain and coercing compliance with the CSR code of conduct.

## *2 There is a Need to Commit to a Monitoring System in Order to Implement the Proposal*

A monitoring system is important. Simple incorporation of CSR standards does not ensure compliance. Furthermore, unlike conventional standards of a sale of goods contract (on quality, fitness for purpose, and description), non-compliance with CSR obligations is not evident in the end-product supplied to the purchasing company. Thus, without a monitoring system, the only way the purchasing company would know of a breach of CSR obligations would be through the media or an NGO report. By this stage, the damage to the company's reputation could be so severe that the potential benefits of incorporating CSR into the contract would be rendered insignificant.

To secure the right to monitor, the purchasing company can include an express right to monitor compliance with the CSR code obligations in the supply contract.<sup>153</sup> A plausible means for securing effective monitoring and enforcement is social auditing. For instance, the Fair Labor Association (FLA) investigated the working conditions at Foxconn factories in China when Apple, a major client of Foxconn, became a member of the FLA.<sup>154</sup> The FLA investigation found serious instances of non-compliance with the FLA code of conduct, as well as Chinese labour law, which prompted Foxconn to adopt measures to address these issues.<sup>155</sup> Boots, a multinational corporation involved in the pharmaceutical and retail industries, reported that it identified 2,500 breaches through its supplier auditing programme in 2005.<sup>156</sup>

The purchasing company may choose to adopt either in-house social auditing or external social auditing. In-house social auditing has proven to be effective in exposing issues in supplier factories and it signals to suppliers the importance of the monitoring process.<sup>157</sup> External social auditing is a service provided by financial firms such as Ernst & Young and PricewaterhouseCoopers as well as specialised monitoring agencies.<sup>158</sup> External auditing, unlike in-house auditing, is recognised to be objective.<sup>159</sup> It can also decrease the burden on purchasing companies to detect violations and increase the effectiveness of the implementation of CSR throughout the supply chain.<sup>160</sup> In order to draw from the strengths of in-house and external auditing, companies may practice both at the same supplier factories, thereby

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153 McBarnet and Kurkchiyan, above n 47, at 75.

154 Peter S Hofman, Bin Wu and Kaiming Liu "Collaborative Socially Responsible Practices for Improving the Position of Chinese Workers in Global Supply Chains" (2014) 4 JCCA 111 at 118.

155 "Independent Investigation of Apple Supplier, Foxconn: Report Highlights" (March 2012) Fair Labor Association <[www.fairlabor.org](http://www.fairlabor.org)>.

156 See McBarnet and Kurkchiyan, above n 47, at 78.

157 At 76.

158 At 76; and Cafaggi, above n 98, at 1603–1608.

159 McBarnet and Kurkchiyan, above n 47, at 76–77.

160 Cafaggi, above n 98, at 1608.

producing two sets of findings that can be calibrated for the most comprehensive snapshot of CSR in the supplier factories.<sup>161</sup>

However, there are limits to the effectiveness of social auditing of suppliers as it is not foolproof in ensuring compliance with CSR standards. For instance, Indonesian workers in factories supplying Nike goods were told to lie to factory inspectors when asked if they used chemical agents.<sup>162</sup> The lie was effective as the inspectors reported that the factories did not use chemical agents to auditing firms such as PricewaterhouseCoopers.<sup>163</sup> Furthermore, whilst social auditing helps to avoid the most evident violations, it does not completely prevent the risk of having relationships with companies further down the supply chain that act in violation of the CSR standards.<sup>164</sup>

### *3 Potentially Not as Effective for Purchasing Companies with Less Coercive Power Over a Supplier Company*

The proposal assumes the purchasing company has superior bargaining power. However, this may not always be the case, such as with smaller purchasing companies and companies with less business with supplier companies. These companies will find it more challenging to incorporate a CSR code of conduct on their preferred terms into the supply contract<sup>165</sup> as the code obliges the supplier to comply with human rights and labour standards that are often above the industry standard or even the national standard.<sup>166</sup>

Incorporating the CSR code into the supply contract is arguably less effective in enforcing CSR compliance through the supply chain for these companies. This is evident in the exercise of the right to terminate the contract upon breach of the code obligations. The exit remedy is only effective if it is seen as a credible threat.<sup>167</sup> It will have little effect if the supplier's products are of vital importance to the buyer, or if the buyer's business is not a sufficient proportion of the supplier's profit.<sup>168</sup> Furthermore, the proposed solution to the lack of monitoring is for the purchasing company to conduct social auditing — whether in-house, external or both. This is quite a costly process of ensuring accountability — perhaps beyond the company's reasonable budget, considering its other interests in quality and price.<sup>169</sup>

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161 “Sourcing Overseas for the Retail sector: CSR and The Ethical Supply Chain” SlideShare – Sourcing Overseas for the Retail sector (2005) PricewaterhouseCoopers <www.slideshare.net>.

162 Mahmood Monshipouri, Claude E Welch Jr and Evan T Kennedy “Multinational Corporations and the Ethics of Global Responsibility: Problems and Possibilities” (2003) 25 Hum Rts Q 965 at 975–976 as cited in David Kinley (ed) *Human Rights and Corporations* (Ashgate, Farnham (UK), 2009) at 133–134.

163 At 133–134.

164 Ciliberti, Pontrandolfo and Scozzi, above n 94, at 1586.

165 McBarnet and Kurkchian, above n 47, at 87.

166 At 67.

167 Esben Rahbek Pedersen and Mette Andersen “Safeguarding corporate social responsibility (CSR) in global supply chains: how codes of conduct are managed in buyer-supplier relationships” (2006) 6 J Publ Aff 228 at 232.

168 At 232.

169 McBarnet and Kurkchian, above n 47, at 76.

#### *4 Could Expose the Purchasing Company to Legal Action from Third Parties to the Contract*

The incorporation of a CSR code of conduct into a supply contract has prompted arguments by scholars that third parties to the contract may be able to enforce them against the purchasing company. Therefore, the proposal may end up exposing the purchasing company to a greater risk of legal exposure. For instance, in response to the issue that workers lack the ability to invoke legal remedies for breach of their rights, some academics have argued that the CSR obligations in the supply contract are for the benefit of the workers and therefore they are parties to the contract.<sup>170</sup> Section 12 of the CCLA provides that a promise in a contract that confers, or purports to confer, a benefit on a person, who is not a party to the contract is enforceable by the beneficiary. However, this presumption can be rebutted by the parties to the supply contract if they can prove that the CSR obligations were not intended to create an obligation enforceable by the workers as the beneficiaries.<sup>171</sup> The legal exceptions to contractual privity on third party benefits are unlikely to bolster a claim by an employee of a supplier factory for obligations under the supply contract. Therefore, the threat of legal action is minimal.

There is a more credible risk of exposure to legal action from third parties in New Zealand, such as consumers, competitors and NGOs. It would be reasonable for the company to try and capitalise on its strong commitment to CSR by advertising to its customers the incorporation of a code of conduct into its supply contracts.<sup>172</sup> However, if there is a breach of the CSR standards in the supply contract and it is publicised by the media, consumers, competitor companies and NGOs could invoke the provisions under the Fair Trading Act on “false advertising”. For instance, s 10 requires that “no person shall, in trade, engage in conduct that is liable to mislead the public as to the nature, manufacturing process, characteristics ... of goods”.<sup>173</sup> Section 13 may also be relevant as it prohibits the use of false representations concerning goods or services.<sup>174</sup> Alternatively, the Commerce Commission can bring a claim under s 12A for “unsubstantiated representations”. There has not been a case brought under the Fair Trading Act based on a company’s CSR commitments so the likelihood of success, if such a claim were brought, is unclear.

#### *5 Is the Purpose of the Solution to Protect the Purchasing Company from Liability, or Improving Standards in the Supply Chain?*

It is questionable whether the sole purpose of CSR is to protect the purchasing company from liability for the supplier’s breach of labour or human rights standards. A critical actor absent from the proposed solution is the workers in

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170 Cafaggi, above n 98, at 1595; and Beckers, above n 4, at 132–136.

171 CCLA, s 13.

172 See the discussion in Part II regarding methods of incorporating codes of conduct into supply contracts.

173 Fair Trading Act 1986, s 10

174 *Commercial Law in New Zealand* (online looseleaf ed, LexisNexis, 2017) at [9.4.1].

the supplier factories. This is odd considering that the movement in favour of corporations' responsibility for promoting social standards in supply chains has been driven by the media and NGO concern for the workers as the direct victims of human and labour rights abuses.<sup>175</sup> Any solution proposed for supply chain CSR should therefore theoretically have these workers' interests in mind.<sup>176</sup> The supplier codes of conduct currently incorporated into supply contracts arguably do not.<sup>177</sup> The workers are not consulted in the process of drafting the supplier code of conduct and their lack of input is reflected in the types of issues which tend to be focused on in the codes, such as child labour and establishing trade unions.<sup>178</sup> Rather, they have been chosen because from the purchasing company's perspective, these are the issues that the media tend to focus on and that have the potential to cause the greatest harm to their reputation if traced to their supply chains.<sup>179</sup>

The remedies available in the supply contract may only be exercised by the purchasing company. Whether the workers benefit from these remedies is entirely up to the benevolence of the purchasing company. Interestingly, it is arguable that it would be unethical for a purchasing company to exercise its right to terminate a contract upon breach by the supplier even though it is potentially a very valuable legal remedy for the purchasing company.<sup>180</sup> To do so would be corporate *irresponsibility* as the purchasing company is abandoning the workers of the supply companies, once it has been revealed that their rights have been abused, without attempting to fix the situation.<sup>181</sup> Companies practicing supply chain CSR through the supply contract seem to recognise this. When Gap first enforced its Code of Conduct, it would terminate its contract with the supplier if child labourers were discovered at the factory.<sup>182</sup> However, Gap realised from their "experience over the years and extensive consultation with stakeholders that such a policy of immediate termination is not necessarily in the best interest of children".<sup>183</sup> Therefore, since 2006, Gap has imposed a new policy which requires that:<sup>184</sup>

... any underage workers found in a factory be immediately removed from the workplace, given access to schooling, paid an ongoing wage and guaranteed a job at the factory as soon as they reach the appropriate age.

The purpose of the policy is to provide greater incentives for the supplier factories to prohibit child labour.<sup>185</sup>

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175 See, for example, Birch, above n 14; and Fox, above n 15.

176 Cafaggi, above n 98, at 1592.

177 Garrett Brown "Corporate Social Responsibility Brings Limited Progress on Workplace Safety in Global Supply Chains" (2007) 69(8) Occupational Hazards 16 at 18 and 20.

178 Pedersen and Andersen, above n 167, at 231; and McBarnet and Kurkchiyan, above n 47, at 65.

179 See, for example, Birch, above n 14.

180 See the discussion in Part IV regarding remedies where a code of conduct is breached.

181 McBarnet and Kurkchiyan, above n 47, at 82.

182 *2005–2006 Social Responsibility Report* (Gap Inc, 2007) at 30.

183 At 30.

184 At 30.

185 Backer, above n 53, at 513.

Having greater worker contribution in the supply contract is not contrary to the ethos of the proposal to incorporate CSR code obligations. It may indeed be in the interests of the purchasing company to have a line of dialogue with suppliers' employees to ensure that the most important and effective issues are addressed. For example, the majority of workers in supplier factories are women and so the two most urgent needs from their perspective are the provision of safe transportation home and job security with pregnancy-induced breaks from work.<sup>186</sup> Worker and manager participation may also ensure effective monitoring of code implementation.<sup>187</sup> One example in a Chinese context is a worker's confidential hotline project that was set up in 2002, which was coordinated by Business for Social Responsibility and five multinational corporations including Nike and Adidas.<sup>188</sup> The hotline was aimed at two-way communication, to educate the workers on their rights and available resources and to relate workers' concerns to the supplier firms.<sup>189</sup> The project was successful in improving communication between the employees and the supplier firms, as well as educating the international players on the needs and concerns of the workers.<sup>190</sup>

#### *6 Does the Solution Sufficiently Recognise the Role of the Purchasing Company in Inducing the Supplier's Breach of its CSR Standards?*

The incorporation of CSR obligations into the supply contract does not sufficiently recognise the potential role of the purchasing company in inducing a breach of the CSR code obligations by the supplier. Nike convened a task force, chaired by its CEO, to look at its role in non-compliance of its suppliers and found that half of the instances of serious non-compliance could be traced back to its own demands for flexible production, fast turnaround, surge orders, changed orders and so forth.<sup>191</sup> The tensions between the purchasing companies' CSR obligations of supplier companies and its own practices have been described as a "transnationals' schizophrenic approach to supply chain management".<sup>192</sup> Suppliers are aware that the cheap and abundant labour in their countries was what attracted the manufacturing of the purchasing companies' goods to their factories. Therefore, a lack of change in the practices of the purchasing companies could lead a supplier to perceive the CSR obligations in the supply contract as mere publicity stunts.<sup>193</sup>

Credibility and sincerity of a purchasing company's commitment to CSR may be earned through a recognition of their own role in supply chain practices (as with Nike's task force), and by inviting suppliers to be part of the process of designing the objectives of the CSR policies in the supply

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186 McBarnet and Kurkchiyan, above n 47, at 89.

187 At 74.

188 Hofman, Wu and Liu, above n 154, at 128.

189 At 129.

190 At 130.

191 Rühmkorf, above n 58, at 88.

192 Brown, above n 177, at 18.

193 Kerr, Janda and Pitts, above n 5, at 559–560.

contract.<sup>194</sup> Furthermore, purchasing companies should recognise that they significantly benefit from a supplier's adherence to the CSR obligations in the supply contract. Therefore, they should contribute sufficient resources for the supplier factories to implement and maintain effective CSR programs.<sup>195</sup>

### *7 Is the Purchasing Company's Enforcement of Human Rights and Labour Standards Through the Supply Contract a Form of Cultural Imperialism?*

One criticism of human rights is that they are "standards that have been developed and enforced by the Western world".<sup>196</sup> The incorporation of a CSR Code into a supply contract and its enforcement by (predominately) Western purchasing companies can therefore be perceived by the supplier companies as a form of cultural imperialism.<sup>197</sup> This is especially true if the purchasing company drafts the CSR policies on the basis of their own conception of labour and human rights standards without recognising the local customs and circumstances.

Purchasing companies that develop CSR policies in a supply contract need to be sensitive to the local customs and circumstances if they want the supplier companies and their employees to be receptive to such standards.<sup>198</sup> For instance, a purchasing company contracting with a Chinese supplier firm would need to be aware of the generally negative perception of the strict environmental and social demands of international companies.<sup>199</sup> Experience has demonstrated that this resistance can be removed by proposing that the parties implement environmental and social projects together.<sup>200</sup> Furthermore, there is an assumption underlying supply chain CSR that the standards of the purchasing company are superior to those of the supplier company. However, it may just be a matter of cultural difference in understanding what constitutes a corporation's social responsibility. For instance, in Brazil, the concept of CSR tends to be much broader than the Western equivalent as it is connected with issues in the local society such as discrimination, inequality, corruption and lack of democracy.<sup>201</sup> Therefore, a purchasing company contracting with a Brazilian supplier firm would need to be aware that companies are expected to give a high priority to issues such as racial diversity within its employees and their average wage, as well as gender pay equality between male and female employees.<sup>202</sup>

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194 McBarnet and Kurkchiyan, above n 47, at 89.

195 Brown, above n 177, at 21.

196 Cramer, above n 44, at 54.

197 At 43.

198 Cramer, above n 44, at 68.

199 At 71.

200 At 71.

201 At 74.

202 At 72–73.

## Does the Proposed Solution of Incorporating a CSR Code of Conduct into the Supply Contract Withstand the Identified Issues?

The directors and CSR managers of a company must be confident that the potential benefits of a proposed CSR strategy outweigh the potential costs. Furthermore, the company must be assured that the strategy will positively promote labour and human rights issues in supply chains.

The benefits of the proposed contractual solution outweigh the potential costs as it is effective in protecting the interests of the purchasing company. The main benefit for a company committed to implementing CSR standards on human and labour rights in its supply chain is that the proposal brings hard, contract law legitimacy to the otherwise soft law area of supply chain CSR. Furthermore, the purchasing company can define the human rights and labour standards that it considers relevant and that the supplier companies will be obliged to observe.<sup>203</sup> If the standards of the contract are breached, then the purchasing company has clear legal remedies against the supplier: those stipulated in the contract or code of conduct, or those of general contract law. The alternative of trying to argue for the implication of CSR terms, through the CCLA, by custom or on the facts, demonstrates the value of having express CSR contractual terms.

Another benefit of the proposed contractual solution is that it is a strong demonstration of the purchasing company's commitment to CSR that can silence accusations that it does not "walk the talk" of CSR.<sup>204</sup> It can also improve its general reputation with its customers and the general public.<sup>205</sup> The proposed solution also gives the purchasing company a rationalised means of positively and effectively influencing the labour and human rights standards in their supply chains.<sup>206</sup> The CSR code of conduct in the first-tier supply contract can be reproduced throughout the supply chain by either suing the first-tier supplier for breach of contract, or requiring that the first-tier suppliers do not contract with non-complying companies.

For the contractual solution to be effective, the purchasing company will need to implement a monitoring system, such as social auditing, to complement the incorporated code of conduct. Social auditing can be a costly process and the purchasing company may need to practice in-house auditing as well as contract external auditors to maximise the effectiveness of the process. However, this is a reasonable expense for purchasing companies to adopt when compared to the potentially devastating costs of being linked to a

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203 There are many CSR-related instruments and issues potentially relevant to a supply chain.

204 Andersen and Skjoett-Larsen, above n 53, at 75.

205 Jennifer Aaker, Kathleen D Vohs and Cassie Mogilner "Nonprofits Are Seen as Warm and For-Profits as Competent: Firm Stereotypes Matter" (2010) 37 *Journal of Consumer Research* 224; Donald R Lichtenstein, Minette E Drumwright and Bridgette M Braig "The Effect of Corporate Social Responsibility on Customer Donations to Corporate-Supported Nonprofits" (2004) 68(4) *Journal of Marketing* 16; Steve Hoeffler and Kevin Lane Keller "Building Brand Equity through Corporate Societal Marketing" (2002) 21 *Journal of Public Policy & Marketing* 78; Henry B Hansmann "Reforming Nonprofit Corporation Law" (1981) 129 *U Pa L Rev* 497; and Jill Klein and Niraj Dawar "Corporate social responsibility and consumers' attributions and brand evaluations in a product-harm crisis" (2004) 21 *Intern J of Research in Marketing* 203.

206 Kerr, Janda and Pitts, above n 5, at 601.

human rights abuse scandal such as experienced by Nike in the 1990s.<sup>207</sup> It is acknowledged that for smaller companies or companies with fewer dealings with supplier factories, social auditing may make the costs of their social standards disproportionate to the potential profit and so the proposal is less attractive for these companies. The potential for legal action from third parties under the Fair Trading Act for breach of CSR standards is hypothetical; the argument has not been raised in New Zealand. Therefore, the benefits of the proposed contractual solution are not outweighed by the potential costs that may arise.

The other, more nuanced issues raised such as concerns of “cultural imperialism”, the pressure exerted by the purchasing companies and the lack of worker participation in the process are all matters that a company should take into consideration when incorporating the CSR code of conduct into the supply contract.

## V CONCLUSION

It is now accepted that corporations, as relevant and influential actors in global supply chains, have a duty known as supply chain CSR: to promote better labour and human rights standards in their supply chains.<sup>208</sup> This article proposes incorporating a CSR code of conduct into the supply contract between the purchasing company and the supplier company. There are many ways to incorporate a CSR code of conduct into the contract and many benefits of incorporating such rights and obligations. There are also potential issues associated with the proposed contractual method of implementing the code of conduct. However, companies cannot stand back and do nothing. They bear a social responsibility to promote better human rights and labour standards within their sphere of influence. The proposed contractual incorporation of a supplier CSR code of conduct into the supply contract is an effective method for purchasing companies to use their influence in a socially responsible manner whilst simultaneously protecting their own interests.

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207 Birch, above n 14.

208 Kerr, Janda and Pitts, above n 5, at 592; and Michael Hopkins and Ivor Hopkins “Labour Standards and Corporate Social Responsibility: The Need for a Planetary Bargain” in Ramon Mullerat (ed) *Corporate Social Responsibility: The Corporate Governance of the 21st Century* (2nd ed, Kluwer Law International, Alphen aan den Rijn (Netherlands), 2011) 157 at 164.