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# Private Regulatory Standards in Commercial Contracts: Questions of Compliance

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*Contract and Regulation* (Edward Elgar)

## 1. Introduction

Regulatory standards developed by non-state, private actors are regularly incorporated in contemporary commercial contracts between professional business parties, such as sales, supply, distribution and investment contracts. By incorporating these standards in commercial contracts, lead firms in the supply chain such as large retailers and brand-name companies, seek to ensure specific qualities of the goods and services they sell to consumers locally, yet source globally. The qualities these standards aim to ensure vary widely and concern (matters of) authenticity, safety, security, sustainability, traceability, welfare or any combination of these. Prominent examples of private regulatory standards that are applied in commercial contracts governing global supply chains include the Fair Labour Association's 'Code of Conduct' for workers involved in the production of goods such as electronics, apparel and footwear,<sup>1</sup> the Forest Stewardship Council's 'Principles and Criteria for Forest Stewardship' for sustainable forestry products,<sup>2</sup> and GLOBALG.A.P. standards for safe agricultural products that are grown by farmers with respect for the environment, workers' rights and animal welfare.<sup>3</sup>

The practice of incorporating private regulatory standards in commercial contracts regulatory global supply chains raises important (socio-)legal questions concerning the enforcement of compliance with these standards. First of all, the question emerges of whether these standards are binding under applicable theories of contract law. Do they create enforceable legal obligations for the parties to the contract? Does it matter whether the

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<sup>1</sup> Fair Labour Association, 'FLA Workplace Code of Conduct and Compliance Benchmarks' (2011) available at: [http://www.fairlabor.org/sites/default/files/fla\\_complete\\_code\\_and\\_benchmarks.pdf](http://www.fairlabor.org/sites/default/files/fla_complete_code_and_benchmarks.pdf), accessed 15 January 2016.

<sup>2</sup> Forest Stewardship Council, 'Principles and Criteria for Forest Stewardship' Version 5.2 (2015), available at: <https://ic.fsc.org/standards.340.htm>, accessed 15 January 2016.

<sup>3</sup> GLOBALG.A.P. has 16 different modules of its Integrated Farm Assurance Standard pertaining to these goals. See: GLOBALG.A.P., 'GLOBALG.A.P. Certification', available at: [http://www.globalgap.org/uk\\_en/what-we-do/globalg.a.p.-certification/globalg.a.p./](http://www.globalgap.org/uk_en/what-we-do/globalg.a.p.-certification/globalg.a.p./), accessed 15 January 2016.

standards are incorporated as express terms in the written contract, in the general terms and conditions of the contract, or simply by reference? Once private regulatory standards are considered binding under the applicable contract law, further questions arise as regards what substantive obligations are created, against whom, and by whom those obligations be enforced: When does a party perform under the contract and what constitutes a breach of contract? Which means or institutional arrangements are deployed to assess and enforce compliance? What remedies and sanctions do these mechanisms use to promote, sanction and restore compliance? Finally, to what extent may third parties (consumers, communities, NGOs or other beneficiaries of the standards) enforce compliance?

It is these questions relating to the substantive and procedural aspects of compliance with private regulatory standards in commercial contracts that this Chapter seeks to discuss. In doing so, it builds on available empirical evidence on the growing practice of incorporating private regulatory standards in commercial contracts. To provide a deeper understanding of why and when the incorporation of private regulatory standards in commercial contracts raises (socio-)legal questions on compliance, the Chapter will first provide an account of the nature, drivers and scale of this practice (Section 2). Subsequently, it discusses the legal forms and techniques used to incorporate these standards in commercial contracts, and the legal implications thereof (Section 3). Section 4 then turns to the mechanisms commonly used in practice to assess and enforce compliance with private regulatory standards incorporated in commercial contracts. As will be argued, private compliance mechanisms are the common sites of compliance and enforcement, offering obvious benefits for those firms imposing compliance with the standards in commercial contracts. Section 5 considers the relevance of contract law interpretation in the rare event that regulatory non-compliance is addressed through court litigation. Section 6 offers brief conclusions.

## **2. Private regulatory standards in contractual practice: nature, drivers and scale**

To better understand why and when the incorporation of private regulatory standards in commercial contracts raises (socio-)legal questions on compliance, this section addresses three interrelated questions:

- a. What is the nature of private regulatory standards?
- b. What are the drivers for their use and incorporation into commercial contracts?
- c. How much of such incorporation is actually going on?

### *a. Nature*

Private regulatory standards are norms developed by non-state, private actors with the view to steer and influence commercial activities of businesses. In a narrow sense, the concept of standards is used to refer to the standards developed by technical standardization bodies, such as the International Standardization Organization (ISO) and its sectoral, regional and national equivalents.<sup>4</sup> More broadly, regulatory standards are conceived as ‘the norms, goals, objectives or rules around which a regulatory regime is organised’ and ‘express, if not the broad outcomes intended for a regime, then at least some aspect of the behaviour which participants in the regime are intended to adhere to.’<sup>5</sup> These regulatory standards are considered ‘private’ if set by businesses, associations, civil society or a combination thereof.<sup>6</sup> Nevertheless, their content may be derived from national or international public law standards (e.g. human rights, UN Global Compact, national safety and quality standards).<sup>7</sup> Finally, private regulatory standards go by many different names and have been identified, amongst others, as codes of conduct, criteria, guidelines, policies, principles and rulebooks.

Common to private regulatory standards is that they are ‘voluntary’ in the sense that the addressees of the standards can choose to abide by them.<sup>8</sup> Unlike public regulatory standards, addressees need to accept private standards before they become legally binding upon them. Contract law determines the conditions for such binding effect, but also the law of associations provides conditions on how and when individuals, firms or others that join associations are bound by the standards set by these bodies. Only if these conditions are met, compliance with the private standards is no longer elective and can be enforced through competent adjudicatory bodies, such as a court or arbitration institution.<sup>9</sup> Obviously, the voluntariness of private standards can be compromised, for example because markets or local

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<sup>4</sup> See in detail on technical standardization e.g., K. Tamm Hallström, *Organizing International Standardization. ISO and the IASC in Quest for Authority* (Edward Elgar 2004), H. Schepel, *The Constitution of Private Governance. Product Standards in the Regulation of Integrating Markets* (Hart Publishing, Oxford 2005), T. Büthe and W. Mattli, *The New Global Rulers. The Privatization of Regulation in the World Economy* (Princeton University Press, Princeton 2011).

<sup>5</sup> C. Scott, ‘Standard-setting in Regulatory Regimes’ in M. Cave, R. Baldwin and M. Lodge (eds) *The Oxford Handbook of Regulation* (Oxford University Press, Oxford 2010), pp. 104-119, at 104.

<sup>6</sup> ‘Private’ thus refers to a sense of ownership of the standards: if they are set and administered by private constituents they are private, while they are considered public if adopted through recognised institutions of public law. See also: C. Scott, ‘Private Regulation of the Public Sector: A Neglected Facet of Contemporary Governance’ (2002) *Journal of Law and Society* 29(1), 56-76, at 58.

<sup>7</sup> This effectively blurs the distinction between public/private regulation. See in detail F. Cafaggi, ‘New Foundations of Transnational Private Regulation’ (2011) 38 *Journal of Law and Society* 20-49, 39ff. However, important legal differences remain as regards the binding effect of both types of regulatory standards, as explained below.

<sup>8</sup> See also: S. Ponte, P. Gibbon, and J. Vestergaard, ‘Governing through Standards: An Introduction’, in S. Ponte, P. Gibbon, and J. Vestergaard (eds), *Governing through Standards. Origins, Drivers and Limitations* (Palgrave Macmillan, 2011), pp. 1-24, 2.

<sup>9</sup> Cafaggi 2011 (n 7), 22.

communities require adherence to them for the purpose of doing business, or when state actors integrate them in legislative arrangements. Without such integration, however, the addressees of the private standard must first commit to the standard, either by accepting them as (part of) a contract or by becoming a member of an association, before they are legally bound by these standards.

An important distinction among (private) regulatory standards concerns *product* and *process standards*.<sup>10</sup> Product standards set out specifications for the design and performance characteristics of goods and services. They may prescribe physical attributes for products, such as dimensions, size, the use of certain materials, but may also concern requirements of what a product must be able to do. Examples of such performance characteristics concern the interoperability with other products, resistance to temperature exposure and the level of safety. Process standards concern specifications for the way in which goods must be produced or services must be provided. They may require the use of certain production or testing methods, for example. Key examples come from the field of health and environmental protection, where the focus of regulatory standards often concerns the process for producing products (e.g. working hours or the level of emissions) rather than the product itself.<sup>11</sup>

It has been observed that there has been a move from product to process standards with the rise of sustainability standards, which are concerned with environmental, social and welfare matters concerned in the production of commodities.<sup>12</sup> Sustainability standards often comprise a combination of both product and process standards. At the same time, standards concerned with the management of qualities and risks related to the production process of goods and provision of services, so-called '*management system standards*', have become increasingly popular.<sup>13</sup> These standards are closely related to process standards and have been developed for specific domains and topics by international standardization organizations.<sup>14</sup> Also codes of conduct in the area of CSR may incorporate management system standards.<sup>15</sup>

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<sup>10</sup> N. Brunsson and B. Jacobsson, *A World of Standards* (OUP 2001), 4-5.

<sup>11</sup> Standards laying down performance and process requirements may equally apply to services. International accounting standards provide an illustration of such standards for service providers. See for an analysis of the development of these standards: S. Botzem, *The Politics of Accounting Regulation. Organizing Transnational Standard Setting in Financial Reporting* (Edward Elgar 2012).

<sup>12</sup> Cafaggi 2011 (n 7), 29.

<sup>13</sup> Brunsson and Jacobsson 2001 (n 10), 4 and M. Power, *The Audit Society: Rituals of Verification* (OUP 1999), 57ff.

<sup>14</sup> Important examples are ISO Standards ISO 9001:2015 (Quality management systems), ISO 14001:2015 (Environmental management systems), ISO 22000 (Food safety management systems) and ISO 26000 (Social responsibility).

<sup>15</sup> See for example the Fair Labour Association's 'Code of Conduct' (n 1), which requires employers to have in place a health, safety, and environmental management system (Section ER.31).

The increased practical importance of process and management systems standards has significant implications for (assessing) compliance with these standards when incorporated in commercial contracts. Traditionally, non-compliance with contractual obligations, i.e. breach of contract, is discovered by the buyer after inspection, use or consumption of the commodity. This approach does not work for the goods and services in relation to which the private regulatory standards discussed here apply. As noted, these process standards aim to warrant environmental, social and welfare aspects of production and require the implementation of a management system ensuring these attributes. These aspects are indeed credence qualities of the goods and services, meaning that the buyer cannot assess their presence and utility, even after consumption, or only at great costs. Accordingly, different mechanisms are needed to overcome the information asymmetry between the seller and buyer (and other firms in the supply chain) and enable compliance assessment. Certification and accreditations schemes have developed as key institutional arrangements to fill the monitoring and compliance gap.<sup>16</sup> In Section 3, we will return to these arrangements in detail.

*b. Drivers*

In the burgeoning literature on private regulatory standards five different yet interrelated circumstances are identified that drive the emergence of such standards and their inclusion in commercial contracts.<sup>17</sup> The first factor concerns the phenomenon of *globalisation* and the creation of global supply chains. Cross-border trade in goods and services has increased rapidly in the past two decades. As goods and services are sold across numerous territorial borders, the transaction costs of controlling the quality and (thus) conformity increase greatly. Buyers cannot easily inspect the commodities given the physical distance with the seller. If the traded goods and services possess credence qualities, such as attributes related to the environmental, social and welfare aspects of production, compliance assessment becomes even more costly. Moreover, the distance commodities may now travel before they are consumed can create systematic risks of safety incidents, as is the case for food.<sup>18</sup> By including private regulatory standards in commercial contracts, large firms at the end of the supply chain seek to manage compliance and control liability risks, while at the same time

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<sup>16</sup> M. Blair, C. Williams and L. Lin, 'The New Role for Assurance Services in Global Commerce' (2008) *Journal of Corporation Law* 33(2), 325-360, at 355 and T Bartley, 'Certification as Mode of Social Regulation', in D Levi-Faur (ed), *Handbook on the Politics of Regulation* (Edward Elgar 2011) 445.

<sup>17</sup> This section and the following build on P. Verbruggen, 'Regulatory governance by contract: the rise of regulatory standards in commercial contracts', *Recht der Werkelijkheid/Cahiers d'Anthropologie du Droit* (2014) 35(3), p. 79-100. See also Beckers in this volume concerning corporate codes of conduct.

<sup>18</sup> D Fuchs, A Kalfagianni 'The Causes and Consequences of Private Food Governance' (2010) *Business and Politics*, 12(3), Article 2, at 12.

shifting the costs of ensuring and monitoring (credence) qualities to firms higher up the chain. It is in these so-called ‘buyer-driven commodity chains’, i.e. supply chains of commodity in which retailers and brand-name companies (the buyers) structure trade in commodities along the (global) supply chain using a variety of sourcing and contracting arrangements,<sup>19</sup> that private regulatory standards are increasingly found as part of commercial contracts.

A second driver of the increased use of private regulatory standards in commercial contracts is described as the *(inter)governmental failure* to devise rules that effectively address the concerns raised by global supply chains. As Vandenberg notes, the inclusion of private regulatory standards concerning environmental performance in commercial contracts to steer behaviour along the supply chain emerged to fill the gap in public regulation concerning exporting firms’ environmental behaviour.<sup>20</sup> Others note, however, that the inability or unwillingness of nation states and international governmental organisations to effectively regulate externalities related to transnational business activities – which do not concern environmental degradation alone, but extend to issues of poor working conditions, child labour and consumer protection – not only concerns the weakness of states as international lawmakers, but also relates to their poor record at monitoring and enforcing existing regulation.<sup>21</sup>

A third driver is the risk of *liability*. Firms may be held liable for selling or placing on the market products that have been produced in breach of safety standards. For food products in particular the potential for liability of food manufacturers and supermarket chains has been considered key in explaining the rise of private food safety standards. The introduction of strict liability under criminal law for food retailers and producers in the United Kingdom sparked the advent of such regulatory standards worldwide.<sup>22</sup> It implied that in the event of a food safety incident, food producers and retailers could be held criminally liable for the breach of food safety requirements without the need to prove fault, unless they could show

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<sup>19</sup> G. Gereffi, ‘The Organisation of Buyer-driven Global Commodity Chains: How U.S. Retailers Shape Overseas Production Networks’, in G. Gereffi and M. Korzeniewicz (eds), *Commodity Chains and Global Capitalism*, Westport, CT: Praeger 1994, pp. 95-122

<sup>20</sup> M. Vandenberg, ‘The New Wal-Mart Effect: The Role of Private Contracting in Global Governance’, (2007) *UCLA Law Review* 54(4), 913-970, at 921. See also F. Mayer and G. Gereffi, ‘Regulation and Economic Globalization: Prospects and Limits of Private Governance’ (2010) *Business and Politics* 12(3), article 11, at 4-5 and A. Beckers, *Enforcing Corporate Social Responsibility Codes. On Global Self-regulation and National Private Law* (Hart Publishing, Oxford 2015), 9-13.

<sup>21</sup> D. McBarnet, and M. Kurkchyan, ‘Corporate social responsibility through contractual control? Global supply chains and “other-regulation,”’ in D. McBarnet, A. Voiculescu, and T. Campbell (eds.), *The New Corporate Accountability: Corporate Social Responsibility and the Law*, pp. 59-92, Cambridge University Press, Cambridge 2007, p 66-67 and Cafaggi 2011 (n 7), 26-27.

<sup>22</sup> L. Fulponi, ‘Private Voluntary Standards in the Food System: The Perspective of Major Food Retailers in OECD Countries’ (2006) *Food Policy*, 31(1), 1-13, at 9-10. See in general P. Verbruggen & T. Havinga, *Hybridization of Food Governance: Types, Trends and Results*, Edward Elgar, Cheltenham 2016.

they had exercised all due diligence to avoid committing the offence. To develop such a ‘due diligence defence’, retailers in Britain created elaborate assurance systems of their own, involving a set of food safety norms, and procedures for monitoring and enforcing compliance with those norms.<sup>23</sup> These norms and procedures are made binding upon suppliers as they are incorporated in the supply contracts used by the retailers.

Liability may trigger huge *reputational concerns* for companies, which can be seen a fourth driver for the incorporation of private regulatory standards in commercial contracts. Even if courts do not formally establish liability, firms may see their reputation crippled if firms that are part of their supply chain turn out to flagrantly breach accepted standards of production, in particular human rights. Well-publicized scandals, often backed by fierce NGO campaigns, have spurred firms to set up elaborate CSR policies that are implemented in supply chain contracts.<sup>24</sup> Reputational concerns have also driven the emergence of private safety standards and certification schemes in the food industry. In the last two decades, a number of high-profile outbreaks of food-borne diseases have had a considerable impact on the reputation of the food industry, and food retailers viewed the adoption of private standards as a key strategy to build and improve their reputation.<sup>25</sup> The use of private regulatory standards, and their implementation via the inclusion in commercial contracts is thus not only a mechanism to protect a company’s reputation, but also to further develop it and contribute to the branding of products.

Finally, broader social and economic trends have also changed the *expectations and preferences of consumers* with respect to the products they buy. Consumers in Western countries are increasingly sensitive to reliable information about the credence attributes of goods and services, such as environmental sustainability, labour rights and worker welfare.<sup>26</sup> For food products these issues, together with the quality and safety of food, animal welfare, as well as gustatory attributes (e.g. taste, smell, and texture of food) are considered very

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<sup>23</sup> S. Henson, J. Northen, ‘Economic Determinants of Food Safety Controls in the Supply of Retailer Own-branded Products in the UK’ (1998) *Agribusiness* 14(2), 113-126.

<sup>24</sup> A telling example is the case of Nike, which had experienced several ‘public relations nightmares’ in the 1980s concerning underpaid workers, child labour, and poor working conditions, which severely stained Nike’s brand image and led to the creation of a company code of conduct for suppliers that is incorporated in its commercial contracts. See: R.M. Locke, *The Promise and Limits of Private Power. Promoting Labor Standards in a Global Economy*, Cambridge University Press, Cambridge 2013, 49. See for other examples: McBarnet & Kurkchian 2007 (n 21), 63.

<sup>25</sup> Fulponi 2006 (n 22), 6.

<sup>26</sup> K. Elliott, ‘Is My Fair Trade Coffee Really Fair? Trends and Challenges in Fair Trade Certification’, (2012) Center for Global Development Policy Paper no. 17 Washington DC, available at: <<http://www.cgdev.org/content/publications/detail/1426831>> (accessed 15 January 2016), 11-13.

important nowadays.<sup>27</sup> Private regulatory standards and accompanying strategies of labelling or certification, which are typically implemented via commercial contracts along the supply chain, enable the industry to respond to these consumer preferences.

*c. Scale*

Several authors provide valuable insights about the use of private regulatory standards in commercial contracts by specific companies, in specific sectors or in specific countries.<sup>28</sup> In the area of CSR several more systematic and empirical studies have been conducted to assess the extent to which multinational corporations use private regulatory standards to regulate their supply chain. For example, McBarnet and Kurkchian have assessed the corporate codes of conduct, websites and CSR reports of 35 multinational corporations listed on the London Stock Exchange FTSE 100, and five foreign multinational corporations, as well as government and NGO reports on these corporate sources. The document analysis was supplemented with telephone interviews with officials at some of these companies and three NGOs.<sup>29</sup> The analysis uncovers an emerging trend towards contractual control of CSR performance by suppliers. As McBarnet and Kurkchian note ‘Best practice is increasingly being treated as setting up a contractual obligation on suppliers to meet specific CSR standards. (...) Companies already adopting this approach are addressing it in stages, usually adding the CSR terms on the next occasion when a contract comes up for renewal, with some committing to a timed schedule for having all suppliers on CSR inclusive contracts, and ‘global templates’ for contracts which include CSR being developed.’<sup>30</sup> Environmental performance is addressed in contracts, but the primary concern of most companies relates to working conditions and child labour. As such, contracts impose CSR standards that stem from accepted international conventions, such as those of the International Labour Organisation.<sup>31</sup>

More recently Vytopil conducted a study of the use of CSR related standards in commercial contracts concluded by multinational corporations incorporated in the Netherlands (13), United Kingdom (12) and California, United States (12).<sup>32</sup> She assessed the

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<sup>27</sup> Fulponi 2006 (n 22), 7-8.

<sup>28</sup> See e.g.: L.-W. Lin, ‘Legal Transplants Through Private Contracting: Codes of Vendor Conduct in Global Supply Chains as an Example’, *American Journal of Comparative Law* (2009) 57(3), p. 711-744; F. Cafaggi, ‘The Regulatory Functions of Transnational Commercial Contracts: New Architectures’, *Fordham International Law Journal* 2013 (36)6, p. 1557-1618 and K. Peterková Mitkidis, ‘Using Private Contracts for Climate Change Mitigation’, *Groningen Journal of International Law* (2014) 2(1), 54-80.

<sup>29</sup> McBarnet & Kurkchian 2007 (n 21), 61-62.

<sup>30</sup> *Ibid.*, p. 65.

<sup>31</sup> *Ibid.*, p. 65-68.

<sup>32</sup> L. Vytopil, *Contractual Control in the Supply Chain: On Corporate Social Responsibility, Codes of Conduct, Contracts and (Avoiding) Liability* (Eleven International Publishing: The Hague 2015), p. 117-140.

CSR policies of the multinational corporations in her sample, as well as the contracts, related general terms and conditions these corporations use to imbed their policies. Accordingly, she mapped and rated the content of the CSR policies and assesses their legal consequences under the private law applicable to the operations of the corporations. Vytopil finds that all but three corporations in the sample deploy codes of conduct as instruments of their CSR policies. Corporations using these codes make them binding upon suppliers by requiring them to sign the code or by incorporating the code in a contractual arrangement with the supplier, either by reference or as general terms. Interestingly, in the Dutch sample the majority of the codes oblige the supplier to require its own supplier to agree to the content of the code and pass this obligation on to other suppliers positioned further up the supply chain.<sup>33</sup>

Also in the area of environmental protection, private regulatory standards are frequently included in commercial contracts as part of company policies on sustainability. A key standard used in this domain is ISO 14001. This private standard is the most widely adopted environmental management standard in the world and has been reported to enhance environmental performance of firms.<sup>34</sup> More insights on the use of ISO 14001 and other private regulatory standards such as supplier codes of conduct on the use of environmentally responsible manufacturing practices is provided by a recent survey held by the Conference Board in corporation with Bloomberg and the Global Reporting Initiative.<sup>35</sup> Nearly 40 per cent of the surveyed corporations in the Bloomberg ESG 3000 index (3000 European and Japanese companies) reported that they impose private regulatory standards concerning environmental performance on actors in their supply chains through commercial contracts and procurement policies, compared to almost 30 per cent of the companies in the S&P 500 index (500 American companies).<sup>36</sup>

The 2012 Conference Board survey thus draws attention to the importance of private procurement as an instrument to ensure compliance with private regulatory standards. Lead firms in buyer-driven commodity chains frequently have in place private procurement policies as a way to organize the supply of goods and services to them and to vet potential suppliers. Similar to procurement by state authorities, private procurement may be organized through a tendering or bidding process. As the survey illustrates, compliance with private regulatory standards is used as a condition for suppliers to compete for a contract. Accordingly, suppliers

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<sup>33</sup> Ibid, p. 124.

<sup>34</sup> M. Potoski, A. Prakash 'Do Voluntary Programs Reduce Pollutions? Examining ISO 14000's Effectiveness across Countries' (2013) *The Policy Studies Journal* 41(2), 273-294.

<sup>35</sup> The Conference Board, 'Sustainability Practices. 2012 Edition', Research Report R-1493-12-RR, available at: <https://www.uvic.ca/gustavson/cssi/assets/docs/Sustainability-practices2012.pdf>, accessed 15 January 2016.

<sup>36</sup> Ibid, p. 101.

may only be eligible for a supply contract after demonstrating compliance with a particular standard set or applied by the lead firm. Compliance with private standards then becomes a *de facto* obligation to gain market access and corporate procurement policies facilitate such *ex ante* compliance. In Section 5, we will return to this issue in detail.

In the area of food, too, commercial contracts include private regulatory standards to govern transnational supply chains. Private food standards or the certification schemes that implement and monitor compliance with these standards are typically incorporated in supply contracts that food retailers or manufacturers conclude with their suppliers.<sup>37</sup> The use of private standards and supplementary certification schemes is widespread in the food industry. In a survey held among quality and safety directors of major food retailers in OECD countries, the respondents estimated that between 75 and 99 per cent of all food products supplied are certified on the basis of private food standards.<sup>38</sup> Franchise agreements are also said to enhance the uptake of private standards by food business operators.<sup>39</sup>

### **3. Incorporating private regulatory standards in contracts: forms and legal implications**

Empirical studies on the use of private regulatory standards identify different ways in which such standards are incorporated in commercial contracts. Four modes of explicit incorporation can be distinguished using two variables, namely where standards are included (in the contract itself or auxiliary documents) and how they are communicated (*in verbatim* or by reference).<sup>40</sup> First, private regulatory standards are included in the contract itself as express terms, detailing all the specific norms of the standard *in verbatim*. More common, however, is the practice of incorporation by reference. In that case, a contractual term requires the business partner to follow the standard(s) that is (are) referred to.<sup>41</sup> In this regard, Cafaggi has

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<sup>37</sup> See in general: T. Havinga, 'Private Regulation of Food Safety by Supermarkets' (2006) *Law & Policy* 28(4), 515-533; F. Cafaggi, 'Transnational Governance by Contract: Private Regulation and Contractual Networks in Food Safety' in A. Marx et al (eds), *Private Standards and Global Governance: Economic, Legal and Political Perspectives*, pp 195-234, Edward Elgar, Cheltenham 2012; P. Verbruggen, *Enforcing Transnational Private Regulation: A Comparative Analysis of Advertising and Food Safety*, Edward Elgar, Cheltenham 2014, 168-171.

<sup>38</sup> Fulponi 2006 (n 22), 6.

<sup>39</sup> Brons-Stikkelbroeck, E. (2011) 'Franchising Strengthens the Use of Private Food Standards', in B. van der Meulen (ed), *Private Food Law*, pp. 255-264, Wageningen Academic Publishers, Wageningen. See more generally on the importance of franchise agreements for the implementation of regulatory standards: Scott 2010 (n 5), 106-107.

<sup>40</sup> See for the question of whether private regulatory standards may be part of a contract as implied terms under English and German contract law Beckers 2015 (n 20), 58-81 and under international commercial law K. Peterková Mitkidis, 'Sustainability Clauses in International Supply Chain Contracts: Regulation, Enforceability and Effects of Ethical Requirements' *Nordic Journal of Commercial Law* (2014) 11(1), 1-30, at 14-15.

<sup>41</sup> An example is provided by the supply contracts that the biggest importer in the world of bananas (Chiquita) concludes with its suppliers ('Chiquita International Banana Purchase Agreement'), which incorporates the following clauses: 'The SELLER and the PRODUCERS commit to maintain the certification under the [Social Accountability International] SA-8000 standard during the term of the agreement hereof.' (Article 6.1.5), 'Both,

noted that express warranties and obligations to deliver conforming goods are the main loci in commercial contracts where one will find duties to comply with regulatory standards. In buyer-driven commodity chains, suppliers – even those positioned higher up the supply chain – will often subscribe to express warranties that require them to comply with these standards or obtain certification testifying to such compliance. Cafaggi thus contends that express warranties are therefore changing their original functions: while express warranties have conventionally reflected market standards, they are now integrating regulatory provisions to make different remedies and sanctions available to buyers to ensure compliance.<sup>42</sup>

Instead of incorporating private regulatory standards in a written commercial contract, they are also included in auxiliary documents of the contract, such as (non-negotiated) general terms and conditions,<sup>43</sup> umbrella agreements that serve as a frame in long-term contractual relations on the supply of goods or services,<sup>44</sup> or supplementary agreements that specifically impose regulatory obligations on the supplier.<sup>45</sup> Also here the standards can be communicated in full or by simple reference. In the former case, the private standards themselves may constitute general terms and conditions to the commercial contract.

Distinguishing between the modes of incorporation of private regulatory standards in commercial contracts is important since contract law may specify different conditions for these standards to gain binding effect. However, scholars that have analyzed the practice of such incorporation do not consider contract law to impose strict barriers that prevent private regulatory standards from gaining binding effect when they are expressly including in the

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the SELLER and the PRODUCERS agree to (...) Maintain, during the term of this agreement, the certification under the Better Banana Program of the Rainforest Alliance, in those farms that comprise the PLANTATION and already have it.' (Article 6.1.6.2) and 'The SELLER commits to make its industrial and cultivation practices at the PLANTATION conform to the GLOBALGAP standard at the time this agreement is signed (Article 6.1.7), available at: <<http://www.sec.gov/Archives/edgar/data/101063/000119312508042574/dex1016.htm>> accessed 15 January 2016. See for more examples: Cafaggi 2013 (n 28), 1585-1586ff.

<sup>42</sup> Cafaggi 2013 (n 28), 1586-1587.

<sup>43</sup> Unilever, 'General Terms and Conditions for the Purchase of Products and Services' (Version 1 November 2015), available at: [https://www.unilever.com/Images/2015.11.01---global-purchasing-gtcs---final---clean-without-signature-block---english\\_tcm244-417216\\_1\\_en.pdf](https://www.unilever.com/Images/2015.11.01---global-purchasing-gtcs---final---clean-without-signature-block---english_tcm244-417216_1_en.pdf), accessed 15 January 2016. See in detail text at n 49-52 *infra*.

<sup>44</sup> See for a description of this practice in the domain of CSR: McBarnet & Kurkchian 2007 (n 21), 69 and 73-74.

<sup>45</sup> A example of this form is Hewlett-Packard's (HP) 'Supplier Social & Environmental Responsibility Agreement', which is intended to supplement any and all contracts and agreements with its suppliers for the supply of goods or services. In this agreement the supplier 'will be responsible for identifying any areas of its operations that do not conform to HP's Supplier Code of Conduct and HP's General Specification for the Environment and for implementing and monitoring improvement programs designed to achieve HP Supplier Code of Conduct and HP's General Specification for the Environment' (Article 1.2). See: Hewlett-Packard, 'Supplier Social & Environmental Responsibility Agreement' (version of November 2015), available at: <http://h20195.www2.hp.com/V2/GetDocument.aspx?docname=c04900239>, accessed 15 January 2016. See for more insights on the use of supplementary contracts imposing CSR obligations on suppliers: Vytopil 2015 (n 32), 117-140.

contract proper or in its auxiliary documents. As Beckers notes, incorporation into contracts represents the ‘easy’ case: ‘Once a contract is concluded between a company and its contractual partner, any term that refers to the requirement to comply with the corporate code also becomes a valid and legally binding express term of the contract.’<sup>46</sup> While the incorporation in general terms and conditions or umbrella agreements raises additional questions in terms of transparency, accessibility and fairness of the terms vis-à-vis the supplier, these conditions are not considered to lead to great difficulties in considering them binding under contract law.<sup>47</sup>

When the private regulatory standards are part of the contract and are as such binding under contract law, what implications do they typically have? A first common feature is that the contract imposes an obligation on the seller of the goods or services to meet the standards. Only rarely does the contract impose such an obligation on the buyer, such as a retailer or large brand-name corporation.<sup>48</sup> Instead, buyers are granted a right to perform audits and inspections in order to assess compliance with the contractual obligations.<sup>49</sup> An example is offered by Unilever’s ‘General Terms and Conditions for the Purchase of Products and Services’, which serve as the standardized terms adjacent to supply agreements concluded between Unilever and its suppliers. Article 6 requires compliance with Unilever’s Supplier Qualification System (“USQS”), the global corporate procurement policy of Unilever in which it sets out, amongst others, safety and sustainability standards for (potential) suppliers to Unilever,<sup>50</sup> as well as compliance with Unilever’s Responsible Sourcing Policy, which constitutes the corporation’s CSR policy.<sup>51</sup> It states:

“6.1. Where required by Buyer, Supplier shall register with USQS and complete any steps required to achieve compliance. Supplier shall maintain its compliance status

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<sup>46</sup> Beckers 2015 (n 20), 48.

<sup>47</sup> Ibid, 52-58 in relation to English and German law. See for similar conclusions in relation to Dutch, English and Californian law Vytopil 2015 (n 32), 123, 129, and 136 respectively, and in relation to international commercial law Peterková Mitkidis 2014 (n 40), 13-14.

<sup>48</sup> In her sample of supplier codes of conduct of multinational corporations (n=37), Vytopil found just one code to impose an obligation on the buyer, but one that was very limited. See Vytopil 2015 (n 32), 224, 252 and 258.

<sup>49</sup> As Cafaggi notes: ‘Rarely does the contract wording define and impose obligations on the main contractor or the retailer to monitor compliance in the interests of the final beneficiaries; rather, these are defined as rights, which the contractual party is free to exercise.’ Cafaggi 2013 (n 28), 1592.

<sup>50</sup> Unilever, ‘Unilever’s Supplier Qualification System’, <https://www.unilever.com/about/suppliers-centre/unilever-supplier-qualification-system/> accessed, 15 January 2016.

<sup>51</sup> Unilever, ‘Implementing our approach’, available at: <https://www.unilever.com/sustainable-living/the-sustainable-living-plan/enhancing-livelihoods/fairness-in-the-workplace/advancing-human-rights-with-suppliers/implementing-our-approach.html>, accessed 15 January 2016.

throughout the term of the Agreement. Failure to comply with any part of this clause 6.1 shall be treated as a material breach of this Agreement.

6.2. The Supplier acknowledges that Unilever may appoint a *3rd party audit agency* to host, maintain, operate and/or support USQS including data Processing. All costs to the Supplier associated with USQS and RSP, including registering, achieving compliance and audits shall be the sole responsibility of the Supplier.

6.3. The Supplier acknowledges that it has read and understood the RSP and agrees to (a) comply at all times with the Mandatory Requirements set out in the RSP (“Mandatory Requirements”), (b) complete risk assessments and *audits* as necessary to verify its compliance and (c) take any action reasonably required to rectify non-compliance within the timeframe stipulated by the Buyer.”<sup>52</sup>

Accordingly, the way in which private regulatory standards are incorporated in commercial contracts typically creates binding contractual obligations for the supplier of the goods or services only. Whether there might nonetheless be a contractual obligation on the part of the buyer to ensure compliance with the regulatory standards, either in relation to the supplier or any interested third parties (consumers, communities, NGOs or other parties that would benefit from compliance with the standards) depends on theories of contract interpretation or supplementation in national private law, which will be discussed in more detail in Section 5 below.

Finally, lead firms in the supply chain may also seek to create contractual obligations to comply with private regulatory standards beyond its self-contracted suppliers. A regulatory perspective would require them to do so. After all, for these standards to be effective they need to be implemented along the entire supply chain and therefore all firms constituting that chain should be subject to the obligation to comply with the same regulatory standards. This means that not only the supplier with whom the lead firm has a contractual relationship (the first tier) must be under an obligation to comply, but also the supplier’s supplier (second tier) and, in turn, that supplier’s supplier (third tier), and so on. However, a lead firm cannot directly regulate the relationships between the various sub-suppliers in its supply chain by contracting with the first-tier supplier. The doctrine of privity (also known as *relativé du contrat*) bars them from exercising direct contractual control over the entities that constitute the second, third and following tiers of the chain. This doctrine is fundamental to international

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<sup>52</sup> Unilever General Terms and Conditions for the Purchase of Products and Services (n 43) (emphasis added).

and national contract law, and holds that a contract can only impose rights and duties on those who are party to the contract.<sup>53</sup> This may also trigger concerns for the enforcement of the incorporated standards as lead firms are third parties to the contractual relationship between the suppliers in the first, second and any further tier of the chain.

One way lead firms may overcome the limitations of privity, however, is by imposing contractual obligations to comply with private regulatory standards on its suppliers, but simultaneously requiring this first tier to impose the same obligation on its own suppliers, and pass on this obligation to any other actor in the supply chain all the way up to the raw material producer.<sup>54</sup> Accordingly, the contractual obligation to comply with the private regulatory standards is effectively implemented along the entire supply chain. Alternatively, lead firms may see to it that they be identified as a third party beneficiaries in the sales contract concluded between its first tier supplier and sub-supplier as regards the obligation of the latter to comply with private regulatory standards when supplying to the first tier supplier. As will be explored in Section 5, lead firms may then effectively enforce private standards beyond their contracting parties. First, however, it will be explored what role intermediaries such as auditors, inspectors and certifiers, play in assessing and enforcing regulatory compliance with these standards as regards the individual tiers in the chain.

#### **4. Monitoring and enforcing regulatory compliance with private standards**

Now that it is established that the incorporation of private regulatory standards brings about binding contractual obligations for (at least) the supplier of the goods or services, a key question is how compliance with such obligations is assessed and ensured. While in theory compliance could be enforced through civil litigation before a court of law, that strategy is only seldom applied in practice.<sup>55</sup> There are a number of reasons that can explain this practice. First of all, and as we know from the pioneering work of Steward Macaulay, professional parties to commercial contracts prefer to work out disputes without reference to contractual provisions or their lawyers, especially if these disputes concern relational contracts.<sup>56</sup> In those cases, responses to non-compliance by the supplier will frequently

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<sup>53</sup> See also Verbruggen 2014 (n 17), 83. However, national contract laws (such as French law) may offer exceptions and may under specific circumstances allow a promisee to pursue a direct claim (*action directe*) against the debtor of the promisor.

<sup>54</sup> Articles 6.1.5, 6.1.6.2 and Article 6.1.8 Chiquita International Banana Purchase Agreement (n 41) include such obligations. See for the use of contractual obligations for suppliers to impose on its own suppliers contractual compliance with CSR codes of conduct Vytöpil 2015 (n 32), 125, 131-132 and 138.

<sup>55</sup> See also: McBarnet & Kurkchayan 2007 (n 21), 79 and Lin 2009 (n 28), 723-727.

<sup>56</sup> S Macaulay, 'Non- Contractual Relations in Business: A Preliminary Study' (1963) 28 *American*

involve the suspension of performance or the refusal to accept non-compliant goods or services, or even more likely, corrective actions to restore compliance and ensure it remains that way.

*a. Private compliance mechanisms*

To facilitate the adoption of alternative responses to contractual non-compliance other than strictly legal responses enforceable through court action (i.e. an award of damages or contract termination), commercial contracts incorporating private regulatory standards often provide for private compliance mechanisms, such as inspection, auditing and certification. The use of inspections and audits is typically formulated as an entitlement (i.e. a right) for the buyer: it may periodically check and verify compliance with the standards, or it may appoint delegated entities (third parties) to carry out such compliance assessments.<sup>57</sup> The costs of inspection and audit are frequently allocated to the supplier.<sup>58</sup>

The creation of buyers' rights to inspection and auditing is congruent with the demand to have in place mechanisms that allow for the verification of compliance by suppliers with private regulatory standards. As noted above, these standards are more and more process or management-based, laying down requirements for the way in which good or services should be produced or delivered, or the way in which risks related to the production process should be managed.<sup>59</sup> Since the kind of qualities these standards aim to ensure for goods and services (e.g. their responsiveness to environmental, social and welfare matters) are of a nature that their presence and utility cannot be assessed upon exchange, or only at great cost, a need is created for mechanisms that can assure compliance.

Inspection and audit systems come in many shapes and sizes.<sup>60</sup> Where buyers require compliance from their suppliers with their own regulatory standards (e.g. corporate codes of conduct), internal and external mechanisms are deployed, either as alternatives or complements to each other.<sup>61</sup> In the first case, trained staff of the buyer (typically working in

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*Sociological Review* 55. See also: H Beale and T Dugdale, 'Contracts Between Businessmen. Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law and Society* 45.

<sup>57</sup> McBarnet & Kurkchiyan cite the following clause from their study: '[The Company] reserves the right to carry out a Social Accountability Assessment at the Supplier's premises'. McBarnet & Kurkchiyan 2007 (n 21), 75.

<sup>58</sup> See for example Article 6.2 of the Unilever General Terms and Conditions for the Purchase of Products and Services (n 43).

<sup>59</sup> See text at n 11-14 *supra*.

<sup>60</sup> See for analysis of different forms of audit: Power 1999 (n 5) and in relation to certification A. Marx, 'Global Governance and the Certification Revolution: Types, Trends and Challenges', in D. Levi-Faur (ed), *Handbook of the Politics of Regulation*, Edward Elgar, Cheltenham 2011, pp. 590-603.

<sup>61</sup> McBarnet & Kurkchiyan 2007 (n 21), 75-77. Unilever's Supplier Qualification System discussed above (n 50-52) is an example of an internal compliance mechanism. In addition to this, Unilever requires suppliers to meet

its quality management or internal audit department) performs the inspection and audits based on the buyer's standards. In the second case, the buyer outsources the audit task to a separate legal entity, which might be a commercial auditing firm or an NGO. An audit typically comprises an on-site inspection (e.g. a factory tour), interviews with employees (including quality managers) and a review of documentation (e.g. risks management systems, payrolls, insurance coverage, etc.).<sup>62</sup>

Alternatively, buyers may require suppliers to show compliance with private standards that involve specific certification schemes.<sup>63</sup> Today, the dominant model for certification is third party certification.<sup>64</sup> In this model, the organization setting the regulatory standard (the standard owner) outsources the function of assessing regulatory compliance by the addressee of the standard (the supplier) to a separate legal entity (the certification body).<sup>65</sup> To gain certification suppliers need to enter into a service contract with the certification body, which then performs inspection or auditing activities with the aim to verify compliance with the regulatory standard, typically on a for-profit basis and upon selection of the supplier himself. This contract determines, amongst others, the procedures and conditions for certification, the audit protocol (including audit frequency and sanctions) and the use of the certificate in commercial relations. The relationship between the standard owner and certification body is managed through a licensing contract, granting the certification body the right to award certifications to a particular standard provided that the applicant supplier complies with the requirements of that standard. In this contract, specific rules are determined about the award, suspension or revocation of the certificate, and procedures to monitor the performance of the certification body in delivering certification services. Accreditation requirements are commonly included in these contracts as well to strengthen the claim of certification bodies as regards their independence, expertise and accountability in compliance assessment.<sup>66</sup> Buyers (or other actors in the supply chain) may simply tap into the capacities of third party

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external compliance mechanisms and imposes certification obligations for private regulatory standards such as Rainforest Alliance.

<sup>62</sup> Lin 2009 (n 28), 724.

<sup>63</sup> See for example Articles 6.1.5, 6.1.6.2 and 6.1.7 of the Chiquita International Banana Purchase Agreement (n 41). See for more examples Vandenberg 2007 (n 20), 922ff, McBarnet & Kurkchian 2007 (n 21), 74-79 and Cafaggi 2013 (n 28), 1601ff.

<sup>64</sup> See for a discussion for the reasons for this: Blair, Williams and Lin 2008 (n 16).

<sup>65</sup> See for a detailed discussion of the contracts involved in third party certification in the food industry Verbruggen 2014 (n 37), 166-171, on which this overview draws.

<sup>66</sup> There is much discussion about the credibility of third party certification. See for an excellent overview of empirical studies: J. Short and M. Toffel, 'The Integrity of Private Third-Party Compliance Monitoring' Working Paper RPP-2015-20 (December 2015) Harvard Kennedy School – Mossavar-Rahmani Center for Business and Government, available at:

[https://www.hks.harvard.edu/content/download/78659/1765209/version/1/file/RPP\\_2015\\_20\\_Short\\_Toffel.pdf](https://www.hks.harvard.edu/content/download/78659/1765209/version/1/file/RPP_2015_20_Short_Toffel.pdf) (accessed 15 January 2016).

certification schemes as regards compliance assessment by including an obligation to comply with the relevant scheme in a commercial contract with its suppliers. The use of third party certification does not exclude, however, the possibility of buyers to deploy internal and external audits in parallel to third party certification.<sup>67</sup>

Whenever the commercial contract requires compliance with a certification scheme, certification bodies come to fulfil important roles in assessing contractual compliance. These bodies will typically detect non-compliance first, triggering follow-up inspection and auditing competences on the suppliers' premises under the rules of certification. Based on these rules, the service contract with the supplier and the licensing contract with the standard owner, the certification body may then impose specific sanctions upon the certified supplier, including warnings, corrective actions, and the suspension or revocation of the certificate.<sup>68</sup> These measures are mainly aimed at restoring compliance by the certified supplier.

In this context, certification bodies have become key proxies for buyers to achieve regulatory compliance among contracted suppliers and thus ensure out-of-court contract performance. Certification bodies will independently deploy a set of sanctions as part of the certification scheme in order to restore regulatory compliance. In doing so, they use notice and comment procedures and offer internal complaint handling mechanisms through which their clients (the certified suppliers) and other interested parties can complain about the decision to grant or withhold certification, or to suspend and withdraw that certification.<sup>69</sup> The adoption of these sanctions takes the form of administrative decision-making in which buyers, consumers, workers or other potential stakeholders do not have standing. These actors typically only have an option to submit a complaint to the certification body, after which the body starts an investigation.

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<sup>67</sup> Havinga (n 37, 525) has noted that supermarkets frequently perform their own on-site audits at supplier premises in addition to the audits performed by certification bodies as part of third-party certification schemes that are imposed upon suppliers via general terms of delivery related to the supply contract. This also applies to Unilever, which applies its own Supplier Qualification System in parallel to other certification programmes (see at note 61).

<sup>68</sup> The discretion to apply sanctions by certification bodies may be seriously limited by the certification scheme. In the case of private food safety standards, the world's leading certification schemes qualify compliance with specific norms as 'major musts', 'minor musts' or 'recommendations', and link specific sanctions to violations of these norms. Further, they might specify a sanction escalation policy, requiring licensed certification bodies to follow a step-by-step approach to respond to non-compliance, amongst others, depending on the rule that is violated, the compliance history of the certified supplier and its responsiveness to previously imposed measures. See in detail Verbruggen 2014 (n 37), 184ff.

<sup>69</sup> A number of very widely applied ISO standards require certification bodies to have in place complaint handling mechanisms and related appeals procedures in order to gain accreditation. See for example ISO/IEC 17065:2012 - Requirements for bodies certifying products, processes and services) and ISO/IEC 17021:2006 (Requirements for bodies providing audit and certification of management systems). The procedures and outcomes of these internal compliance procedures are not open to the public, however, and remain hidden from public sight.

Compliance may thus be restored without the need to rely on formal contract law and legal procedures. In long-term business relationships, this is exactly what business partners have been reported to consider desirable.<sup>70</sup> Therefore, the use of certification also takes away some of the need for buyers to respond to non-compliance by deploying contractual remedies, and initiate court litigation to enforce these remedies.

Where buyers do want to use contractual remedies, the information generated by the inspection and auditing mechanisms as regards the non-compliance of suppliers with private regulatory standards – this typically takes the form of warnings, suspension or revocation of certificates – allows the buyers to develop a more refined and targeted response to non-compliance linked to the type and frequency of non-compliance. Such information may be provided to buyers by the suppliers themselves as part of their obligations under the contract or the certification scheme.<sup>71</sup> More particularly, buyers may use this information on non-compliance to inform their choices as regards the use of contractual remedies, which may range from suspension of performance<sup>72</sup> to ultimately contract termination.<sup>73</sup> The integration of third party auditing and certification in commercial contracts may thus lead to efficiency gains in terms of monitoring and sanctioning breach of contract.<sup>74</sup>

#### *b. Reputational concerns*

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<sup>70</sup> Cf. Macaulay 1963 (n 56).

<sup>71</sup> Third party certification schemes in the food industry require suppliers to inform customers (including buyers) about the suspension or revocation of their certification. See Verbruggen 2014 (n 37), 211.

<sup>72</sup> Article 6.1.5 the Chiquita International Banana Purchase Agreement (n 41) reads: If any of these farms were to be decertified [under the Social Accountability International SA-8000 standard], the SELLER and the respective PRODUCER will have six months as of the date of notification of the decertification or suspension to remedy the farm decertification. If it does not obtain the recertification within the period stipulated hereof, the BUYER will have right to suspend the purchase of FRUIT originating from such farms until they regain their respective certifications.’ Similarly Article 6.1.6.2 holds: ‘If the farms are decertified or their certification is suspended by the Rainforest Alliance or the verifying organization designated by such organization, the SELLER and the PRODUCERS will have six months as of the day of the notification of decertification or suspension to recertify the affected farms. If the SELLER and the PRODUCERS cannot recertify the property within the stipulated term, the BUYER will have the right to suspend the purchase of FRUIT from those farms until such farms obtain their respective certification.’

<sup>73</sup> Article 10.2 Unilever General Terms and Conditions for the Purchase of Products and Services (n 43) holds: ‘The Agreement may be terminated earlier in whole or part by the Buyer without any penalty or further obligation or liability: (...) b) on no less than 7 days’ written notice where there is material or deliberate or persistent non-compliance with clause 6.3(a), or the Supplier breaches clause 6.3(c).’ Articles 6.3(a) and 6.3(c), as noted in the text at n 52 *supra*, require compliance with Unilever’s Responsible Sourcing Policy.

<sup>74</sup> Cf. Cafaggi, who notes: ‘Through certification buyers achieve a much more effective monitoring of the whole supply chain than via contract law. Unlike contract law, which segments transactions and forces delegation along the chain, certification provides a higher degree of coordination by combining both hierarchical and peer monitoring of various enterprises along the chain. With third-party contribution, chain leaders achieve effective monitoring which would be much harder given the limitations of contract law described above.’ Cafaggi 2013 (n 28), 1604.

Another reason why compliance with private regulatory standards incorporated in commercial contracts is only very rarely enforced via court litigation concerns the publicity related to such litigation. Disputes in court initiated by a major retailer or a brand-name company about non-compliance by actors in its supply chain will attract unwanted attention from the public. These lead firms may be unable to disconnect themselves from the irresponsibility label that is attached to them by the public in the context of such litigation.<sup>75</sup> Again, audits and certification can provide much needed discretion and confidentiality in addressing regulatory non-compliance. Internal and external auditors typically need to comply with confidentiality obligations included in service contracts for auditing and certification, and the results of the compliance assessment are not disclosed to the public.<sup>76</sup>

*c. Private procurement*

Attention should be also drawn to the practice of private procurement and its salience in assessing and ensuring compliance with private regulatory standards and related potential to reduce court litigation concerning compliance with these standards. As noted, the private procurement policies of lead firms in the supply chain frequently include compliance with private regulatory standards as a condition to ‘win’ a contract with these firms.<sup>77</sup> The economic power these lead firms (major retailers and brand-name companies) exercise in the chain induces regulatory compliance among suppliers before the contract is even concluded. Non-compliance is thus sanctioned by refusing to deal with a supplier. In the context of commercial trade, this sanction has been considered, as Collins notes, ‘perhaps the most pervasive and effective non-legal sanction’.<sup>78</sup>

As part of the established practice of private procurement, lead firms in the chain require suppliers applying for a contract to undergo an *ex ante* compliance assessment carried out by the buyer or contracted third party auditors to provide accurate information about (the level of) regulatory compliance of the supplier. Unilever, for example, requires potential contracting partners to pass its ‘Understanding Responsible Sourcing Audit’, which ‘enables

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<sup>75</sup> Lin 2009 (n 28), 725.

<sup>76</sup> Ibid, 727. In the case of the certification there is some public disclosure as regards the findings of the audit. This is, however, strictly limited to the outcome of the audit, namely the decision to suspend or revoke certification. The underlying reasons are not disclosed due to confidentiality obligations in the service contract for certification.

<sup>77</sup> See text at n 36 *supra*. See also Vandenberg 2007 (n 20), 925 and 944-945 in relation to environmental standards, Lin 2009 (n 28), 734 in relation to ISO 14001 and Vytopil 2015 (n 32), 132, 139-140 in relation to CSR codes of conduct.

<sup>78</sup> H Collins, *Regulating Contracts* (OUP 1999) 101. See more generally on the enforcement of non-legal sanctions in contract D. Charny, ‘Nonlegal Sanctions in Commercial Relationships’ (1990) *Harvard Law Review* 140(2), 373-467.

an independent assessment of a supplier's performance and compliance against all applicable laws and regulations and the additional requirements of Unilever's Responsible Sourcing Policy [RSP].<sup>79</sup> These *ex ante* assessments may become linked with compliance assessments carried out within the context of established contractual relations (*ex post* assessments) where the standards used to assess compliance in order to determine the eligibility of suppliers for a contract prior to the award of a contract, are incorporated in the actual supply contract.<sup>80</sup> By thus requiring continued compliance with the private regulatory standards under the supply contract the difference between the *ex ante* assessment through private procurement and the *ex post* audit or certification requirements is very small. *Ex ante* and *ex post* compliance become conflated.

Arguably, private procurement practices limit the potential risk that suppliers fail to comply with the private regulatory standards incorporated in its supply contract. By carefully selecting their contracted suppliers, and including in the selection criteria compliance with private regulatory standards, buyers make sure they contract with suppliers only that have shown the ability to meet these regulatory standards. Of course, this practice does not warrant that suppliers will continue to comply throughout the full duration of the contract, yet it ensures a minimum level at the start of the contractual relationship and one on which the supplier can improve throughout that relationship. This desire of lead firms in supply chain to improve regulatory compliance along the chain is reported to be a common feature of commercial contracts incorporating private regulatory standards as regards environmental, social and welfare aspects of the production of commodities.<sup>81</sup>

## **5. Enforcement of private regulatory standards in court**

Compliance with private regulatory standards is thus frequently enforced through mechanisms other than courts, as is the case with the bulk of commercial disputes. This does not mean, however, that court litigation (and threat of initiating it by the promisee) does not play a

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<sup>79</sup> See Unilever, 'Understanding the Responsible Sourcing Audit (URSA). Guide for Suppliers' (April 2015, Rev. No. 1.0), p. 3, available at [https://www.unilever.com/Images/ursa-guide-for-suppliers-understanding-responsible-sourcing-audit\\_fin\\_tcm244-425722\\_en.pdf](https://www.unilever.com/Images/ursa-guide-for-suppliers-understanding-responsible-sourcing-audit_fin_tcm244-425722_en.pdf), accessed 15 January 2016.

<sup>80</sup> This is the case for the compliance assessments carried out in the context of Unilever's procurement policy and supply contracts. To obtain a supply contract with Unilever, they need to comply with Unilever's Responsible Sourcing Policy as assessed through the USRA audit. However, compliance with the Responsible Sourcing Policy is also a contractual obligation under Article 6.3(a) Unilever General Terms and Conditions for the Purchase of Products and Services (n 43).

<sup>81</sup> McBarnet & Kurkchian (2007, n 21) speak of 'soft contracts' that promote a partnership between buyers and suppliers in delivering sustainable outcomes (at 73-73). Unilever, for example, speaks about its deliberate choice to 'encourage our suppliers to drive their businesses towards the good and best practices of responsible sourcing' and that these suppliers 'become part of a continuous improvement process, in which they not only meet compliance requirements but also are audited having a positive social impact'. Unilever 2015 (n 79), 3.

significant role in the functioning of these alternative mechanisms. Quite the opposite seems true. Several authors have highlighted that (the potential for) court litigation constitutes a key variable to the effectiveness of private compliance mechanisms and non-legal sanctions in commercial relationships. Court litigation and resulting liabilities cast a ‘shadow of hierarchy’, which sustains private ordering and backs informal sanctions through non-judicial mechanisms.<sup>82</sup> The absence of a credible threat of state-supported enforcement may seriously compromise the regulatory potential of non-state, private means.<sup>83</sup>

In the rare event that non-compliance with private regulatory standards incorporated in commercial contracts is litigated before a court of law, two types of questions appear particularly relevant. The first type relates to the substance of the standards and the material obligations that follow from them for (one of) the contracting parties: What performance do the standards actually require taking into consideration, amongst others, their wording and the way in which compliance with them is required in the contract? Answering these questions is conditional to determine whether there is contractual performance or not (i.e. a breach of contract), and in the latter case what remedies can be applied (e.g. suspension of performance, replacement or repair of goods, restitution, or damages). The second type relates to whom can enforce compliance with the regulatory standards: What actor(s) can require compliance (i.e. contractual performance)? Can third parties require (specific) performance from (one of) the contracting parties or can they sue for damages if a party violates these standards? Ultimately, the answer to all these questions depends on the applicable rules of contract interpretation.

*a. What is required for contractual performance?*

Contractual performance with the contracts discussed in this Chapter requires compliance with the private regulatory standards incorporated in the commercial contract. But what do the

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<sup>82</sup> See for example R. Wai, ‘Enforcement in the Shadows of Transnational Economic Law’, in: H.-W. Micklitz and A. Wechsler (red.), *The Transformation of Enforcement. European Economic Law in a Global Perspective* (Hart Publishing 2016), 15-46; F. Cafaggi, ‘Judicial Enforcement of Transnational Private Regulation’ in F. Cafaggi (ed.), *Enforcement of Transnational Regulation. Ensuring Compliance in a Global World* (Edward Elgar 2012), 75-130; C. Whytock, ‘Litigation, Arbitration, and the Transnational Shadow of the Law’ (2009) 18 *Duke Journal of Comparative and International Law* 449; and P. Verbruggen, ‘Gorillas in the Closet? Public and Private Actors in the Enforcement of Transnational Private Regulation’ (2013) 7 *Regulation & Governance* 512. See also Beckers in this volume.

<sup>83</sup> The importance of state actors, such as courts, for the effectiveness of private standards, is widely recognized in the broader literature on (transnational) regulatory governance. See for example: I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, New York 1992), 101-132; N. Gunningham and D. Sinclair, ‘Designing Environmental Policy’ in N. Gunningham and P. Grabosky, *Smart Regulation: Designing Environmental Policy* (Oxford University Press, Oxford 1998), A. Héritier and S. Eckert, ‘New Modes of Governance in the Shadow of Hierarchy: Self- Regulation by Industry in Europe’ (2008) 28 *Journal of Public Policy* 113 and K. Abbott and D. Snidal, ‘The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State’ in W. Mattli and N. Woods, *The Politics of Global Regulation* (Princeton University Press, Princeton 2009) pp. 44-88.

standards actually require of the committing contracting party (the ‘promissor’), which is, as noted, typically the supplier?<sup>84</sup> Private regulatory standards can be very specific in what they require from the supplier. Product standards may dictate the exact technical specifications of a product, whereas process standards may detail every relevant step from sourcing component parts or ingredients, to the manufacturing, packaging, storage, transport and retail of the products. Management system standards, in particular, have been reported to be extremely detailed in the requirements they set out for suppliers. The certification and auditing protocols that underpin these standards and detail all individual requirements under a specific standard, may cover up to one hundred pages.<sup>85</sup> Typically, these protocols are standardized documents to achieve uniform application of the standards across the many hundreds or even thousands of suppliers lead firms in buyer-driven commodity chains do business with. Accordingly, what is required from a supplier in meeting the certification criteria and thus to demonstrate compliance with its contractual obligation to gain certification for a specific standard, may not be a real matter for dispute.

However, the level of specificity of the private regulatory standards can be much lower. Various empirical studies have reported that the content of CSR codes of conduct is not infrequently vague and ambiguous. For example, McBarnet and Kurkchian cite several clauses they found to be part of codes of conduct that an international retailers included in their commercial contracts with foreign suppliers, including clauses such as: suppliers ‘must meet all *the appropriate* relevant industry and country standards’, or ‘must work to towards *higher* standards’ and ‘the code must be observed *wherever it is possible*’.<sup>86</sup> These clauses leave ample space for interpretation and clearly invite litigation on what they mean.<sup>87</sup>

However, litigating on what the contract terms and standards exactly mean is not the intension of the multinational corporations requiring compliance with their codes of conduct. As McBarnet and Kurkchian stress, the clauses are deliberately phrased in a very open way so to allow for flexibility and practicability throughout the contractual relationship. The function of these clauses is to ‘put the matter of the social performance of the supplier on the agenda of communication between the corporation and the supplier’ and give ‘flexibility to

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<sup>84</sup> See text at n 48-52 *supra*.

<sup>85</sup> The GLOBALGAP Integrated Farm Assurance module for Fruits and Vegetables, one of the most widely applied certification schemes in the world for agricultural produce (over 100,000 certified farmers), covers 96 pages. See: GLOBALGAP, ‘Integrated Farm Assurance: All farm based, Crops Base, Fruit and Vegetables: Control Points and Compliance Criteria’ (English Version 4.0 March 2013) available at: [http://www.globalgap.org/export/sites/default/.content/.galleries/documents/130315\\_gg\\_ifa\\_cpcc\\_af\\_cb\\_fv\\_v4\\_0-2\\_en.pdf](http://www.globalgap.org/export/sites/default/.content/.galleries/documents/130315_gg_ifa_cpcc_af_cb_fv_v4_0-2_en.pdf) (accessed 15 January 2016).

<sup>86</sup> McBarnet and Kurkchian 2007 (n 21), 70 (emphasis as in original).

<sup>87</sup> Similar results are found by Vytopil 2015 (n 32), 122-140.

both sides in deciding the actual level of standards that (...) is ‘appropriate’ or ‘reasonable’ to expect from an individual supplier in a particular country under a specific set of circumstances’.<sup>88</sup> Cultural settings and local changes in the law, economic conditions and even factory management can make rigorous demands on compliance both difficult and even counterproductive.<sup>89</sup> The resulting openness in the standards and contract clauses should thus be considered as a mechanism for the contracting parties to respond to change. This again underlines that it is unlikely that a case on non-compliance with a corporate code of conduct imposed by a multinational firm on a foreign supplier will be brought before a court of law.

In the case that non-compliance with a contract-imposed private regulatory standard leads to court litigation, and it is unclear what the standard demands from the committing contracting party (the ‘promisor’), what does a court need to do? In contract law, ambiguities in the contract or in terms part of that contract, are resolved by contract interpretation (or ‘construction’). The primary goal of contract interpretation is noted to be the ascertaining of the parties’ intentions at the time they drafted the contract.<sup>90</sup> To determine these intentions the competent court of law may use several normative theories.<sup>91</sup> Placed on a continuum, these theories vary between, on the one end, the view that the *expressions* used in the contract is the basis on which the intentions of parties must be constructed, and at the opposing end the view that it is the *intension* of the promisor that has determinative value.<sup>92</sup>

What normative theory a court will apply will of course depend on the law applicable to the contract under the rules of private international law. However, it might be held that the degree to which the court will use the expressions in the contract and the intentions of the contracting parties to determine the meaning of the standard also depends on the proximity between these parties and the incorporated regulatory standard. Where this proximity is low and the parties have not been involved in the drafting of the standard, a court is more likely to remain close to the objective characteristics of the standard, such as its wording, structure and aim and other contextual features, to determine its meaning. In doing so, the court effectively

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<sup>88</sup> McBarnet and Kurkchiyan 2007 (n 21), 70.

<sup>89</sup> *Ibid.*, 71.

<sup>90</sup> K. Zweigert and H. Kötz, *An Introduction to Comparative Law* (3rd edn, trans. T. Weir, Clarendon Press, Oxford 1998) 400; G. McMeel, *The Construction of Contracts, Interpretation and Rectification* (OUP 2011), 35-36 and S.J. Burton, *Elements of Contract Interpretation* (OUP 2008) 2.

<sup>91</sup> I refer here to a court of law, although I am fully aware of the fact that in international commercial contracts, arbitration clauses are commonly used to award exclusive competences to arbitrators or arbitration institutions to hear disputes between the parties to the contract. The theories used by courts for contract interpretation are equally available to arbitrators, however. See on the use of contract law theories of interpretation in the context of commercial arbitration: J.K., ‘The Arbitral Role in Contractual Interpretation’ (2015) *Journal of International Dispute Settlement* 6(1), p. 4-41.

<sup>92</sup> Zweigert and Kötz 1998 (n 90), 401. Compare: Burton 2008 (n 90), 2, who distinguishes between the theories of literalism, objectivism and subjectivism.

facilitates the regulatory function of the standard, in that the application of the standard remains uniform across parties agreeing to the standard and not dependent on the intentions of the individual parties, in particular the promisor. This approach would also match with the idea that the parties, by incorporating the standard in their contract, have effectively delegated to the standard setter what the meaning the standard is. They may simply have wanted the application of the standard because everybody else in the industry does, and without really knowing what was agreed to.<sup>93</sup> Such an approach is akin to the one taken by courts, at least in the common law tradition, when interpreting standard form (boilerplate) clauses. Such clauses, the content of which is typically not negotiated between the contracting parties, but has been shaped over the years through industry usage and judicial guidance, are generally interpreted objectively, turning on what meaning reasonable persons would have attached to it at the time of contract.<sup>94</sup>

A case in point in English contract law is *Messer UK Ltd v Britvic Soft Drinks Ltd and others*.<sup>95</sup> This case concerned the sale by Messer to Britvic and others of quantities of carbon dioxide that was contaminated with benzene, a carcinogen. Britvic and others had used this contaminated carbon dioxide in the manufacture of sparkling drinks. These, as a result, contained traces of benzene, although not in quantities that posed any risk to health. Commercially, however, the contamination was dynamite. Following a similar contamination at its competitor Perrier, which had caused widespread unrest among consumers, the buyers had to allay public concerns and withdrew from wholesalers quantities of the drinks that had been manufactured and remained unsold. Britvic and others brought a claim to recover the loss suffered thereby.

The judge in first instance found that the only relevant express term of the supplies to Britvic and others was that the carbon dioxide would conform with British Standard 4105 (BS 4105), a private technical standard developed by the British Standards Institution, which had been included in the sales contract by reference via the warranties section. This standard

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<sup>93</sup> Choi and Gulati make this claim in relation private standards in the financial sector. See: Choi, S. and Gulati, G. (2006) 'Contract as Statute', *Michigan Law Review* 104 (March) 1129-1173, p. 1152.

<sup>94</sup> E. A. Farnsworth, *Farnsworth on Contracts* (3rd edn Aspen Publishers, 2004), para 7.11. In para 7.9 Farnsworth notes about the interpretation of standard form contracts: 'In many disputes arising out of contemporary business transactions, however, the parties gave little or no thought to the impact of their words on the case that later arose. (...) The court will then have no choice but to look solely to a standard of reasonableness. Interpretation cannot turn on meanings that the parties attached if they attached none, but must turn on the meaning the reasonable persons in the position of the parties would have attached if they had given the matter thought'. See for English law E. Peel, 'The Common Law Tradition: Application of Boilerplate Clauses Under English Law', in Giuditta Cordero-Moss (ed), *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (CUP 2011). See for the interpretation of boilerplate clauses in the Germanic, Romanist, Nordic and Russian tradition the other contributions in the edited volume by Cordero-Moss.

<sup>95</sup> [2002] EWCA Civ 548.

differentiated between two types of carbon dioxide: Type 1, which is suitable for industrial non-food applications, and Type 2, which is ‘a higher quality grade which is also suitable for industrial food applications’. The judge in first instance held that both under the terms of BS 4105 and s. 14 of the Sale of Goods Act 1979, Britvic and others were entitled to recover damages from Messer. The contested issue in appeal is whether BS 4105 – in particular the phrase concerning Type 2 carbon dioxide as being ‘a higher quality grade which is also suitable for industrial food applications’ – can be interpreted as containing an express warranty or undertaking of suitability relevant to the presence of benzene, and can thus, in parallel to s. 14 of the 1979 Act, be considered a basis for holding Messer liable.

In finding that BS 4105 contains no express warranty or undertaking of suitability, the judge giving judgement, Lord Justice Mance, assesses, rather implicitly, the wording and goals of the standard to conclude that ‘*because* BS 4105 does not address or cover the possibility of other contaminants, such as benzene’, it provides ‘no basis for reading BS 4105 either as covering such other contaminants or as containing a general contractual undertaking of suitability’.<sup>96</sup> Moreover, as he notes, ‘The authors of BS 4105 were concerned to regulate the quantities of and methods of testing for elements which carbon dioxide might be expected to contain. They did not identify or regulate other elements, not because the contemporary understanding was that carbon dioxide might contain them, but because the presence of an extraneous or deleterious substance such as benzene or strychnine was wholly unexpected, and could only occur due to some manufacturing or other mishap’.<sup>97</sup>

Justice Neuberger, who concurs with Lord Justice Mance on his finding that BS 4105 does not contain express warranty or undertaking of suitability, is more explicit about how the BS 4105 standard should be interpreted. He draws stark attention to the context, function and purpose of the words and sentences constituting the standard to explain its meaning.<sup>98</sup> He holds that to read the standard as including an express warranty or undertaking of suitability:

‘(...) is contrary to the natural meaning of the words used, particularly in their context, and, indeed, requires them to have a slightly uncomfortable double function. The second sentence of paragraph 1 of Section 1 suggest that Type 1 is merely being described: “Type 1 is suitable ...”, not “should be” or “shall be” suitable. This reading is reinforced by the structure of BS 4105 (...). Further, as I have mentioned, it is clear

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<sup>96</sup> Ibid, para 13 (emphasis as in original) (per Lord Justice Mance).

<sup>97</sup> Ibid, para 14 (per Lord Justice Mance).

<sup>98</sup> Ibid, paras 30-31 (per Justice Neuberger).

that the words of paragraph 1 of Section 1 define and explain Types 1 and 2; it is not therefore likely that they were intended to have the additional and distinctive function of setting a standard. So to hold would involve giving a double meaning to the word “is” in the second and third sentences of paragraph 1, which it does not naturally or comfortably bear.<sup>99</sup>

Accordingly, the judges in this case remain very close to the objective characteristics of the standard, including its wording, structure and aim. No reference is made to what the parties to the contract might have meant with the standard at the time of concluding the contract, arguably because they did not have an opinion at that time. Instead, a strong degree of deference is given to what ‘the authors’ of the standard meant by the standard. By using that standard in their contract, it might be argued, the contracting parties also implicitly agreed that the final meaning awarded to these standards would be not theirs. Accordingly, the judges in this case preserve the regulatory function of the private standard incorporated in the sales contract.

The approach taken by the Appeal Court in *Messer v Britvic Soft Drinks and others* fits well with the general normative theory used for contract interpretation in English law and other common law jurisdictions, namely ‘objectivism’ (or ‘contextualism’). Objectivism promotes the view that contracts are to be interpreted taking into account a limited set of contextual factors, at least including the document as a whole, the ordinary meaning that can be ascribed to the terms in it, the goal(s) of the contract and the circumstances in which it was drafted.<sup>100</sup> To determine the meaning of contract terms regard must be had to the expressed terms, their ‘natural and ordinary meaning’,<sup>101</sup> and what ‘a reasonable person having all background knowledge which would reasonably be to the parties in the situation in which they were at the time of the contract’.<sup>102</sup> As a result, statements made during contract negotiations, the parties’ prior dealings or the parties’ behaviour after the conclusion of the contract are generally not considered in English law when determining the meaning of a contract term.<sup>103</sup> So, even if Messer in the discussed case was able to provide evidence that Britvic and others, by including the reference to BS 4105 in the sales contract, had meant that

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<sup>99</sup> Ibid, para 32 (per Justice Neuberger).

<sup>100</sup> Burton 2008 (n 90), 22.

<sup>101</sup> McMeel 2011 (n 90), 37-39

<sup>102</sup> *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912-913 (per Lord Hoffmann). See in detail McMeel 2011 (n 90), 26ff.

<sup>103</sup> This restrictive approach is also known as the ‘parol evidence rule’. See McMeel 2011 (n 90), 43-45 See on the American parol evidence rule Burton 2008 (n 90), 64ff.

the carbon dioxide supplied would be apt for manufacturing sparkling drinks destined for human consumption, it would not have been allowed to bring such evidence in the case.

While the *Messer v Britvic Soft Drinks and others* may be typical for the approach judges take under English contract law (and perhaps other common law jurisdictions) to interpret the meaning of private regulatory standards included in commercial contracts,<sup>104</sup> the obvious caveat to place here is that the exact approach to interpreting these standards ultimately depends on the applicable contract law. Several commentators have shown that there is a strong difference between common law and civil law tradition in this regard.<sup>105</sup> This finding invites deeper comparative study of how courts from these two different traditions go about interpreting private regulatory standards and to what extent this approach is reflective of the interpretation theories advanced by national contract law.<sup>106</sup>

*b. Who can require contractual performance?*

Usually it will be clear which of the contracting parties is required to comply with the private regulatory standard ('the promisor') in relation to the other (the 'promisee'). As noted above, in buyer-driven supply chains the promisor typically is the supplier, while the promisee is the retailer or brand-name company.<sup>107</sup> The question may arise, however, to what extent also third parties may require contractual performance in relation to the obligation to comply with the private regulatory standards. That question emerges in particular where the incorporated regulatory standards are beneficial (also) to others beyond the contracting parties. In the case of product safety standards, third party beneficiaries might be the final consumers of the

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<sup>104</sup> See for two examples from the US: *Eternity Global Master Fund v Morgan Guar. Trust*, 357 F.3d, 168 (2d Cir. 2004) and *Aon Fin. Prods. Inc. v. Société Générale*, 476 F.3d 90 (2d Cir. 2007), both concerning the interpretation of private regulatory standards adopted by the International Swaps and Derivatives Association (ISDA) and incorporated in commercial contracts.

<sup>105</sup> See in relation to the enforcement of corporate CSR codes Beckers 2015 (n 20), 284ff (discussing English and German law) and Vytopil 2015 (n 32) 68-70, 81-83, and 98-99 (discussing Dutch, English and Californian law respectively).

<sup>106</sup> Also in European Union (EU) law the question of how private regulatory standards incorporated in commercial contracts need to be interpreted has attracted attention recently. At the time of writing a key case is pending at the Court of Justice of the EU (CJEU) on this matter. In the case (Case C-613/14, *James Elliot Construction Ltd v Irish Asphalt Ltd*) an Irish construction company sued a supplier for breach of contract as the latter had failed to provide construction materials that met the specifications as set out in the technical standard EN 13242:2002, which was incorporated in the supply contract. The standard was developed by the European Committee for Standardisation (CEN), a private not-for-profit association established under Belgian law, adopting standards within the so-called 'New Approach' framework to technical harmonization and standards (Council Resolution of 7 May 1985). The key question in the case is of an institutional nature, i.e. related to the competences of the CJEU: does it have to authority to interpret the technical standard as it were a measure of an EU institution in the context of a national procedure concerning breach of contract and sales law? On 28 January 2016 Advocate General Campos Sanchez-Bordona delivered his opinion in this case (ECLI:EU:C:2016:63), in which he argued that the CJEU indeed has jurisdiction over the interpretation of these harmonised technical standards. The opinion does not discuss the appropriate technique for interpreting these standards, however.

<sup>107</sup> See text at n 48-52 *supra*.

product. In the case of corporate CSR codes addressing labour conditions and environmental sustainability, the potential beneficiaries might include employees of foreign suppliers, local communities in which the production facilities are located, and NGOs.

Whether these third parties can actually require performance (i.e. compliance with the private regulatory standards) under a commercial contract between a buyer and supplier, and in the event of a breach of contract, also claim damages, is determined by the doctrine of ‘third party beneficiaries’. National and international contract law recognise the ability of contracting parties to include in a contract rights for third parties that can be enforced by the beneficiary third parties themselves.<sup>108</sup> For third parties to be able to enforce rights under a contract it is generally required that the contracting parties provide for those rights in their contract. A much disputed question, at least in the literature, is whether the beneficiaries of a corporate code of conduct that is incorporated in a contract between a buyer and a supplier may sue for damages under the contract against the promisor.<sup>109</sup> The answer to that question, again, depends on contract interpretation and (by extension) the applicable contract law.

A case in point that has attracted much scholarly attention is *Doe v. Wal-Mart Stores, Inc.*<sup>110</sup> In this case, which offers a perspective from another common law jurisdiction, employees of a number of foreign suppliers of the US retailer Wal-Mart brought claims against the retailer relying primarily on a code of conduct (‘Standards for Suppliers’) included in Wal-Mart’s supply contracts that required its suppliers to meet specified basic labour standards and local industry standards regarding working conditions like pay, hours, forced labour, child labor, and discrimination. The claimants held, however, that Wal-Mart had failed to adequately monitor its suppliers’ compliance with this code, leaving them exposed to clear violations of the code, including excessive working hours, denial of (overtime) pay, pay below minimum wage, and physical abuse. The damages they had suffered consequently, they sought to recover.

The Wal-Mart code contained the following clause in the paragraph entitled ‘Right of Inspection’: ‘To further assure proper implementation of and compliance with the standards set forth herein, Wal-Mart or a third party designated by Wal-Mart will undertake affirmative

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<sup>108</sup> Article 5.2.1 Unidroit Principles of International Commercial Contracts; Article 6:110 Principles of European Contract Law; and Article II.–9:301 Draft Common Framework Reference. The specific conditions under which persons acquire an enforceable right under a contract to which they are not a party vary per country. See for an analysis of European jurisdictions: H. Beale, B. Fauvarque-Cosson, J. Rutgers, D. Tallon and S. Vogenauer, *Cases, Materials and Text on Contract Law* (2nd ed.), Oxford: Hart Publishing 2010, 1232-1250.

<sup>109</sup> See for an analysis of the conditions for the use of third-party beneficiary clauses in relation to CSR codes of conduct Beckers 2015 (n 20), 126-144 (discussing English and German law) and Vytopil 2015 (n 32) 145-146, 177-178, and 203-211 (discussing Dutch, English and Californian law respectively).

<sup>110</sup> *Doe v. Wal-Mart Stores, Inc.*, 572 F.3d 677, 681 (9th Cir. 2009).

measures, such as on-site inspection of production facilities, to implement and monitor said standards. (...)'. Relying on the language of this paragraph, the claimants argued, that they were third party beneficiaries to this specific clause and that they could as such enforce against Wal-Mart its promise to its suppliers that it would monitor their compliance with the code. The failure to do so adequately represented a breach of contract, for which damages were claimed.

The Ninth Circuit Court did not allow the claim. The contract law applicable to the case, Californian law, following the Restatement (Second) of Contracts, establishes that 'A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty'.<sup>111</sup> A beneficiary is 'an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties.'<sup>112</sup> The court held that, basing itself on the language used in the code, that code does not create a duty of the part of Wal-Mart to monitor its suppliers, and thus does not provide the claimants a right of action against the retailer as third party beneficiaries.<sup>113</sup> The court further considered that the claimants could only seek redress against the party that undertook a promise under the contract for the benefit of the beneficiary. In this case, Wal-Mart did not assume obligations to maintain these labour standards – the individual suppliers did. Moreover, the claimants did not provide sufficient support for their claims that Wal-Mart and the suppliers intended them to be third parties beneficiaries under the supply contracts.<sup>114</sup>

As this case shows, the conditions under which third parties may enforce terms under a contract to which they are not a party as determined by the applicable (national) contract law may prove difficult to overcome in practice. In particular, the *Doe v. Wal-Mart Stores, Inc.* case draws attention to the question whether a private regulatory standard incorporated in a commercial contract is enforceable as a promise or duty between the contracting parties, and whether the beneficiaries of the standard are also the intended third party beneficiaries that

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<sup>111</sup> Restatement (Second) of Contracts §304 (1981).

<sup>112</sup> Restatement (Second) of Contracts §302(1) (1981).

<sup>113</sup> *Doe v. Wal-Mart Stores, Inc.* (n 110). More specifically, in interpreting the contract and its terms it considered: 'The language and structure of the agreement show that Wal-Mart reserved the right to inspect the suppliers, but did not adopt a duty to inspect them. The language on which Plaintiffs rely is found in a paragraph entitled "Right of Inspection," contained in a two-page section entitled "Standards for Suppliers." And after stating Wal-Mart's intention to enforce the Standards through monitoring, the paragraph elaborates the potential consequences of a supplier's failure to comply with the Standards – Wal-Mart may cancel orders and cease doing business with that supplier – but contains no comparable adverse consequences for Wal-Mart if Wal-Mart does not monitor that supplier. Because, as we view the supply contracts, Wal-Mart made no promise to monitor the suppliers, no such promise flows to Plaintiffs as third-party beneficiaries. (...)'

<sup>114</sup> *Ibid.* See also: Cafaggi 2013 (n 28), p. 1591-1593.

can enforce the substantive obligation to comply with the standard against the promisor.<sup>115</sup> The answer to both questions, it was shown, depends on the interpretation of the language of the contractual terms, including that of the incorporated regulatory standards.

The *Doe v. Wal-Mart Stores, Inc.* case concerned the question of whether employees of foreign suppliers of Wal-Mart could enforce private regulatory standards applying in the relationship between Wal-Mart and their employers under a third party beneficiaries doctrine. This doctrine might also serve as a basis for lead firms in the supply chain, such as Wal-Mart, to enforce compliance with private standards by suppliers down that chain. For example, a sales contract between sub-supplier A and first tier supplier B may qualify the subsequent buyer of the goods, lead firm C, as a third party beneficiary of the express warranty A assumed in its contract with B, according to which supplier A must supply goods that comply with a specific private standard. That qualification may enable lead firm C to enforce A's obligation to provide conforming goods to B. Accordingly, lead firms may effectively enforce private standards beyond their contracting parties and ensure compliance with the regulatory standards in other tiers of the supply chain.

However, there is little sign of the use of third party beneficiary clauses by lead firms as instruments to implement regulatory standards in supply chains in practice, however.<sup>116</sup> One explanation is that lead firms may not have sufficient incentives to enforce rights under a contract to which it is not a party. Provided that also the first tier supplier is under the obligation to comply with the standards, it can be less costly to enforce this obligation against this supplier directly. In the example discussed above, rather than taking action against sub-supplier A, who might be located in a different jurisdiction, lead firm C may simply enforce its rights under the sales contract entered into with supplier B to obtain redress for the damages incurred as a result of the fact that B was unable to provide goods that complied with the regulatory standards specified. This might be different, however, in the case that lead firm C does not want to lose its well-established relationship with supplier B due to the failure of A to comply, or when B has become insolvent.<sup>117</sup> It might therefore still be interesting for firms seeking to regulate supplies beyond their contracting parties and see to it that they are third party beneficiaries to the sales contracts concluded between suppliers down the chain.

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<sup>115</sup> See for a discussion of these elements under Californian law: Vytopyl 2015 (n 32), 205-211.

<sup>116</sup> More common why to regulate the chain for lead firms is by imposing contractual obligations on their suppliers and at the same time requiring this first tier to impose the same obligation on its own suppliers, and pass on this obligation to any other actor in the supply chain all the way up to the raw material producer. See n 54 above and also Verbruggen 2014 (n 17), 90.

<sup>117</sup> See also Beale et al. 2010, p. 1232.

## 6. Conclusion

Private regulatory standards are often incorporated in contemporary commercial contracts and come to fulfil an important role in the management and control of risks along global supply chains. Their incorporation may involve a range of different techniques, potentially affecting not only contracted suppliers but also other actors constituting the chain. It was observed that in practice private compliance mechanisms such as auditing and certification schemes are the principal sites of monitoring and enforcement of incorporated regulatory standards, offering important benefits for business actors compared to formal judicial proceedings. In the rare event that non-compliance with contractual obligations is litigated in court through an action in contract, theories of contract interpretation are highly relevant in determining the outcome of the case. Here, courts in common law jurisdictions are likely to show a strong degree of deference to the standard, attributing primary importance to the wording of standards and the clauses through which they are incorporated in the contract. Such reading of the contract terms and adjacent standard may also raise difficulties for third parties potentially benefiting from the contractual imposition of regulatory standards on suppliers to be considered as the intended third party beneficiaries that can seek redress against non-compliant suppliers. Consequently, the formal law of contract may not be considered truly effective in encouraging compliance with private regulatory standards.<sup>118</sup> Arguably, this is also a key explanation as to why the monitoring and enforcement of compliance with private regulatory standards for the most part takes place outside the formal institutions of contract law enforcement.

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<sup>118</sup> The contributions by Menting, Mataija and Beckers in this volume similarly highlight the conflicts in and challenges for contract law to effectively regulate private codes of conduct. These authors more closely address the normative question of how contract law should respond to these issues and may better accommodate the widespread usage of codes of conduct in contract law and contract enforcement.