

Fordham International Law Journal

Volume 36, Issue 6

2013

Article 5

The Regulatory Functions of Transnational Commercial Contracts New Architectures

Fabrizio Cafaggi*

*Scuola Nazionale dell'Amministrazione

Copyright ©2013 by the authors. *Fordham International Law Journal* is produced by The Berkeley Electronic Press (bepress). <http://ir.lawnet.fordham.edu/ilj>

ARTICLE
THE REGULATORY FUNCTIONS OF
TRANSNATIONAL COMMERCIAL CONTRACTS:
NEW ARCHITECTURES

Fabrizio Cafaggi *

INTRODUCTION.....	1558
I. SUPPLY CHAINS AS TRANSNATIONAL REGULATORY REGIMES.....	1563
II. SUPPLY CHAINS, CONTRACTS, AND THE REGULATORY RELATIONSHIPS	1566
III. PATTERNS AND CONSEQUENCES OF TRANSNATIONAL REGULATION BY CONTRACTUAL GOVERNANCE	1571
A. Compliance with Human Rights Policies and Contractual Regulatory Provisions.....	1573
1. Instruments to Ensure Human Rights Compliance: Comparing Corporate and Contractual Tools	1573
B. Compliance with Technical Standards via International Contracts	1583
1. The Broadening Scope of Warranties and Seller's Performance in Transnational Commercial Contracts.....	1586
2. Product and Process Standards.....	1596
3. How Does Contractualization of Standards Complement or Substitute Existing Contract Remedies?.....	1598
IV. MONITORING AND SANCTIONING BREACH OF REGULATORY PROVISIONS IN TRANSNATIONAL COMMERCIAL CONTRACTS: RETHINKING THE CONTRACTUAL ARCHITECTURE.....	1600
A. Monitoring Contractual Performance of Regulatory Provisions: The Interplay Between Private Regulators and Certifiers.....	1601

1. Certifiers and Third-Party Monitoring of Contractual Performances Along the Supply Chain	1603
2. External Monitoring by Third-Parties and Internal Monitoring Within the Supply Chain Become Intertwined	1609
B. Remedies and Sanctions for Regulatory Breaches: Conflicts and Coordination of Different Systems ..	1611
CONCLUSION	1616

INTRODUCTION

Transnational commercial contracts are changing in their functions and scope.¹ They are used to coordinate supply chains, and reflect a system of coordinated exchanges whose aims include quality and safety management. In many contracts between retailers and suppliers, or between different tiers of suppliers along the supply chain, the commercial sections of the contract concerning, inter alia, the terms of exchange, price, quantity, place of delivery, and means of payments, tend to become relatively standardized, while a growing regulatory

* Professor of regulation at Scuola Nazionale dell'Amministrazione; Professor of private law at University of Trento (on leave); Director of the Center for Judicial Cooperation at the European University Institute ("EUI"); founding member of the European Law Institute ("ELI") and member of the American Law Institute. This Article has been written within the Tekes Project on "Transnational Private Regulation ("TPR") and System Level Innovations in Global Food Value Chains" in collaboration with Turku University of Applied Sciences (Finland, 2011-2013). It was presented at EUI in Florence in April, 2012, at the University of Victoria, BC, Canada, on September 6th and 7th, and at the University of Pennsylvania regulation program on October 15. Thanks to Ken Abbott, Cary Coglianese, Chuck Mooney, and David Zaring for their comments. This Article has greatly benefited from the collective research at EUI within the Hague Institute for Internationalisation of Law (HiIL) Project on Transnational Private Regulation and Contractual Practices. I am particularly grateful to my students at the EUI who have challenged many of these hypotheses, forcing me to rethink many of my descriptive and normative assumptions. Thanks to Aditi Bagchi, Olivier de Schutter, John Humphrey, and Paola Iamiceli for very thoughtful comments on a previous draft. Thanks to Stephanie Law and Maciej Borowicz for excellent research and editorial assistance. Thanks to the editors of the *Fordham International Law Journal* for their excellent editorial support.

1. See generally Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 *YALE L.J.* 814, 878-79 (2006) (characterizing transnational commercial contracts as moving beyond a formalist approach to a function of contractual governance as they are increasingly developed to anticipate not only litigation but also arbitration, renegotiation, and settlement).

section is inserted.² These regulatory provisions often refer to transnational regimes implemented via transnational commercial contracts.³ Transnational contracts are used to import or export regulations across countries, sometimes complementing and, in other times, replacing modes of implementation defined by international public regimes.⁴

Transnational commercial contracts have become vehicles for the implementation of transnational regulation, giving rise to new contractual architectures combining different logics: international trade and transnational regulation. The logic of commercial exchanges differs from that of regulatory provisions, both in terms of focus and objectives, as follows: (1) commercial exchanges focus mainly on products, whereas regulatory provisions focus mainly on process; (2) the former is often limited to individual transactions, while the latter encompasses a number of linked transactions focusing on the interdependence of contractual relationships along the chain; and (3) the former aims at redressing the victim of the breach, while the latter tries to restore compliance with regulatory process in order to pursue regulatory objectives and deter future violations.

The focus of this Article is on public, private, and hybrid regulatory regimes as they relate to social, environmental, and safety standards incorporated by reference into transnational

2. See Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 545 (2003) (arguing the broadening functions of contract law retain the singular purpose of promoting efficient trade and investment); see also Richard Craswell, *Contract Law: General Theories*, in 3 ENCYC. OF LAW & ECON. § 4000 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (referring to the more long-standing discourse of behavioral economists about the regulatory effect of default contractual provisions). See generally Peer Zumbansen, *The Law of Society: Governance Through Contract*, 14 IND. J. GLOBAL LEGAL STUD. 191 (2007) (exploring the critique of governance through contract, the understanding of contractual governance from formalist and realists perspectives, distinguishing between “governance by contract” and “governance of contract,” and promoting the understanding of contract as an embedded societal arrangement encompassing conflicting rationalities).

3. See Fabrizio Cafaggi, *New Foundations of Transnational Private Regulation* 5–9 (Eur. Univ. Inst., Working Paper No. 53, 2010) [hereinafter *New Foundations*] (exploring the link between transnational private regulation and the choice of instruments, in particular the use of contract and contractual governance at the transnational level).

4. See *id.* at 5 (discussing State inability to regulate and monitor compliance with international law).

contracts.⁵ In particular transnational commercial contracts are increasingly transforming international soft law into binding requirements for private parties.

These regulatory regimes may include rules concerning safety standards implementing, for example, Hazard Analysis & Critical Control Point (“HACCP”), or pesticide codes of conduct in the area of food safety.⁶ They may have clauses that require suppliers to respect minimum wage laws, protections against child labor, the freedom of association, and collective bargaining provisions in the area of corporate social responsibility (“CSR”).⁷ They may also include commitments to environmental standards, ranging from barring the use of ozone-depleting substances to carbon footprint regimes.⁸

5. Similar problems arise with investment contracts between private parties and between states and investors. For an introduction, see Lorenzo Cotula, *Int’l Inst. for Env’t & Dev., Investment Contracts and Sustainable Development* (2010), *available at* <http://pubs.iied.org/pdfs/17507IIED.pdf>.

6. *See, e.g.*, Amended and Restated Manufacturing Agreement, GFA Brands, Inc.-Ventura Foods, LLC, para. 15.10, Jan. 1, 2011 [hereinafter *Smart Balance Amended*] (on file with author) (“Ventura shall provide Customer with the following policies, which shall be updated and resubmitted to Customer from time to time: Allergen Policy, HACCP Plan and Metal Detection Policy.”); Amended and Restated Master Distribution Agreement, Aramark SCM, Inc. para. A(1) (2006) [hereinafter *Aramark Agreement*] (on file with author) (“All Suppliers must establish and administer the following programs: 1. An operating Hazard Analysis Critical Control Point Program . . .”). *See generally* U.N. Food & Agric. Org., *Food Quality and Safety Systems—A Training Manual on Food Hygiene and the Hazard Analysis and Critical Control Point (HACCP) System*, <http://www.fao.org/docrep/w8088e/w8088e00.HTM> (last visited Sept. 28, 2013).

7. *See, e.g.*, License Agreement, Motorola, Inc.-Forward Indus., Inc., Exhibit 3, para. 2(b), Jan. 1, 2008 [hereinafter *Forward Agreement*] (on file with author) (“Manufacturer will assure that Products (including parts) will not be produced, manufactured, mined, or assembled with the use of forced, prison, or indentured labor, including debt bondage . . .”); *id.* para. 2(c) (“Manufacturer will operate safe, healthy and fair working environments, including managing operations so levels of overtime do not create inhumane working conditions. Manufacturer will pay workers at least the minimum legal wage, or where no wage laws exist, the local industry standard. Manufacturer will assure that workers are free to join, or refrain from joining, associations of their own choosing, unless otherwise prohibited by law. Manufacturer will not routinely require workers to work in excess of six consecutive days without a rest day.”).

8. *See, e.g., id.* para. 3(a) (“Manufacturer will implement a functioning environmental management system in accordance with ISO 14001 or equivalent . . .”); *id.* para. 3(b) (“Manufacturer certifies that Products and their parts do not contain and are not manufactured with a process that uses any Class I ozone-depleting substances . . .”).

Regulatory provisions can be included in collective or individual codes of conducts issued by MNCs.

Incorporation by reference is one dimension of a much broader phenomenon of the increasing interaction between transnational contracting, transnational regulation, and certification. The inclusion of regulatory provisions is often combined with reference to one or more certification schemes.⁹ Certification plays a major role in the implementation of contractual obligations of a regulatory nature affecting performance and breach standards. Certification requirements may be directly included in the provisions of the commercial contract, or they may be referred to, and articulated in, a separate certification contract.¹⁰ The functional connection between exchange (sale or sale plus services) and certification contracts is in place, binding the participants to the chain even when the certification system is not directly incorporated into the relevant contract. The content and the architecture of the former are affected by the requirements of the latter: not only do certification schemes demand compliance with regulatory provisions, but they also impose terms of exchanges directly affecting the contractual structure. For example, they may require minimum price clauses or impose a long-term duration of the contract.¹¹

Although this Article concentrates on incorporation of regulatory regimes into commercial contracts, its findings and conclusions could also apply to other forms of impact of transnational public and private regulation in contractual architectures. This Article more specifically focuses on the implications for monitoring and reacting to breaches of regulatory provisions when they result from simultaneous

9. See, e.g., Smart Balance Amended, *supra* note 6 (referring to manufacturer compliance with allergen, hazard, and metal detection policies); see also Forward Agreement, *supra* note 7, para. 2(b) (referencing compliance with minimum age and child labor policies).

10. See, e.g., *id.* para. 3(c) (“Manufacturer will provide material disclosure or certification, as defined in Motorola’s Controlled and Reportable Materials Disclosure Process . . .”).

11. See, e.g., *Aims of Fairtrade Standards*, FAIRTRADE INT’L, <http://www.fairtrade.net/aims-of-fairtrade-standards.html> (last visited May 20, 2013) (listing such key objectives of the Fairtrade International standards as “ensur[ing] that producers receive prices that cover their average costs of sustainable production” and “[f]acilitat[ing] long-term trading partnerships”).

breaches of multiple contracts and regulatory regimes. The following illustrations may exemplify the research questions addressed below.

If, for example, in the area of food safety, a farmer has to comply with a standard concerning the use of pesticides whose level is defined in a code of conduct, its violation constitutes both a breach of contract and an infringement of the code. The farmer/supplier will be subject to the typical sanctions for breach of warranty or breach of contract, which may range from replacement to payment of damages or price reduction, and also to those from the food safety code, which may include warnings, fines, or temporary or permanent exclusion from the regulatory regime with reputational consequences.

When suppliers commit to comply with social standards related to children, gender, or general labor conditions and these obligations have become part of the commercial contract, a breach may refer to the “commercial” contract with the buyer, to the employment contract, and to the code of conduct imposing obligations and the certification regime that attests compliance with fair labor conditions.

A third example concerns environmental rules. For example, if the seller/supplier violates process standards enacted to protect environmental standards, s/he breaches, at the same time, the contract with the buyer, the regulatory provision concerning environmental protection associated with the regime to which he committed, and the certification contract s/he has signed as a requirement of the commercial transaction.

A fourth example relates to electronic commerce. When traders use an electronic platform, they subscribe via the user agreement to different policies often enshrined in codes of conduct concerning privacy and copyright.¹² Once the transaction is concluded, parties are bound by the obligations arising from the sale contracts and those linked to the “regulatory” policies of the trading platforms concerning, for example, privacy and data protection. If the seller breaches the contract because s/he transfers the data to a third party without

12. See, e.g., *eBay User Agreement*, EBAY, <http://pages.ebay.com/help/policies/user-agreement.html> (last visited May 20, 2012).

authorization, in addition to the breach of contract, s/he breaches some of the codes to which s/he subscribed when s/he adhered to the user agreement concerning compliance with copyright and trademark principles.¹³

These examples are only illustrations of a much wider range of instances where the violations constitute at the same time a breach of the sale contract, of the certification contract, and violation of codes or guidelines, triggering simultaneous or sequential remedial systems. These regimes co-exist and interact to a much wider extent than contract scholarship, case law, and legislation have so far acknowledged. We distinguish different hypotheses depending on whether the same entity commits all of the violations or whether, technically, the same violation translates into breaches by different parties, inferring consequences for the design and architecture of transnational commercial contracts.

I. SUPPLY CHAINS AS TRANSNATIONAL REGULATORY REGIMES

Regulation concerning safety, environmental, and social standards may affect the entire supply chain governance, from the choice of the activities' location to those concerning the production process, transportation of goods and provision of services, and to distribution.¹⁴

For many commodities, standards increasingly concern process rather than product, and influence the relationship among the different knots of the chain. The production process by definition includes several modules of the chain and, therefore, cannot be encapsulated into single contracts. Thus changes driven by the pursuit of regulatory objectives concern not only individual contracts but also the entire set of contracts within modules of supply chains. In this Article, the impact of regulatory provisions on the architecture of transnational

13. See, e.g., *id.*

14. See Gary Gereffi et al., *The Governance of the Global Value Chain*, 12 REV. INT'L POL. ECON. 78, 99–100 (2005); see also Colin Pilbeam et al., *The Governance of Supply Networks: A Systematic Literature Review*, 17 SUPPLY CHAIN MGMT. 358, 358 (2012); John Humphrey & Hubert Schmitz, *Inter-Firm Relationship in Global Value Chains: Trends in Chain Governance and Their Policy Implications*, 3 INT'L J. TECH. LEARNING INNOVATION & DEV. 258, 258–82 (2008).

commercial contracts is examined to determine how contract design and contractual chain governance are affected by combining commercial and regulatory functions along global supply chains.

Transnational commercial contracts are used to implement public, private, and hybrid transnational regimes, the main purpose of which is often to increase the value chain and the welfare of beneficiaries.¹⁵ The differences among these regimes may affect the contractual technologies of regulatory implementation given that some standards may be mandatory whilst others are voluntary.

Private regulatory regimes related to quality and safety may be designed by codes of conduct, bilateral or multi-stakeholder agreements, and individual firms' policies. Transnational commercial contracts similarly to domestic ones have always had provisions concerning the safety or quality of the exchanged commodities. What is new, is that now the entire regulatory regime contained in a code of conduct or in a technical standard is incorporated and given binding force between parties or, as we shall see, all along the supply chain. This modifies the contractual architecture with the inclusion of new external relevant players and instruments involved in defining the terms of the bilateral exchange.

Private regulatory regimes differ as to the source and the effects. Clearly there is a difference between instances where the private regulatory provisions are adopted by an entire sector and those that are supply-chain specific. In the former case, they are aimed at building market-private regulation; in the latter, they generate private regulatory competition via product differentiation among supply chains. In both instances, commercial contracts serve as regulatory instruments but for very different purposes.

Transnational commercial contracts have also become vehicles of implementation of public international regulation. Public international regimes are often referred in contracts in order to bind private parties thereby ensuring horizontal effects between the actors, a result difficult to achieve through

15. See Michael E. Porter & Mark R. Kramer, *Creating Shared Value*, HARV. BUS. REV., Jan.–Feb. 2011, at 62, 75 (giving the example of environmental protection as a productivity driver rather than a constraint).

conventional public international law where obligations are primarily addressed to the states.¹⁶ Clearly, private parties have to comply with international mandatory law provisions. It is less clear whether they have to abide by soft law regimes. Public regimes include both treaty-based legislation, declarations of international organizations, conventions, and soft law instruments like, for example, guidelines or recommendations enacted by the Organization for Economic Co-operation and Development (“OECD”), the International Labour Organization (“ILO”), and the Food and Agriculture Organization of the United Nations (“FAO”). The most important point here is that implementation via transnational commercial contracts influences the legitimacy and effectiveness of these regimes, making them binding between private parties.¹⁷ Commercial contracts hence expand the effects of international public regulation to relationships between private parties and may increase their effectiveness by using private law as an enforcement mechanism.¹⁸

The inclusion of regulatory provisions in contracts modifies the unit of analysis. To the extent that contracts become transnational regulatory vehicles, they aim at producing effects well beyond the signatories of individual bilateral contracts. Hence, the unit of analysis for transnational regulation should no longer be the individual bilateral contracts between the supplier and the retailer; it should rather become the whole supply chain and the associated contracts which reflect the regulatory commitments undertaken by the parties, either by incorporating parts or entire codes of conduct and agreements or by making reference to them.¹⁹ Coordination along the

16. It is worth noting that while, for example, the OECD Guidelines for Multinational Enterprises, or ILO Recommendations, are technically non-binding, in practice, they might be adhered to as if they were binding. The ILO and OECD are also capable of making “hard” law, with the conventions constituting legally binding international treaties.

17. See Cafaggi, *supra* note 3, at 28 (“[S]trong public institutions are needed for private regulation to operate effectively and with credibility.”).

18. See, e.g., THE ENFORCEMENT OF TRANSNATIONAL REGULATION: ENSURING COMPLIANCE IN A GLOBAL WORLD 3 (Fabrizio Cafaggi ed., 2012) (“[R]egulated entities . . . undertake contractual or organizational commitments to abide by the rules and to comply with sanctions when infringements occur.”).

19. See Gereffi et al., *supra* note 14, at 98–99 (“The global value chains framework focuses on the nature and content of the inter-firm linkages, and the power that

chain, required by the obligation to implement regulatory standards, may affect power allocation because it can give stronger control to some of the participants in the chain or to third-parties associated with specific knots. In the recent past retailers have gained power over producers and imposed compliance standards to contractual parties along the chain. Different linkages between contracts reflect power allocation among participants.²⁰ The numerous structures of global supply chains, in particular, the ratio between in-house and outsourcing, may influence the definition of regulatory compliance procedures as will be illustrated below. This in turn affects performance and breach standards, often determined by chain leader even for upstream chain participants.

II. SUPPLY CHAINS, CONTRACTS, AND THE REGULATORY RELATIONSHIPS

If contracts are used as regulatory vehicles to implement standards and the unit of analysis becomes the supply chain, it is useful to further clarify how the supply chain operates as a transnational regulatory regime. More precisely, who are the regulators and the regulated?

Within the supply chain, the role of the regulator is performed, at times, by one of the contracting parties, the chain leader, and at other times by several contractual partners, consensually determining the content of standards and the compliance mechanisms including reference to certification schemes.²¹ Many times regulators are outside the chain and the chain leader simply requires standards defined outside the chain to be implemented by chain's participants. For the purpose of

regulates value chain coordination Thus, the governance of global value chains is essential for understanding how firms in developing countries can gain access to global markets"). *See generally* Humphrey & Schmitz, *supra* note 14.

20. *See* Humphrey & Schmitz, *supra* note 14, at 263 (highlighting the parameters used to govern supply chains, underlining the difference between hierarchies, networks, and markets as a means for inter-firm coordination, and identifying three types of linkages within this network: modular, relational and captive). *See generally* CORPORATE GOVERNANCE AND FIRM ORGANIZATION: MICROFOUNDATIONS AND STRUCTURAL REFORMS (Anna Grandori ed., 2004).

21. *See generally* Fabrizio Cafaggi, *Transnational Governance by Contract: Private Regulation and Contractual Networks in Food Safety*, in PRIVATE STANDARDS AND GLOBAL GOVERNANCE 195 (Axel Marx et al. eds., 2012) (explaining the integration of the value supply chain perspective with regulatory theory).

this Article we will include both direct regulation by the chain leader and adoption of standards produced by organizations outside the chain.

The regulated are generally the suppliers in the upstream part of the chain. In the former case, the regulatory process is highly hierarchical and generally deploys standard contract forms.²² In the latter case, regulatory power is more evenly distributed and both the content of performances and the choice of regulatory regimes are the outcomes of a bargain between contracting parties.²³ In the former case, the source of the regulatory power is authority, based primarily on market power; in the latter, it is a combination of authority and consent based on a collaborative project.²⁴ One therefore should not assume that the use of contracts as regulatory vehicles to implement regulation necessarily shifts the source of regulatory power from hierarchical to consensual. The allocation of regulatory power depends on the relative contractual bargaining power of the various enterprises along the chain and on thickness of the market structure. The *ex ante* distribution of contractual power influences the combination between hierarchy and consent, which, in turn, affects the choice of regulatory strategy and implementing tools, including joint problem solving between contractual partners along the chain.²⁵

Some tensions may arise between the regulatory and contractual dimensions. Within the supply chain, one party, usually the retailer, tends to regulate the other participants' conduct by way of contracting. Currently, this is primarily done via sequential bilateral contracting where the chain leader (the buyer) *de facto* imposes the same regulatory requirements along the chain on all contracting parties. The main contractor (the seller) is forced to assume contractually binding obligations towards the buyer not only for himself but also for the parties located upstream. Accordingly, the buyer 'delegates' control to

22. *See id.* at 197–99.

23. *See id.*

24. *See* A. Claire Cutler et al., *Private Authority and International Affairs*, in *PRIVATE AUTHORITY AND INTERNATIONAL AFFAIRS* 3, 15–20 (A. Claire Cutler et al. eds., 1999).

25. *See* Charles Sabel & Jonathan Zeitlin, *Experimentalist Governance*, in *THE OXFORD HANDBOOK OF GOVERNANCE* 169 (David Levi-Faur ed., 2012) (explaining how the “experimentalist architecture of EU governance” relates to “joint problem solving” between parties in the supply chain).

the seller to ensure compliance with regulatory requirements; the seller therefore becomes an agent, and to some extent, a trustee of the buyer and eventually of the final beneficiaries (customers or consumers). This delegation grounded in the commercial logic contrasts however with many regulatory regimes, which require instead coordination and active participation among all the participants, calling for multilateral rather than bilateral contracts and for sharing rather than conferring unilateral power to one participant. This tension emerges between the bilateral structure of commercial contracts and the multilateral architecture of regulatory regimes.

Monitoring compliance is entrusted in the final buyer and in the certifiers; but do the final beneficiaries have legal tools or does the fragmentation of the supply chain forces delegation to the retailer? Transnational commercial contracts are business-to-business contracts, but the regulatory provisions often aim at benefiting third-parties.

The beneficiaries of regulatory clauses vary depending on the individual provisions.²⁶ In safety regulation, beneficiaries are primarily consumers; in labor standards they are suppliers' employees; in environmental regulation, they are communities and collective groups.²⁷ As we shall see, these beneficiaries often cannot use contract remedies in case of non-performance due to the limits of domestic contract laws, primarily based on the principle of privity (*relativité du contrat*). In some limited cases, despite a lack of privity, contract law allows third-parties to recover against a breaching party.²⁸ However given the limits of

26. See, e.g., Ian Ayres & Jennifer Gerarda Brown, *Mark(et)ing Nondiscrimination: Privatizing ENDA with a Certification Mark*, 104 MICH. L. REV. 1639, 1645 (2006) (developing the concept of a private certification mark for "fair employment," which they would not enforce themselves but for which they would instead allow third-party beneficiaries to bring an action for breach: "Licensee and Licensor agree to designate as express third-party beneficiaries . . . all persons and entities that would be entitled to sue if EDNA were in effect [including] . . . all persons who are or have been employed by the Licensee or applied for employment with Licensee . . .").

27. In some instances the beneficiaries define the objectives in community development agreements that are referred to in transnational commercial contracts. These agreements are often the outcome of legislative requirement of free prior informed consent by indigenous communities or other local communities.

28. See RESTATEMENT (SECOND) OF CONTRACTS § 302 (1981) (explaining under what circumstances a third-party has a right to performance of the contract); see also 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 10.3 (3d ed. 2004) ("For example, a number of courts have held that a person who fails to get what a decedent

privity, domestic and international contract laws do not permit *action directe* by the buyer against third-parties (suppliers of the seller), with very few exceptions.²⁹ Direct legal protection of the beneficiaries through adjudication is predominantly ensured through tort, unfair competition, and other non-contractual doctrines.³⁰ However the increasing use of express warranties as a vehicle for ensuring compliance with third-party obligations is opening new regulatory avenues under contract law.

Contractual power influences the choice of regulatory implementation. The analysis of transnational contracts as regulatory vehicles should not be limited to the static perspective, assuming that power allocation remains the same

intended under a will has a claim against the lawyer who drafted the will as an intended beneficiary of the contract between the decedent and the lawyer even though the lawyer's performance was rendered to the decedent."); JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 17.4 (6th ed. 2009) ("A person may qualify as a third party beneficiary even if the person is not named, identifiable, or even in being at the time of contracting.").

29. *Action directe* is an instrument developed by French courts that permits an injured individual to sue for breach of a contract to which he or she is not a party. See, e.g., Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Mar. 9, 1983, Bull. civ. I, No. 92, 81 (Fr.); see also Cour de cassation [Cass.] [supreme court for judicial matters] com., May 15, 1972, Bull. civ. IV, No. 144, 143 (Fr.); Cour de cassation [Cass.] [supreme court for judicial matters] com., Apr. 27, 1971, JCP 1972 II 17280 (Fr.). For an example, see C. Aubert de Vincelles, *Linked Contracts Under French Law*, in CONTRACTUAL NETWORKS, GROWTH, AND INNOVATION 163, 177 (Fabrizio Cafaggi ed., 2011) ("Under French law, there is no possibility of 'action directe' except if there is specific legislation."). In relation to product liability, the French courts have engaged certain Code provisions, bringing together an *obligation de sécurité*, understood to be attached to the product, with the *garantie contre les vices cachés*, with which the *action directe* allows for the circumvention of *la relativité des conventions*, and essentially provides the buyer with the scope to "skip" stages in the supply chain and bring a contractual action against the manufacturer. See CODE CIVIL [C. CIV.] arts. 1641-48 (Fr.) (explaining *garantie contre les vices cachés* as the liability of the seller to the buyer); see also Cour de cassation [Cass.] [supreme court for judicial matters] ass. plén., July 12, 1991, Bull. civ. 1991, No. 5, JCP 1991 II 21743, note G. Viney (Fr.) (attachment to the product); Simon Taylor, *Harmonisation or Divergence? A Comparison of French and English Product Liability Rules*, in PRODUCT LIABILITY IN COMPARATIVE PERSPECTIVE 221, 232 (Duncan Fairgrieve ed., 2005) ("French judges have got round the principle of 'la relativité des conventions' (the equivalent of our privity of contract) by various techniques in order to allow buyers to jump the links in the supply chain to sue in contract the manufacturer of the goods or any intermediate supplier.").

30. Compare Sale of Goods Act, 1979, c. 54, §§ 14(1), 49(1) (U.K.) (in English law, the professional seller will be strictly liable to his immediate buyer), with *Dunlop Pneumatic Tyre Co. v. Selfridge & Co.*, [1915] A.C. 847 (H.L.) (appeal taken from Eng.) (the doctrine of privity ensures that a contractual action can be brought against a manufacturer only by the immediate buyer; any other action must be in tort).

and does not change over time. It should rather move to a dynamic perspective where both changes in the regulatory regimes and changes in the allocation of contractual power along the chain may require re-definition of the regulatory choices. How does the supply chain adapt to regulatory changes related to safety or quality standards driven by the chain leader? Often the content of the contracts between main contractors and suppliers depends upon the contract between the retailer and contractor, and unilateral modifications to the latter contracts are “automatically” transferred to those upstream.³¹ The retailer acts as a regulator, imposing on upstream regulatees (the sellers), the new rules when for example s/he adopts a new quality management system. Contract law provides relatively efficient mechanisms to ensure regulatory adaptation.³²

I have argued elsewhere that often this type of contractual architecture might not optimize the achievement of the underlying regulatory objectives and have suggested that

31. *See, e.g.*, Aramark Corp., Master Distribution Agreement (Form 10-Q), para. 18(a), at 22-23 (May 12, 2011) (on file with author) (“Sysco shall cause its suppliers of SYSCO ® Brand products (including the Specialty Companies) to adhere to such standards as are applicable to such suppliers of such products. Such standards may be revised at any time and from time to time by ARAMARK, and unless otherwise agreed shall be effective upon receipt thereof by Sysco.”).

32. Contracts often have clauses that permit automatic modifications following the modifications to which the main contract between retailer and supplier have been subject. Most of these contracts make reference to the need for modifications to be in writing and expressly agreed upon by the parties. *See e.g.*, BMW Group International Terms and Conditions for the Purchase of Production Materials and Automotive Components, Navigation Tech. Corp.-BMW Grp. Int’l, para. 20.1, Sep. 24, 2001 [hereinafter Navteq Terms and Conditions], *available at* <http://contracts.onecle.com/navteq/bmw.terms.shtml> (“No amendment, modification, termination or waiver of any provision of these Terms and Conditions or of any Supply Contract . . . shall under any circumstances be effective unless the same shall be in writing and signed by both parties, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given.”); *see also* Supply Agreement, Cone Mills Corp.-Levi Strauss & Co., para. 9, Mar. 1992 (on file with author) (“Neither this Agreement nor the Order Documentation may be amended or modified except by an instrument in writing signed by both parties.”); Manufacturing Agreement for Margarines and Spreads, GFA Brands, Inc.-Ventury Foods LLC, para. 24, May 2, 2007 (on file with author) (“[T]his Agreement shall be suitably amended so that it will comply with such law, ordinance, rule, order or regulation”); International Banana Purchase Agreement, Chiquita Int’l Ltd.-Banana Int’l Corp. para. 8.3 [hereinafter Chiquita Purchase Agreement] (on file with author) (providing for the “unilateral termination” of the contract for the reasons provided in the clause).

contractual networks, possibly combined with bilateral contracts, might perform better.³³ In this Article the focus is not on the alternative forms of contractual governance of supply chains acting as regulatory implementation vehicles; it is rather on the implications for contractual architecture of combining commercial and regulatory dimensions within the same contract.

III. PATTERNS AND CONSEQUENCES OF TRANSNATIONAL REGULATION BY CONTRACTUAL GOVERNANCE

Three questions concerning the use of transnational commercial contracts as vehicles for implementation of regulatory regimes are examined:

- (1) Why has the increase of regulatory provisions been incorporated into commercial contracts and what are the drivers of this phenomenon?
- (2) How have regulatory provisions been incorporated into the contracts?
- (3) What are the consequences, proximate and remote, of regulatory provisions' incorporation into transnational commercial contracts?

The answers to these questions should contribute to explain how regulatory power is allocated through contracts and how that power is exercised along the chain. Furthermore, answers to these questions should provide some insights on wider issues of legitimacy and effectiveness of transnational governance by contracts.

(1) Why has the increase of regulatory provisions been incorporated into commercial contracts and what are the drivers of this phenomenon?

Before engaging in a fully-fledged analysis, it is worth pointing out that commercial contracts have always had a regulatory dimension. Quality and safety of the exchanged commodities were mainly ensured via warranties or contractual performance. The standards to define and measure contractual

33. See Cafaggi, *supra* note 21, at 207–10.

obligations were defined by the parties using express warranties or by judicial intervention in the case of implied warranty. References in business-to-business contracts were primarily to trade and commercial standards. Nowadays references to define safety and quality are made to transnational regulatory regimes and to technical standards. The landscape of transnational commercial contracts is composed not only by parties and adjudicators but it also includes many other actors participating in the definition of contractual obligations and in the monitoring architecture. The introduction of regulatory provisions implies (intentional and unintentional) contributions to contractual design and architecture by additional actors.

The drivers of the process, leading to incorporation of regulatory clauses in commercial contracts, are multiple and can be distinguished between endogenous and exogenous factors, varying across regulatory domains and types of commodities.

Endogenous factors depend on the modifications of market structures, business models and the evolution of industrial organizations schemes. The traditional Coasean “make or buy” choice applies also to regulatory schemes where the large enterprises face the dilemma between internally-produced rules and externally-generated rules to be internally implemented.³⁴ In the former case, the multi-national corporation (“MNC”) produces its own standards through policy, compliance programs, and codes of conduct. In the latter case, it refers to codes produced by external players, such as trade associations, non-governmental organizations (“NGOs”), private meta-regulators like the ISEAL Alliance or certifications schemes and technical standards produced by the International Organization for Standardization (“ISO”) or other standard-setting bodies like Fairtrade Labeling Organization (“FLO,” now Fair Trade International). Even in the latter case, the implementation within the supply chain is driven by the objective of economizing the sum of governance and transaction costs, which leads to a certain degree of tailoring.³⁵ Regulatory provisions’ compliance may be subject to different monitoring regimes. The choice between internal versus external monitoring may bring about a

34. See R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937).

35. See generally HENRY HANSMANN, *OWNERSHIP OF ENTERPRISE* (1996).

different role for certifiers in ensuring contractual performance along the supply chain.³⁶

Among the exogenous factors, at least two are worth examining more specifically: compliance with human rights policies and compliance with technical standards. We will show how human rights policies concerning different human rights use commercial contracts to ensure regulatory compliance.

A. *Compliance with Human Rights Policies and Contractual Regulatory Provisions*

Before examining these two factors in turn, it is useful to locate regulatory provisions in the more general framework of private law instruments aimed at controlling human rights compliance.

1. Instruments to Ensure Human Rights Compliance: Comparing Corporate and Contractual Tools

The control of human rights compliance over the supply chain, according to the standard view, may be based on two different instruments: (1) compliance programs, applicable to subsidiaries and branches, which mainly deploy corporate law; and (2) obligations along the supply chain imposed on the sellers, which operate primarily through contract law.³⁷ The two instruments reflect two organizational models. Often MNCs deploy both models simultaneously; the compliance of human rights policies would thus depend on the coordination between internal compliance models and contractual obligations across a

36. See, e.g., Stefano Boccaletti & Kostas Karantininis, *Quality Signals and Agri-Food "Chain Reactions"*, in PARADOXES IN FOOD CHAINS AND NETWORKS 260 (J.H. Trienekens & S.W.F. Omta eds., 2002) (distinguishing, in the empirical part of their analysis, between organizations signaling quality with collective, individual, and both collective and individual brands); see also Maki Hatanaka et al., *Third-Party Certification in the Global Agrifood System*, 30 FOOD POL'Y 354, 354-69 (2005) (focusing on the role of third-party certifiers in monitoring). For a more general analysis emphasizing the substitution effects of public domestic regulation by third-party monitoring, see Margaret M. Blair et al., *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325 (2008).

37. See Humphrey & Schmitz, *supra* note 14, at 258-61 (discussing the alternative between the two models from the perspective of governance).

sequence of bilateral contracts along the supply chain.³⁸ Due diligence is now also applied to the relationship with contractual partners and those closely linked to the MNC.³⁹ Due diligence imposes on the MNC the duty to include contractual provisions in contracts with suppliers and monitor their compliance.⁴⁰ John Ruggie's approach to the spheres of influence has broadened the scope of CSR; the inclusion of contractual relationships are clearly now within the scope of due diligence.⁴¹ Due diligence instruments, driven by the necessity to comply with human rights policies, primarily deploy contracts when they have to apply to suppliers and partners along the chain.⁴² They translate into different commitments depending on whether they operate ex ante to ensure compliance or ex post as remediation devices when the violation has been committed.⁴³ Within the due diligence context, both the Ruggie principles and some courts include the duty to remedy the infringement, which implies the necessity to have in place both an effective monitoring system

38. See International Code of Conduct for Private Security Service Providers para. 16 (2010), <http://www.icoc-ppsp.org/> (follow "English" hyperlink) [hereinafter Int'l Code Private Security] (requiring signatory companies to ensure that the personnel and subcontractors comply with the code provisions).

39. See Special Representative of the U.N. Secretary-General, *Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises: Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework* ¶17(a), U.N. Doc. A/HRC/17/31 (Mar. 21, 2011) (by John Ruggie) [hereinafter Final Report of the Special Representative] ("[D]ue diligence ... [s]hould cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationship."); see also INT'L ORG. FOR STANDARDIZATION, ISO Standard 26000:2010 on Social Responsibility cl. 7.3.1 (2010) [hereinafter ISO 26000:2010] (defining due diligence as "organizational policies related to the relevant core subject that give meaningful guidance to those within the organization and those closely linked to the organization"); Shift & Inst. for Human Rights and Bus., *Oil and Gas Sector Guide on Implementing the UN Guiding Principles on Business and Human Rights* 30 (2011), http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr-sme/csr-oag-hr-business_en.pdf (highlighting the applicability of human rights due diligence obligation in any relationship whether with governments or suppliers).

40. See Keynote Address, Former Special Rep. of the Sec'y Gen. John Ruggie, *Engaging Business: Addressing Respect for Human Rights* (Feb. 25, 2010), www.hks.harvard.edu/m-rcbg/CSRI/newsandstories/Ruggie_Atlanta.pdf.

41. See Final Report of the Special Representative, *supra* note 39.

42. See *id.*

43. See Laura A. Dickinson, *Privatization and Accountability*, 7 ANN. REV. L. & SOC. SCI. 101, 104 (2011).

and a procedure to mitigate or remove adverse effects.⁴⁴ Thus, there are contractual commitments and duties to inform third-parties, which may affect compliance of the MNC with due diligence requirements.⁴⁵ Transnational commercial contracts are used to prevent or to mitigate other parties' violations.⁴⁶ The seller may undertake an obligation to control his suppliers and, in case of violation, to remedy the consequences.⁴⁷ While in theory one can draw a parallel with commercial obligations to cure defects of products and services, in practice, violations of regulatory duties often imply much more intrusive policies into

44. See California Transparency in Supply Chains Act of 2010, ch. 556, § 3, Cal. Legis. Serv. 556 (West 2010) (codified as amended at CAL. CIV. CODE § 1714.43 & CAL. REV. & TAX CODE § 19547.5) (requiring that retailers and manufacturers disclose their efforts to "evaluate and address" certain human rights-related considerations—including human trafficking and slavery—in their supply chains); see also Dodd-Frank Wall Street Reform and Consumer Protection Act § 1502, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (requiring that publicly-traded companies using certain conflict minerals must report on whether those minerals are "conflict free," requiring particular due diligence steps to be taken); ORG. FOR ECON. COOPERATION & DEV., DUE DILIGENCE GUIDANCE FOR RESPONSIBLE SUPPLY CHAINS OF MINERALS FROM CONFLICT-AFFECTED AND HIGH-RISK AREAS 17 (2011), available at <http://dx.doi.org/10.1787/9789264111110-en> (providing guidelines for risk-based due diligence in the mineral supply chain).

45. See Final Report of the Special Representative, *supra* note 39, paras. 25–27; Miriam Saage-Maass, Friedrich Ebert Stiftung, *Labour Conditions in the Global Supply Chain What Is the Extent and Implications of German Corporate Responsibility?* 13-18 (Dec. 2011), <http://library.fes.de/pdf-files/iez/08822.pdf> (providing an outline of jurisprudence of German courts on German parent companies for human rights violations). Nevertheless, this may be difficult to implement in practice. See, e.g., MARJON VAN OPIJNEN & JORIS OLDENZIEL, CTR. FOR RESEARCH ON MULTINATIONAL CORPS., RESPONSIBLE SUPPLY CHAIN MANAGEMENT 165–68 (Christine Anderton ed., 2011), available at http://ec.europa.eu/index_en.htm (search "Marjon van Opijnen") (discussing transparency in relation to published supplier audits).

46. See Larry Catá Backer, *Multinational Corporations as Objects and Sources of Transnational Regulation*, 14 ILSA J. INT'L & COMP. L. 499, 509–10 (2008) (noting the social and regulatory functions of commercial contracts).

47. It is also clear that this is the case in the production and supply of goods context. See Laura A. Dickinson, *Contract as a Tool for Regulating Private Military Companies*, in FROM MERCENARIES TO MARKET: THE RISE AND REGULATION OF PRIVATE MILITARY COMPANIES 217 (Simon Chesterman & Chia Lehnardt eds., 2007); see also LAURA A. DICKINSON, *The Unexplored Promise of Contract*, in OUTSOURCING WAR AND PEACE: PRESERVING PUBLIC VALUES IN A WORLD OF PRIVATIZED PUBLIC AFFAIRS 69 (2011); Valentina Calderai, *The Privatization of Military and Security Services and the Limits of Contract: Lessons from the U.S.* (Eur. Univ. Inst., Working Paper No. 31, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1887688 (discussing contracts between private military and security companies ("PMSCs") and major sovereign customers).

the governance of the firm which affect interdependence between the chain leader and the participants to the chain.

From a legal perspective, there is, however, a significant difference between the two instruments outlined above: corporate and contract.⁴⁸

The internal compliance model, which applies to the corporation, imposes duties to monitor its own divisions, and also to subsidiaries and increasingly often to their suppliers. Violations can have civil and even criminal liability implications.⁴⁹ Large corporations impose contractual obligations concerning compliance with human rights policies on the partners along the supply chain, but do not have a duty to monitor and ensure compliance towards consumers or other stakeholders.⁵⁰ They have a duty under criminal law on the basis of due diligence, but so far it has hardly given rise to contractual claims before courts.⁵¹ In certain cases, third-party enforcement occurs when, for example, banks introduce, in lending or other financial contracts, obligations of the borrower to effectively monitor human rights policies along the supply chain.⁵²

Requests to monitor human rights policies via contracts can come from codes of conduct signed by the MNCs.⁵³ If these are binding codes, then the private regulator, as the 'owner of the code,' monitors the undertakings of the MNCs.⁵⁴ If the codes are not binding, neither the private regulator nor, at least in theory, the third-party can enforce these duties to monitor against the

48. There has been some attempt to connect the discourse on corporate governance with contract governance. See Peer Zumbansen, *Rethinking the Nature of the Firm: The Corporation as a Governance Object*, 35 SEATTLE U. L. REV. 1469, 1470–71 (2012); see also Karl Riesenhuber, *A Need for Contract Governance?*, in FINANCIAL SERVICES, FINANCIAL CRISIS AND GENERAL EUROPEAN CONTRACT LAW 61 (Stefan Grundmann & Yesim M. Asamer eds., 2011).

49. See K.B. Huff, Note, *The Role of Corporate Compliance Programs in Determining Corporate Criminal Liability: A Suggested Approach*, 96 COLUM. L. REV. 1252, 1253–54 (1996).

50. *Id.* at 1275–76.

51. *Id.* at 1272–75, 1279.

52. See, e.g., Ioannis Ioannou & George Serafeim, *The Impact of Corporate Social Responsibility on Investment Recommendations* 22–23 (Harv. Bus. Sch., Working Paper No. 11-017, 2010), available at <http://ssrn.com/abstract=1507874> (discussing how investors view CSR obligations).

53. See Sara Coleman, Note, *Enforcing International Framework Agreements in U.S. Courts: A Contract Analysis*, 41 COLUM. HUM. RTS. L. REV. 601, 607–08 (2010).

54. *Id.* at 623.

MNC before a court.⁵⁵ Here, the obligations are imposed on suppliers, and MNCs have the power to monitor their execution, while under the code they do not have a duty to comply.⁵⁶ Codes of conduct may instead impose positive obligations to include clauses that require subcontractors to comply with human rights.⁵⁷ In some cases, they also provide general guidelines related to sanctions, in order to ensure an effective remedial system in case of non-compliance.⁵⁸ In other instances, they complement these provisions with obligations, which forbid entering into contracts whose clauses may violate human rights policies.⁵⁹ Further, codes of conducts may include negative obligations, with provisions that forbid entering into contracts (for example lending contracts for banks) with companies that do not comply with human rights policies. The latter is a contractual technique to implement the conditionality principle often used by financial and credit institutions.⁶⁰

We can now turn to the more specific analysis of the relationship between human rights standards and contractual governance, leaving aside corporate law instruments.

55. *Id.* at 625–26.

56. *Id.* at 608.

57. For the view that under an analysis of current US law, codes of conduct should not be understood to be binding, see Katherine E. Kenny, *Code or Conduct: Whether Wal-Mart's Code of Conduct Creates a Contractual Obligation Between Wal-Mart and the Employees of Foreign Suppliers*, 27 NW. J. INT'L L. & BUS. 453, 459–63 (2007).

58. *See id.* at 467.

59. *See, e.g.*, Int'l Code Private Security, *supra* note 39, art. 20 (“Signatory Companies will not knowingly enter into contracts where performance would directly and materially conflict with principles of this Code, applicable national or international law, or applicable local, regional and international human rights law, and are not excused by any contractual obligation from complying with this Code. To the maximum extent possible, Signatory Companies will interpret and perform contracts in a manner that is consistent with this Code.”).

60. *See, e.g.*, *Cooperative Bank Policy on Human Rights*, COOPERATIVE BANK, <http://www.goodwithmoney.co.uk/ethical-banking/> (last visited May 23, 2013) (explaining that the bank has withheld large amounts of funding from “business activities that its customers have said are unethical”); *see also Barclays Group Statement on Corporate Conduct and Ethics*, BARCLAYS 8, <http://group.barclays.com/about-barclays/citizenship/policy-positions> (follow “Corporate conduct and ethics” hyperlink; then follow “Barclays Statement on Corporate conduct and ethics (PDF)” hyperlink) (last visited May 23, 2013); *Barclays Group Statement on Human Rights*, BARCLAYS 4, <http://group.barclays.com/about-barclays/citizenship/policy-positions> (follow “Barclays Statement on Human Rights” hyperlink; then follow “Barclays Statement on Human Rights (PDF)” hyperlink) (last visited May 23, 2013).

Human rights policies are increasingly incorporated into CSR standards, which deploy contracts as vehicles for regulatory implementation. An important factor is the NGOs' and international organizations' pressure on retailers to take some responsibility for monitoring human rights standards along the chain.⁶¹

Both CSR and food safety provide an illustration of how the changing perspective of human rights protection and its link with the supply chain is inducing a wider scope for transnational contractual governance.⁶²

In the field of CSR, John Ruggie, the UN Rapporteur, has published the guidelines, which, in two Principles, expressly reference the supply chain implementation.⁶³ The OECD

61. See Christopher McCrudden, *Human Rights Codes for Transnational Corporations: What Can the Sullivan and MacBride Principles Tell Us?*, 19 OXFORD J. LEGAL STUD. 167, 169 (1999); César A. Rodríguez-Garavito, *Global Governance and Labor Rights: Codes of Conduct and Anti-Sweat Shop Struggles in Global Apparel Factories in Mexico and Guatemala*, 33 POL. AND SOC'Y, 203–33 (2005) (affirming that multi-stakeholder initiatives and NGOs can work to strengthen government enforcement of national laws, particularly when states lack the capacity or the resources). On the campaign brought on by NGOs against several financial institutions as regards their investment policies, which triggered an internal debate in one of the targeted institutions, namely the Deutsche Bank, see Harald Schumann, *The Hunger-Makers: How Deutsche Bank, Goldman Sachs and Other Financial Institutions are Speculating with Food at the Expense of Poorest*, FOODWATCH (2011).

62. See GRAF-PETER CALLIESS & PEER ZUMBANSEN, *ROUGH CONSENSUS AND RUNNING CODE: A THEORY OF TRANSNATIONAL PRIVATE LAW* 96–112 (2010) (reassessing the transnational regulation of consumer contracts and corporate governance in light of proliferation of rule-creators and compliance mechanisms that can no longer be clearly associated with either the state or the market); CHRISTOPHER MCRUDDEN, *BUYING SOCIAL JUSTICE: EQUALITY, GOVERNMENT PROCUREMENT, AND LEGAL CHANGE* (2007); Larry Catà Backer, *Economic Globalization and the Rise of Efficient Systems of Global Private Law Making: Wal-Mart as Global Legislator*, 39 CONN. L. REV. 1739, 1739–84 (2007) (analyzing the development of efficient systems of private law-making that are grounded in private law, contractual and business connections between the great multinational corporations and the many entities with which they have business relationships); see also *Nestlé Cocoa Plan*, NESTLÉ, <http://www.nestlecocoaplan.com/> (showing that the Nestlé plan includes the training of farmers and improving social conditions in cocoa-growing areas).

63. See Final Report of the Special Representative, *supra* note 39, para. 13 (“The responsibility to respect human rights requires that business enterprises: (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.”); see also *id.* para. 17 (“In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out

Guidelines for Multinational Enterprises subscribe to this approach.⁶⁴ Ruggie's principles reflect a widespread policy development where MNCs are required to control compliance with human rights policies codified in the principle of respect as part of the protect, respect, remedy strategy.⁶⁵ There is a strong tendency to impose on MNCs the control and the burden of ensuring human rights' respect by enterprises along the entire supply chain, with some differences depending on the business models. This approach is justified on the basis of multiple rationales. From an efficiency standpoint, to delegate the management of monitoring and enforcement costs to the MNCs saves international organizations and states costs and increases effectiveness. MNCs have devised different governance mechanisms to ensure compliance, which are partly dependent on the combination of outsourcing and vertical integration. From the perspective of accountability, the structure of the global value chain also suggests that the main responsibility for control should lie where the value accrues, i.e. in MNCs.

A different yet even more connected approach from that of Ruggie is the shared value perspective promoted by Michael Porter, where significant importance is attributed to supply

human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed. Human rights due diligence: (a) Should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships; (b) Will vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations; (c) Should be on-going, recognizing that the human rights risks may change over time as the business enterprise's operations and operating context evolve.”).

64. See Org. for Econ. Co-operation & Dev., Guidelines for Multinational Enterprises 31 (2011), <http://www.oecd.org/daf/inv/mne/48004323.pdf> (“Enterprises should . . . [s]eek ways to prevent or mitigate adverse human rights impacts that are directly linked to their business operations, products or services by a business relationship, even if they do not contribute to those impacts.”).

65. See Final Report of the Special Representative, *supra* note 39, paras. 11, 13 (“The responsibility to respect human rights . . . [extends to] adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.”). In the commentary it is clarified that “business relationships’ are understood to include relationships with business partners, entities in its value chain, and any other non-State or State entity” *Id.* para. 13, at 14.

chains and clusters when designing and implementing regulations to enhance both productivity and societal values.⁶⁶

Human rights policies go well beyond CSR. In the field of food safety, the UN Rapporteur Olivier de Schutter has linked the right to food to the supply chain and has recommended changes in contractual practices in order to comply with the human right to food.⁶⁷

In the context of food safety and quality, as in the case of CSR, the role of certification in defining both access and modes of relationships, including contractual relationships among participants to the chain, has become very relevant.⁶⁸ Buyers often require sellers to be compliant with certification schemes as a prerequisite to enter into long-term contractual relationships.⁶⁹ Lack of compliance symmetrically can determine exit from the contractual relationship and eventually from the chain. The issue of decertification is relevant here to ensure adequate incentives for compliance.⁷⁰

Internet Service Providers (“ISPs”) have similarly committed to comply with human rights policies by adopting internal compliance programs and contractual policies that

66. See Porter & Kramer, *supra* note 15, at 65 (asserting that addressing societal values ultimately leads to greater productivity through innovation).

67. Special Rapporteur, *The Right to Food*, ¶¶ 29–32, 38–42, U.N. Doc. A/67/268 (Aug. 8, 2012) (by Olivier De Schutter) [hereinafter U.N. Doc. A/67/268].

68. See *id.* paras. 62–63.

69. See, e.g., TESCO PLC, TESCO CORPORATE RESPONSIBILITY REPORT 2011, at 12, available at <http://www.tescopl.com/media/60113/tesco-cr-report-2011.pdf> (reporting that Tesco delisted their supplier, Asia Pulp and Paper, because Tesco could not be satisfied as to the sustainability of their timber sourcing); see also Wal-Mart Commitment to Sustainable Seafood, WAL-MART [hereinafter Wal-Mart Supplier’s Agreement], available at http://www.msc.org/documentos/otros-documentos-sobre-el-msc/compromiso-walmart-de-sostenibilidad-de-productos-del-mar-2011-ingles/at_download/file (last visited May 23, 2013) (requiring that seafood suppliers be “third-party certified as sustainable using Marine Stewardship Council (MSC), Best Aquaculture Practices (BAP), or equivalent standards. . . Should they fail to so do . . . Wal-mart U.S. and Sam’s Club U.S. will cease purchasing product from those fisheries”).

70. See e.g., *Australian Certified Organic Standard*, BIOLOGICAL FARMERS AUSTRALIA, §§ 3.1.17–21 (2010), http://www.bfa.com.au/Portals/0/ACO_2010_Standard_full.pdf (on decertification); see also Cal. Dep’t of Food & Agric., California Leafy Green Products Handler Agreement art. V, § D, at 8 (2008), available at <http://www.calefygreens.ca.gov/sites/default/files/LGMA%20marketing%20agreement%2003.08.pdf> (setting out the consequences of loss of certification).

should ensure compliance.⁷¹ The Global Network Initiative, an NGO self-described as committed to protecting online freedom of expression, constitutes one example of the type of commitment that Special UN Rapporteur Frank La Rue has acknowledged as encouraging good practices by corporations.⁷² The criteria for evaluating how these commitments are complied with are still being debated.⁷³

Two conflicts are particularly interesting for transnational regulatory contracts: the conflict between ISPs and privacy right holders, and that between ISPs, content providers, and copyright holders.⁷⁴ In both instances there are public, international, primarily soft law sources, and private agreements, mainly through Memoranda of Understanding (“MoUs”), which promote the adoption of contractual terms of services by imposing obligations to avoid or mitigate violations.⁷⁵ Absent an

71. See, e.g., Council Eur., *Human Rights Guidelines for Internet Service Providers* 3, http://www.coe.int/t/information/society/documents/HRguidelines_ISP_en.pdf (last visited Apr. 25, 2013) (declaring that Internet Service Providers (“ISPs”) are in a position to exercise the promotion of human rights).

72. See Special Rapporteur on the Promotion and Protection of the Right to Freedom of Opinion and Expression para. 48, Human Rights Council, U.N. Doc. A/HRC/17/27 (May 16, 2011) (by Frank La Rue) (“[T]he Special Rapporteur encourages corporations to establish clear and unambiguous terms of service in line with international human rights norms and principles, increase transparency of and accountability for their activities, and continuously review the impact of their services and technologies on the right to freedom of expression of their users, as well as on the potential pitfalls involved when they are misused.”).

73. When scrutinizing compliance by corporations with human rights commitments via internal policies of contract law, an open question can be asked relating to the applicability of the principle of proportionality. The principle of proportionality applies to state laws when conflicts between different regimes like freedom of expression and security or freedom of expression and data protection are in place. See *Governance Charter*, GLOBAL NETWORK INITIATIVE, § 1, https://globalnetworkinitiative.org/sites/default/files/GNI_Governance_Charter.pdf (last visited May 23, 2013). Similarly, I contend, the principle of proportionality should guide the analysis of contractual practices reflecting commitments with human rights.

74. For debate and analysis addressing the recent Italian case that, in the first instance, acknowledged the liability of an ISP for a violation of data privacy of a disabled person, see Mario Viola de Azevedo Cunha et al., *Peer-to-Peer Privacy Violations and ISP Liability: Data Protection in the User-Generated Web*, 2 INT’L DATA PRIVACY L. 50 (2012). As regards to the copyright debate, see Irina Baraliuc et al., *Copyright Enforcement in the Digital Age: A Post-ACTA View on the Balancing of Fundamental Rights*, 21 INT’L J. L. & INFO. TECH. 92 (2013).

75. See, e.g., *Memorandum of Understanding*, CTR. COPYRIGHT INFRINGEMENT (2011), <http://www.copyrightinformation.org/wp-content/uploads/2013/02/Memorandum-of-Understanding.pdf> (providing an example of the use of a Memorandum of

international agreement on the sale of counterfeited goods,⁷⁶ a proliferation of private agreements have emerged to ensure compliance with human rights policies, often without any direct binding force, especially in the field of copyright infringements.⁷⁷ These agreements constitute a clear example of private regulation concerning human rights compliance implemented through contractual terms on behalf of third-parties. The final beneficiaries in both cases, privacy right holders and copyright holders, are often not parties to the transnational commercial contract. In the former case, the contracts are between content and service providers and they impose obligations on content providers to respect privacy rights. In the latter case, the terms of use of internet trading platforms should impose an obligation on buyers and sellers to respect copyright laws and protect copyright owners.⁷⁸

Understanding ("MoU") to impose obligations). In the case of privacy issues, the drafting of shared principles has also been used. *See, e.g.*, Am. Assoc. of Adver. Agencies, "Self-Regulatory Principles for Online Behavioral Advertising" (2009), http://www.iab.net/public_policy/behavioral-advertisingprinciples (drafted and signed by leading industry associations as regards online behavioral advertising across the Internet); *Safer Social Networking Principles for the EU* (Feb. 10, 2009), http://ec.europa.eu/digital-agenda/sites/digital-agenda/files/sn_principles.pdf (drafted and signed by social networking sites in consultation with the European Commission, which acted as a facilitator, and a number of NGOs involved in child welfare). For a review of different forms of transnational cooperation involving private actors, see Fabrizio Cafaggi et al., *Transnational Private Regulation*, in ORG. FOR ECON. CO-OPERATION & DEV., 3 INTERNATIONAL REGULATORY CO-OPERATION: CASE STUDIES 9 (2013), available at <http://ec.europa.eu/digital-agenda/sites/digital-agenda/files/discussions/Transnational%20Private%20Regulation%20-%20F.%20Cafaggi.%20A.%20Renda.%20R.%20Schmidt.pdf>.

76. *See* Anti-Counterfeiting Trade Agreement, Dec. 3, 2010, 50 I.L.M. 243 (The Anti-Counterfeiting Trade Agreement ("ACTA") is a multinational agreement with the purpose of establishing standards for the enforcement of intellectual property rights which has been signed by thirty-one jurisdictions including the European Union and United States).

77. *See Memorandum of Understanding*, *supra* note 75, § 4(F) ("Each Participating ISP agrees to communicate the following principles in its Acceptable Use Policies ("AUP") or Terms of Service ("TOS") . . .").

78. Consider, for example, eBay's "copyright policy," which provides that "eBay urges its sellers and buyers to comply with all governmental laws and regulations." *Copyright Basics: Why Does eBay Have this Policy?*, EBAY, <http://pages.ebay.com/help/sell/copyrights.html> (last visited Sept. 29, 2013). Further, see craigslist's policy regarding prohibited items, where it is stated that "craigslist users remain responsible for complying with all applicable laws, regulations or restrictions on items, services, or manner of sale, payment or exchange, that may apply to transactions in which they participate—including but not limited to those imposed by the state of California, where craigslist physically resides. We encourage you to research the applicable laws and

B. *Compliance with Technical Standards via International Contracts*

Technical standardization is a second driver of using transnational commercial contracts as vehicles for implementation of transnational regulation.⁷⁹ There has been a remarkable shift at the transnational level from public regimes toward technical standardization. What is considered to be a legal standard at the domestic level often shifts towards a technical standard in the transnational domain, partly due to the weaknesses of states as global regulators.⁸⁰ CSR is a typical example of an area that has progressively been subsumed by the technical standardization domain. The ISO approach to CSR under ISO Standard 26000, requires both the adoption of internal programs ensuring compliance, and the promotion of respect along the supply chain.⁸¹ The adoption of the Ruggie approach of the sphere of influence in ISO 26000 has consequences over the regulatory functions of contracts along the supply chain.

Under section 7 of ISO 26000, the standard indicates how due diligence should be interpreted in relation not only to the organization but also to its sphere of influence which can

regulations that may apply to your usage of and activities on and relating to craigslist." *Prohibited Items*, CRAIGSLIST, <http://www.craigslist.org/about/prohibited.items> (last visited Sept. 29, 2013). Similarly, in Etsy Marketplace, the terms and conditions affirm that "You are solely responsible for your conduct and activities on and regarding to Etsy and any and all data, text, information, usernames, graphics, images, photographs, profiles, audio, video, items, and links (together, "Content") that you submit, post, and display on Etsy. Restricted Activities: Your Content and your use of Etsy shall not: . . . [i]nfringe upon any third-party's copyright, patent, trademark, trade secret or other proprietary or intellectual property rights or rights of publicity or privacy." *Terms of Use: Prohibited, Questionable and Infringing Items and Activities*, ETSY, para. 5, <http://www.etsy.com/help/article/479> (last visited Sept. 29, 2013).

79. See, e.g., Navteq Terms and Conditions, *supra* note 32, para. 9.1 ("Unless stated otherwise in the Supply Contract, Seller shall comply with the quality standards set out in the Technical Specifications ISO/TS 16949 'Quality systems - automotive suppliers - Particular requirements for the application of ISO 9001: 1994', as the same may be amended or replaced from time to time . . ."); *id.* para. 9.2 ("A series process quality evaluation . . . must be successfully completed by Seller before Goods are supplied: for the first time; or under a new part number; or after any process modification.")

80. See Janelle M. Diller, *Private Standardization in Public International Lawmaking*, 33 MICH. J. INT'L L. 481, 485 (2012) ("ISO 26000 thus represents a new generation of international private standardization initiatives that thrusts the private sphere into a more organized and direct commerce with public policy matters typically subject to public law and regulation.").

81. See ISO 26000:2010, *supra* note 39.

include those over which it has de facto rather than de jure control.⁸² It is worth underlining that contracts are among the instruments mentioned through which influence can be exercised.⁸³

Under section 6.6 of the fair operating practices of ISO 26000, several actions are suggested. In particular section 6.6.6 is focused on promoting social responsibility in the value chain.⁸⁴ Six actions are described, ranging from obligations to include contractual policies, and practices to integrate ethical, social, environmental, and gender equality criteria to encourage other organizations to adopt similar policies, carry out due diligence and the monitoring of organizations with which it has business relationships.⁸⁵

The ISO approach to food safety, with the 22000 standard, clearly reflects a supply chain approach even if the standard and its management are specifically referred to individual organizations.⁸⁶ In particular, hazard and risk related information need to be disseminated in the most effective way along the different part of the chain regardless of the degree of vertical integration. The standard equally applies, (this is perhaps on the limits), both to highly integrated chains and to fragmented chains where outsourcing to suppliers is predominant. In the latter case, the responsibility lies with the

82. *See id.* § 7.3.3.2 (“When an organization has de facto control over others the responsibility to act can be similar to the responsibility that exists where the organization has formal control. De facto control refers to situations where the organization has the ability to dictate the decisions and the activities of another party even when it does not have the legal or formal authority to do so.”).

83. *See* ISO 26000:2010, *supra* note 39.

84. *See id.* § 6.6.6.

85. *See id.* § 6.6.6.2 (“To promote social responsibility in its value chain an organization should: Integrate ethical, social, environmental and gender equality criteria and health and safety in its purchasing, distribution and contracting policies and practices to improve consistency with social responsibility objectives, Encourage other organizations to adopt similar policies, without indulging in anti-competitive behaviour in so doing, Carry out appropriate due diligence and monitoring of the organizations with which it has relationships, with a view to preventing compromise of the organization’s commitments to social responsibility . . .”).

86. *See* INT’L ORG. FOR STANDARDIZATION, ISO 22000:2005 on Food Safety Management § 7.3.1 (2005) [hereinafter ISO 22000:2005] (“This international standard requires to enable an organization (d) to effectively communicate to their suppliers, customers and relevant interested parties in the food chain . . .”).

outsourcing organization.⁸⁷ As outlined for CSR regulation, implementation may occur via corporate or contract instruments depending on the degree and mode of vertical integration.⁸⁸ Even within contractual instruments, depending on the scope and objectives of the standards, different contractual practices may be selected to enhance effectiveness.

ISO 22000 defines in great detail the control of non-conformity and the actions that need to be taken when hazards become known. They reflect only to a limited extent the actions required by sellers in a conventional commercial context. In particular, the link between curative and corrective actions and the role of withdrawals (which include recalls) regulated by section 7.10 of the standard often deviate from the logic of commercial transactions where the individual consumer or customer is considered. Here, the focus is on hazard elimination to ensure food safety; this concerns all the affected products.⁸⁹ The first distinction is clearly related to the difference between the individual dimension, which characterizes commercial aspects of the exchange along the chain, and the collective dimension of regulatory requirements. But, the second distinction is concerned with the parameters to be used to evaluate the choice between corrective actions and withdrawals, the obligation to repair, and the obligation to replace defective products in the commercial context. The contract law logic focuses on product rather than process and on the individual transaction rather than the whole supply chain. The regulatory logic instead privileges processes' and supply chains' collective management.

(2) How have regulatory provisions been incorporated into the contracts?

Different techniques are deployed to include these regulatory standards into commercial contracts. In some

87. *See id.* § 4.1 ("When an organization chooses to outsource any process that may affect end product conformity, the organization has to ensure control over such processes. Control of such outsourced processes shall be identified and documented within the food management system.").

88. *See id.*

89. *See id.* § 7.10

instances, standards are directly included while in other instances they are incorporated by reference. The instruments are warranties or obligations to deliver conforming goods.

1. The Broadening Scope of Warranties and Seller's Performance in Transnational Commercial Contracts

One channel for incorporation of regulatory provisions is warranties, both implied and express. The expansion of the scope of warranty, in particular, express warranties referring to regulatory provisions, represents an important vehicle of regulatory implementation. Warranties have always reflected quality and safety standards. Conventionally, implied warranties express legal standards or judicially defined requirements whereas express warranties usually reflect market standards and are vehicles to compete.⁹⁰ Similar distinctions concern the obligation to deliver conforming goods even if the language of warranty is not used.⁹¹ Traditionally the difference concerns the liability standard associated with breach of warranty and breach of the obligation to deliver conforming goods.

The seller, the supplier in the supply chain, subscribes to a written express warranty where she commits to comply with the regulatory standards by making reference to them.⁹² Express

90. See *e.g.*, U.C.C. §§ 2-313, 2-314 to -315 (2011) (describing the express and implied warranties of merchantability and fitness for a particular purpose).

91. See United Nations Convention on Contracts for the International Sale of goods, art. 32, Apr. 11, 1980, 19 I.L.M. 268, 1489 U.N.T.S. 3. For a comparative commentary, see CLAYTON GILLETTE & STEVEN WALT, *SALES LAW: DOMESTIC AND INTERNATIONAL* (2d ed. 2008).

92. See UNILEVER, General Terms & Conditions of Purchase of Goods of Unilever Supply Chain Company AG para. 2.2 (Nov. 26, 2008), <http://www.unilever.com/images/USCCAGGeneralTermsConditionsofPurchasetcm13272811.pdf> (“Each supplier shall at all times remain solely responsible for quality assurance with respect to the products. Each supplier shall nevertheless comply and ensure the products shall be manufactured, packaged, supplied and transported strictly in accordance with the quality assurance procedures and requirements specified or referred to in this agreement, the specifications and written instructions of Unilever or the buyer from time to time. The supplier shall keep records of its compliance with such procedures and requirements.”); *id.* paras. 6.1–3 (“Requiring each supplier along the chain to comply with certain regulatory standards such as that “each supplier . . . shall ensure that the HACCP principle referred to in the General Food Law and Hygiene Regulations and any other EU legislation (as amended from time to time) are applied from the intake of ingredients and components to through manufacture to the distribution of products with the respect of the control of microbiological, foreign body, allergens and chemical hazards and that there is documentation evidencing the

warranties are therefore changing functions from those deployed in the conventional commercial domain, since they are integrating regulatory and commercial provisions and make corresponding remedies available to ensure regulatory compliance. The signaling function of express warranty, long explored in relation to market competition, has become an instrument of regulatory competition when standards are supply chain specific.⁹³ Remedies for breach of regulatory provisions in express warranty cannot be exclusively or even primarily compensatory. The main purpose is to ensure compliance rather than to provide compensation via damages. The inclusion of these remedies generates a potential tension between the conventional logic of contract and that linked to the ‘new’ regulatory provisions. In commercial contracts, remedies for breach of express warranty concerning regulatory provisions often encompass two radical and conflicting strategies:

(i) Suspension of performance associated with an obligation to fix the problem and, in more serious cases, termination by the buyer.⁹⁴ Clearly there is a difference depending upon time of identification of the problem: if the problem is identified at an early stage and can be solved by modifying the production process remedies in kind would be preferred. If the problem is detected at time of delivery the only available strategy is replacement by purchasing on the market.

(ii) Cooperative agreement between the different parties to “remedy” the consequences of the breach when these are repeat players and the risk of occurrence of a violation of process-related standards is serious.⁹⁵

application of such principles”); *see also* Wal-Mart Supplier’s Agreement, *supra* note 69 (requiring fisheries and aquaculture suppliers to become third-party certified).

93. *See* George L. Priest, *A Theory of the Consumer Product Warranty*, 90 *YALE L.J.* 1297, 1297 (1981) (pioneering the work of consumer product warranty theory).

94. *See, e.g.*, Chiquita Purchase Agreement, *supra* note 32, para. 5.4 (“[T]he Buyer is empowered by the Seller and the Producers to suspend immediately and without any liability on its part whatsoever, the purchase of Fruit”); *see also* Sourcing Agreement, Heeling Sports Ltd.-TGB, LLC at ex. 3 para. 5 (May 1, 2010) [hereinafter Heeling Sourcing Agreement] (on file with author) (“In the event of any non-compliance with the Code of Conduct, HEELYS may terminate or refuse to renew our supply agreement.”).

95. *See, e.g.*, Chiquita Purchase Agreement, *supra* note 32, para. 6.1.3 (“The Seller, Producers and the Buyer, in common accord, shall develop a strict plan in order to remedy the breaches detected during the evaluation.”); *see also* Navteq Terms and

The latter probably constitutes the more radical departure from the traditional logic of contract remedies in sales. Here, the main aim is to re-establish the regulatory process as it was agreed upon via collaboration among multiple enterprises often including parties outside the bilateral contract where the primary breach has occurred.⁹⁶

(3) What are the consequences, proximate and remote, of regulatory provisions' incorporation into transnational commercial contracts?

After exploring (1) the drivers and (2) the different avenues through which transnational regulatory provisions, both public and private, are incorporated into commercial contracts, we now examine (3) the consequences on both the scope of transnational contracts and the implementation of the regulatory regimes. The claim is that contract design and architecture are implicitly or explicitly modified when integrating a regulatory part into the commercial conventional structure, but this comes at a cost.

The phenomenon can in fact be scrutinized from, at least, the following double perspective:

(i) The use of contract as a regulatory vehicle for implementing private and public transnational regulatory regimes changes the architecture of contracts, strengthening the links along supply chains, and redefines contractual governance.

(ii) The co-existence of several regimes for sanctioning breaches may change the objectives of remedies in contract law and affect objectives of compliance by including third party

Conditions, *supra* note 32, para. 10.4 (“In circumstances other than those specified in Provision 10.3 Buyer is entitled either to rework the defective Goods itself or have such Goods reworked by a third party at Seller’s cost or return Goods to Seller at Seller’s cost and terminate the Supply Contract. Seller shall indemnify Buyer against all and any costs and expenses incurred by the Buyer in complying with the terms of this Provision 10.4.”); *id.* para. 10.5 (“If the same Goods are repeatedly supplied in a defective condition, Buyer shall upon notice be entitled to terminate not only the Supply Contract, but also any other Supply Contract for the same or similar Goods.”).

96. See Complaint and Demand for Jury Trial at 4, *Palmer v. Jensen Farms*, No. 2011CV05007 (D. Colo. Sept. 15, 2011), 2011 WL 4503413, available at <http://articles.law360.s3.amazonaws.com/0271000/271857/Palmer%20Complaint.pdf> (alleging breach of warranties due to a *Listeria* bacteria outbreak).

monitors and reinforcing cooperative at the expense of hierarchical enforcement.

As we have seen in many commercial contracts, often three sets of regulatory provisions are incorporated. They concern safety, environmental, and social standards.⁹⁷ Regulatory regimes may be defined in private instruments ranging from codes of conduct to framework agreements, from memoranda of understanding to guidelines. Some of these instruments have binding effects independently of incorporation while others are not directly binding themselves; in the latter instance only contractualization provides some binding effect over the contracting parties, and possibly, even towards third-parties.

The contractualization of transnational regulation in transnational commercial contracts has at least two potential relevant effects:

(i) It can broaden the range of potential claimants for breach and add or substitute new contract remedies to pre-existing ones.

(ii) It expands complementarity between different types of sanctions for violations of private regulatory regimes with some potential tension between the commercial and the regulatory logics.

How might contractualization broaden the range of potential claims and claimants? Third-party beneficiaries and certifiers on the basis of independent linked contracts can bring claims for breach of the same violation.

When regulatory obligations are included in commercial contracts they may simply add another actor (the standard setter or the certifier) empowered to monitor suppliers' performance without modifying the content or may impose additional obligations on suppliers, integrating the content of the contract.⁹⁸ In the former case, the clauses simply refer to existing regulation, in general, the laws and statutes of the country

97. See *supra* text accompanying notes 6–8.

98. See Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. ECON. & ORG. 53, 54 (1986) (noting that regulatory measures can create parties “where none existed before”); cf. Lesley K. McAllister, *Regulation by Third-Party Verification*, 53 B.C. L. REV. 1, 2 (2012) (“With third-party verification, regulated entities are required to contract with a ‘verifier’ or ‘verification body’ to make a regulatory compliance determination.”).

hosting the supplier.⁹⁹ The objective of contractualization in this case is to increase the compliance rate with more effective monitoring.¹⁰⁰ In the latter case, standards may become stricter and/or the content of contractual performance may be broadened. This is the one we shall focus on. The supplier may be required to comply with stricter standards designed by the final buyers and/or retailers concerning safety, environmental and social norms or with rules defined by private bodies to which retailers are linked by contract or membership. Suppliers are generally asked to bear the costs of higher standards and performance monitoring for the benefit of third-parties, consumers, employees, or the protection of collective goods, e.g. the environment.¹⁰¹

The effects, as between increasing compliance and modifying performance standards, are rather different in terms of international political economy. In the former case, contractualization increases the control power of the retailer by empowering her over domains that were not previously under her direct legal control. In the latter case, regulatory standards

99. See McAllister, *supra* note 98, at 2 (“Third-party verification,’ in turn, denotes a system in which governmental agencies rely on these third parties to verify regulatory compliance.”).

100. See *id.* at 3 (“Third-party verification may substitute for direct compliance monitoring by the governmental agency.”); see also Kraakman, *supra* note 98, at 54 (noting that additional regulatory measures can impose a duty on “private ‘gatekeepers’ to prevent misconduct by withholding support”).

101. There are some exceptions where the buyer bears these costs or the regulatory regime calls for fair distribution of costs along the chain by paying higher or premium prices or providing inputs for free. See, e.g., *Fair Trade Standards for Contract Production*, FAIRTRADE INT’L (2011), http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/2012-09-25_CP_EN.pdf. Those buyers who subscribe to FLO standards commit to pay a fairtrade premium to producers that invest in social, economic and environmentally sustainable development. See Gary Gereffi & Joonkoo Lee, Final Report, *A Global Value Chain Approach to Food Safety and Quality Standards* (Feb. 4, 2009), available at http://www.cggc.duke.edu/pdfs/GlobalHealth/Gereffi_Lee_GVCFoodSafety1_4Feb2009.pdf (using a global value chain approach to explain the relationship between value chain structure and agrifood safety and quality standards and to discuss the challenges and possibilities this entails for the upgrading of smallholders); Spencer Henson & John Humphrey, CODEX ALIMENTARIUS COMMISSION, *The Impacts of Private Food-Safety Standards on the Food Chain and on Public Standard-Setting Processes*, ALINORM 09/32/9D-Part II (May 2009) (providing an analysis of how and why private standards relating to food safety have evolved and outlining some of the impacts of these private standards on agri-food value chains in developing countries).

are effectively taken away from hosting states and placed within the domain of private actors, individual multinationals, or trade associations.¹⁰² The suppliers have to comply with higher, privately imposed standards if they want to remain part of the global value chain.

It should be clarified that in general, contractualization of regulatory provisions adds to, rather than replaces, the previous regimes. In relation to safety, the final consumers already dispose of claims, but contractualization may enhance their width, to the extent that the retailer commits with the final consumers to ensuring compliance with transnational safety standards. In relation to environmental protection, contractualization provides a contractual claim to the retailer and possibly to the final consumer for violations that would have previously been pursued only via extra-contractual liability or administrative enforcement.¹⁰³ In relation to social and labor standards, contractualization provides additional claims to the retailers in matters traditionally regulated by employment contracts between suppliers and their employees.¹⁰⁴

The beneficiaries of these regulatory obligations may be third-parties: the consumer, as is the case in relation to safety provisions, environmental organizations, as is the case in relation to environmental obligations, and suppliers' workers, in the case of labor standards. The question before the courts in several countries is the extent to which third-party beneficiary doctrines or equivalent ones can empower third-parties to bring legal claims in order to ensure contractual compliance. More broadly the question is: who is benefiting from this expansion of contractual architecture? And consequently, whether broadening the monitoring of suppliers' contractual

102. See Cafaggi, *supra* note 3.

103. See NEW FRONTIERS OF CONSUMER PROTECTION: THE INTERPLAY BETWEEN PRIVATE AND PUBLIC ENFORCEMENT pt. V (Fabrizio Cafaggi & Hans-W. Micklitz eds., 2009) (discussing administrative and judicial enforcement regimes in relation to consumer protection).

104. See Cynthia Estlund, *Enforcement of Private Transnational Labor Regulation: A New Frontier in the Anti-Sweatshop Movement?*, in ENFORCEMENT OF TRANSNATIONAL REGULATION 237 (Fabrizio Cafaggi ed., 2012); see also Richard Locke et al., *Virtue Out of Necessity? Compliance, Commitment, and the Improvement of Labor Conditions in Global Supply Chains*, 37 POL. & SOC'Y 319, 324 (2009).

performance can expand the enforceability of detected violations along the chain.

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.¹⁰⁵ This wording makes it extremely difficult to bring a contract claim based on the doctrine of the third-party beneficiary.¹⁰⁶ But the limits of third-party beneficiary doctrines¹⁰⁷ are also associated with the definition of intended beneficiary.¹⁰⁸ For the most part, intended beneficiaries are considered as individuals rather than collective groups.¹⁰⁹ A

105. See *Doe v. Wal-Mart Stores Inc.*, 572 F.3d 677, 681–82 (9th Cir. 2009) (clarifying that a supplier can reserve the right to inspect subsidiaries without creating an affirmative duty to supervise compliance); see also *Marina Tenants Ass'n v. Deauville Marina Dev. Co.*, 181 Cal.App.3d 122, 132 (Cal. Ct. App. 1986) (“A third-party beneficiary cannot assert greater rights than those of the promisee under the contract.”).

106. See RESTATEMENT (SECOND) OF CONTRACTS §§ 302–315 (1981) (third-party right to performance); see also FARNSWORTH, *supra* note 28, at 27–29 (stating that, in drafting, the issue is one of party intent); 17A AM. JUR. 2D *Contracts* §§ 430–438 (2008) (intent of contracting parties to benefit third persons).

107. Since *Lawrence v. Fox*, 20 N.Y. 268 (N.Y. 1859), it has generally been accepted that a third-party can enforce a contractual obligation made for his benefit. Initially, this applied only to donee beneficiaries and creditor beneficiaries, but the scope of the doctrine was expanded in the Restatement (Second) of Contracts in 1981, where the “intention to benefit” test was adopted. See RESTATEMENT (SECOND) OF CONTRACTS §§ 302–315. The third-party doctrine seems to be well-established, however, as noted above, issues arise when the intent is unclear and where it becomes necessary for the courts to determine intent. As George S. Geis observes in the US context, the common law of third-party beneficiary contracting provides little assistance in weighing the legitimate economic gains from what he calls “broadcast contracting,” i.e., adjusting legal rights en masse via contract against the negative effects that can occur. See George S. Geis, *Broadcast Contracting* 4 (Va. L. & Econ. Research, Working Paper No. 2011-06, 2011), available at <http://ssrn.com/abstract=1926747> (“In particular, the open-ended nature of the law, and the difficulty in distinguishing intended beneficiaries (who do have rights) from incidental beneficiaries (who do not), generates powerful incentives to pursue specious litigation.”).

108. See RESTATEMENT (SECOND) OF CONTRACTS § 304 (“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.”). But see RESTATEMENT (SECOND) OF CONTRACTS § 302(1) (“Unless otherwise agreed between promisor and promisee, 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 . . .”).

109. This may have something to do with the way in which the law has developed. Compare *Lawrence*, 20 N.Y. at 270 (third-party beneficiary understood as a creditor beneficiary), with *Seaver v. Ransom*, 224 N.Y. 233, 233 (N.Y. 1918) (third-party

third-party beneficiary contract can be said to exist, even if the beneficiary is not expressly named, nor identifiable, nor in existence even at the time of execution.¹¹⁰ The same is true in French law, and while it was initially questionable whether a right could be validly designated to a generically identified, undefined third-party beneficiary, it is now generally accepted.¹¹¹

As we shall see, the difficulty of bringing contractual claims for breach of regulatory provisions does not exclude the role of the third-party in monitoring contractual obligations, and it influences the conventional contractual architecture when these

beneficiary understood as a donee beneficiary). The First Restatement of Contract similarly provided doctrine on these bases. See RESTATEMENT (FIRST) OF CONTRACTS § 133 (1932) (defining Donee, Creditor, and Incidental beneficiaries). This terminology was abandoned in the Second Restatement of Contracts. See RESTATEMENT (SECOND) OF CONTRACTS (discussing only Intended and Incidental beneficiaries). Nevertheless, even if a contract merely refers to a class of persons that provision may still be considered to have established an intended beneficiary, provided that subsequently there is clear identification. See RESTATEMENT (SECOND) OF CONTRACTS § 308 (“It is not essential to the creation of a right in an intended beneficiary that he be identified when a contract containing the promise is made.”). Several cases illustrate how a third-party beneficiary can be identified. See *Heroth v. Kingdom of Saudi Arabia*, 565 F.Supp.2d 59, 65 (D.D.C. 2008), *aff’d*, 331 F.App’x 1 (D.C. Cir. 2009) (providing that expression of intent can be implied, provided it is to directly benefit the third-party); see also *Commercial Ins. Co. v. Pac.-Peru Constr. Corp.*, 558 F.2d 948, 954 (9th Cir. 1977) (holding a third-party beneficiary identifiable at the time of performance may enforce the terms of the agreement); *Fort Lincoln Civic Ass’n v. Fort Lincoln New Town Corp.*, 944 A.2d 1055, 1064 (D.C. 2008); *Bowhead Info. Tech. Servs. v. Catapult Tech., Ltd.*, 377 F. Supp. 2d 166, 171 (D.D.C. 2005) (“[A] contract must ‘directly and unequivocally intend to benefit a third-party in order for that third-party to be considered an intended beneficiary.’” (internal citations omitted)). Some cases suggest that reference might be made to an individual or group. See, e.g., *Flexfab, L.L.C. v. United States*, 424 F.3d 1254, 1260 (Fed. Cir. 2005) (“We note, too, that ‘the intended beneficiary need not be specifically or individually identified in the contract, but must fall within a class clearly intended to be benefited thereby.’ Evidence of intent can be adduced. In short, it is sufficient to ask in the typical case ‘whether the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him.’” (internal citations omitted)). Further, while the third-party beneficiary claim was rejected in the Wal-Mart case there did not seem to be an issue specifically with the notion that the intended beneficiary might be a group and not an individual. See *Jane Doe I v. Wal-Mart Stores Inc.*, No. CV 05-7307 AG (MANx), 2007 WL 5975664, at *5–6 (C.D. Ca. Mar. 30, 2007).

110. See *Commercial Ins. Co.*, 558 F.2d at 954.

111. See Hendrik Verhagen, *Contemporary Law*, in *CONTRACTS FOR A THIRD PARTY BENEFICIARY: A HISTORICAL AND COMPARATIVE ACCOUNT* 137 (Jan Hallebeek & Harry Dondorp eds., 2008); see also CHRISTIAN LARROUMET & DOMINIQUE MONDOLONI, *STIPULATION POUR AUTRUI* (1998) (Fr.).

obligations also constitute certification standards or are part of private regulatory regimes to which the retailer is a signatory.¹¹²

Courts have considered other avenues to ensure that commitments made by retailers concerning suppliers' compliance with regulatory provisions are enforced. In the United States, the limits of contract law, and in particular of third-party beneficiaries, have been addressed by tort doctrines, (specifically, negligence), by labor law doctrines (such as the joint employer), and by unjust enrichment.¹¹³ Many of these lawsuits are class actions, which may also explain why we do not see claims of this nature in Europe.

In Europe, in issues relating to contractual provisions for the benefits of third-parties, the starting point is the doctrine of *alteri stipulari nemo potest* (nobody can stipulate for another).¹¹⁴ With the development of contract law in the 19th and 20th centuries, the rules precluding contracts for third-parties gradually became less significant. In French law, the *Code Civil* provides for a general rule that one cannot make a stipulation for another, and that contracts have effects only between the contracting parties.¹¹⁵ Article 1121 of the *Code Civil* stipulates that contracts for the benefit of a third-party are only available either as a gift or where the promisee makes a stipulation of something for himself.¹¹⁶ Implied stipulations for another have been upheld, for example, in cases relating to carriage.¹¹⁷ The

112. See, e.g., *Chen v. Street Beat Sportswear, Inc.*, 226 F. Supp. 2d 355, 363 (E.D.N.Y. 2002) ("Based on the language of the agreement itself, it is strikingly obvious that [its] entire purpose . . . is to ensure that employees of factories which contract with [the buyers] are paid minimum wage and overtime, and that it was they who were directly intended to be benefited.").

113. See, e.g., *Doe v. Walmart Stores Inc.*, 572 F.3d 677 (9th Cir. 2009) (plaintiffs claimed, inter alia, that: (1) they derived rights as third-party beneficiaries of supply contracts (not by being directly employed by Wal-Mart); (2) Wal-Mart was their joint employer; (3) that Wal-Mart had negligently breached their duty to monitor and protect their working conditions; and (4) that Wal-Mart was unjustly enriched by profiting from relationships with suppliers which Wal-Mart knew engaged in substandard labor practices). For a new perspective on third-party beneficiaries, and reference to the notion of "broadcast contracting," see Geis, *supra* note 107.

114. DIG. 45.1.38.17 (Ulpian, Ad Sabinum 49) (*alteri stipulari nemo potest*); J. INST. 3.19.19.

115. CODE CIVIL [C. CIV.] arts. 1119, 1165 (Fr.).

116. See *id.* art. 1121.

117. See Cour de cassation [Cass.] [supreme court for judicial matters] civ., Dec. 6, 1932, D.P. 1933.1.137 (Fr.) (holding that the obligation *de securité* owed to a passenger was also an implicit obligation in favor of his wife and children); see also Cour de

German BGB provides explicitly in section 328 that a contract may be made for the benefit of a third-party, thus giving the third-party a right to demand performance.¹¹⁸ The right can either be expressly stipulated or deduced from the circumstances surrounding the contract.¹¹⁹

In Scottish law, by contrast, contracts for the benefit of a third-party have long been recognized by virtue of the doctrine of *ius quaesitum tertio*; nevertheless, the third-party's right to claim damages on the basis of such a contract is not clear.¹²⁰ In English law, the doctrine of privity, which provides that a contract can give rise to rights and duties only for those who are party to the contract, has long prevailed.¹²¹ But recent legislation has modified the scope of the doctrine.¹²² Further, the doctrine of consideration dictates that promises are only enforceable when some form of consideration from the promisee supports them.

cassation [Cass.] [supreme court for judicial matters] 2e civ., Dec. 17, 1954, D. 1955, 269 (Fr.) (finding that a patient who receives a blood transfusion in a public hospital is a third-party beneficiary of the contract for the supply of blood and therefore has a claim to recover).

118. See BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, BUNDESGESETZBLATT [BGBL.] 87, as amended, § 328, para. 1 (Ger.); Stefan Grundmann, *Contractual Networks in German Private Law*, in CONTRACTUAL NETWORKS, INTER-FIRM COOPERATION AND ECONOMIC GROWTH 111 (Fabrizio Cafaggi ed., 2011); GUNTHER TEUBNER, NETWORKS AS CONNECTED CONTRACTS (Hugh Collins ed., Michelle Everson trans., 2012).

119. See BGB CIVIL CODE, BGBL., para. 2.

120. See WILLIAM W. MCBRYDE, THE LAW OF CONTRACT IN SCOTLAND 10–24 (3d ed. 2007).

121. See *Dunlop Pneumatic Tyre Co. v. Selfridge & Co.*, [1915] A.C. 847 (H.L.) (appeal taken from Eng.) (establishing that an agreement for resale price maintenance was unenforceable as a matter of privity); see also *Darlington Borough Council v. Wiltshier Northern Ltd.*, [1995] 1 W.L.R. 68 (Eng.); Simon Whittaker, *Contract Networks, Freedom of Contract and the Restructuring of Privity of Contract*, in CONTRACTUAL NETWORKS, INTER-FIRM COOPERATION AND ECONOMIC GROWTH 179 (Fabrizio Cafaggi ed., 2011).

122. Contracts (Rights of Third-parties) Act, 1999, c. 31, §1(1)(a), (b) (U.K.). The Contracts (Rights of Third-parties) Act provides for limited cases in which exceptions to the doctrine of privity might arise. Section 1 provides that a third-party “may in his own right enforce a term of the contract if (a) the contract expressly provides that he may, or (b) . . . the term purports to confer a benefit on him.”

2. Product and Process Standards

The introduction of regulatory and certification regimes in commercial contracts broadens the scope of contractual obligations in three different yet related directions: (1) it enhances the content of the obligations including standards that would not otherwise be part of the exchange; (2) it especially integrates process standards whose compliance was regulated primarily by administrative and tort law; and (3) it multiplies the potential claimants for the violations not by giving direct access to contractual claims, but rather by combining various enforcement regimes like certification.

The incorporation of regulatory provisions has different effects depending on their content. (1) In the field of safety, as we have seen while examining warranty as an instrument for incorporation of regulatory provisions, process standards have been reinforced; the inclusion of safety standards regulated by codes of conduct and guidelines broadens the scope of pre-existing liability regimes, and, at times, widens the range of available remedies.¹²³ Codes of conduct and ISO standards concerning process requirements, like the use of pesticides or other toxic substances in farming and food processing, are incorporated in commercial contracts by reference.¹²⁴ The consequences of violating process standards incorporated in commercial contracts vary depending on their content. For example, violations of safety process standards may result in direct repercussions on the product such as requiring corrective actions or product withdrawals from the market. (2) This is not,

123. See *supra* text accompanying notes 90–91.

124. See, e.g., *Del Monte Purchase Order Terms and Conditions*, cl. 7, DEL MONTE FOODS, <http://www.delmontefoods.com/company/Del%20Monte%20Purchase%20Order%20Terms%20and%20Conditions%20FINAL%20JULY%202010.pdf> (“Seller further warrants that such goods are not in violation of the provisions of the Food Additives Amendment of 1958 and have not been treated with any pesticide as defined in the Federal Insecticide, Fungicide and Rodenticide Act other than those accepted by the Environmental Protection Agency”); Chiquita Purchase Agreement, *supra* note 32, cl. 5.4 (“The SELLER and the PRODUCERS commit to apply, during the production process and the post-harvests stage, only pesticides, herbicides, fungicides, insecticides, plant growth regulators or other chemical or organic, natural, artificial or synthetic substances, that have been previously authorized by the BUYER or its TECHNICAL REPRESENTATIVE and are authorized for use in the Republic of Colombia and the destination countries of the FRUIT, including the United States of America and the countries that comprise the European Union.”).

or at least has not, been the case in respect to the violation of social standards where corrective actions do not imply product withdrawals but rather modifications of working conditions at the farm or factory site. The focus of corrective action here is on practices rather than products.

(3) Between safety and social violations stand violations of environmental process standards as they may eventually have a direct effect on products. For example, the use of toxic substances might increase product safety, but harm the environment. In the field of environmental standards, the consequences of contractualization are more relevant. In the past, commercial contracts had not traditionally incorporated obligations to comply with environmental standards, predominantly process standards.¹²⁵ Compliance, linked to production processes along the supply chain, was primarily secured by tort and private, non-judicial, enforcement.¹²⁶ Furthermore, administrative enforcement was used to ensure compliance with environmental public regulation and, to a limited extent, with private regulation.¹²⁷ Contractualization adds a new set of remedies, which are especially relevant for public soft law international environmental standards.

In the previous scenario, a labor allocation among different legal instruments was relatively clear. Product standards compliance was addressed via contract while compliance with process standards was primarily achieved via torts or administrative regulation. The integration of regulatory provisions in commercial contracts expands the scope of contract law to ensure compliance with process in addition to product standards. This, in turn, modifies not only the range of remedies for breach of contract but also the overall contractual architecture.

125. For a general discussion on environmental regulatory instruments and the nature of standards, see Michael P. Vanderbergh, *Private Environmental Governance*, 99 CORNELL L. REV. (forthcoming 2013) (discussing the role of private activities as a new model for environmental governance); Richard B. Stewart, *Instrument Choice*, in THE OXFORD HANDBOOK OF INTERNATIONAL ENVIRONMENTAL LAW 147 (Daniel Bodansky et al. eds., 2008).

126. See *id.* at 151 (discussing ex post defined liability for causing environmental harm under a negligence standard).

127. See, e.g., *id.* at 159 (discussing the United States' quota and credit trading systems to regulate air and water pollution).

3. How Does Contractualization of Standards Complement or Substitute Existing Contract Remedies?

Contractualization provides contracting parties with new claims and instruments of compliance monitoring, which complement those operationalized by the single regulatory or certification regimes. For example, references to the ten principles of the Forest Stewardship Council or to the ISEAL codes in commercial contracts not only widen the scope of a seller's obligation but can also give the buyer (a retailer, for example) stronger control over compliance by upstream suppliers.¹²⁸

Compliance with social standards, in particular standards associated with employment and fair labor, has generally been implemented at the transnational level via collective agreements or international framework agreements, separately from commercial contracts.¹²⁹ Here the effects of the incorporation into transnational commercial contracts are multiple. Contractualization of labor law provisions concerning minimum wages, freedom of association, collective bargaining, and forced labor provides remedies that may be scarce or unavailable where labor law is underdeveloped or where its enforcement is insufficient.¹³⁰ The inclusion of the fair labor provisions, often

128. See *Mission and Vision*, FOREST STEWARDSHIP COUNCIL, <https://us.fsc.org/mission-and-vision.187.htm> (last visited May 28, 2013) (ten principles). See generally *infra* note 137 and accompanying text.

129. Businesses may seek to enforce their own codes of conducts, or they may be enforced against the company, either judicially or non-judicially. See, e.g., *Doe v. Walmart Stores Inc.*, 572 F.3d 677, 677 (9th Cir. 2009). There are generally three types of mechanisms of enforcement: (1) managerial (compliance determined by process of auditing along the chain); (2) bilateral (meetings between concerned parties—managers and employees and trade unions); and (3) complaint (scope for employee to lodge complaint of violation). These will vary with different IFAs. See Estlund, *supra* note 104, at 237.

130. See, e.g., *Wal-Mart Standards for Suppliers*, WAL-MART, <http://corporate.walmart.com/global-responsibility/ethical-sourcing/standards-for-suppliers>, cl. 1 (last visited Apr. 7, 2013) (“Suppliers and their designated manufacturing facilities must fully comply with all applicable national and/or local laws and regulations, including, but not limited to, those related to labor, immigration, health and safety, and the environment.”); see also *Heeling Sourcing Agreement*, *supra* note 94, ex. 3 para. 4 (“HEELYS expects its suppliers to adopt sound labor practices and treat their workers fairly in accordance with local laws and regulations. In addition, suppliers must comply with the following standards: a. Freely Chosen Employment . . . b. No Child Labor . . . In no event may a worker be less than 15 years old (except as permitted by ILO Minimum Age Convention No. 138). Workers under 18 years of age may not perform

going beyond the single contract with first tier suppliers, has not only produced an integration of commercial and labor law, but is also imposing a closer coordination between the allocation of physical and human resources with important implications for the theory of the firm. Accordingly, by incorporating regulatory regimes, transnational contracts are now redefining the boundaries of the firms along the supply chain.

Incorporation of social standards into commercial contracts may reinforce labor protection especially where labor law and/or enforcement are 'institutionally' weak at the transnational level and suppliers are under strong pressure to reduce costs. However, there is also the symmetric risk, arising if contractual remedies only become available if they substitute rather than complement those provided by the specific labor agreements. This substitution would have significant political economy implications, moving control of labor and social standards compliance from the conventional actors like unions in producing countries, to the control of retailers or chain leaders in consumer countries.¹³¹

In normative terms, contractualization should be evaluated under both the efficiency and distributional perspectives.

In relation to efficiency the question is whether the benefits of using contracts as regulatory vehicles outweighs the increase in costs. The three actors to be considered are the buyer (usually the retailer), the suppliers (the sellers) and the final beneficiaries of the regulatory provisions, which vary depending on their content (for example, consumers, employees, environmental organizations). Higher compliance rates and stricter standards are efficient when the benefits outweigh the costs.

work likely to jeopardize the health, safety or morals of young persons, consistent with ILO Minimum Age Convention No. 138. This Code does not prohibit participation in legitimate workplace apprenticeship programs that are consistent with Article 6 of ILO Minimum Age Convention No. 138. c. Minimum Wages . . . d. Working Hours . . . e. No Harsh, Inhumane Treatment or Abuse . . . f. No Discrimination . . . g. Freedom of Association . . . h. Overtime."); see also Eslund, *supra* note 104, at 237.

131. See Fabrizio Cafaggi & Katharina Pistor, *Regulatory Capability: A Normative Framework for Assessing the Distributional Effects of Regulation* (Columbia Law Sch. Pub. Law & Legal Theory Working Paper Grp., Paper No. 13-354, 2013) (discussing the shift from states to transnational regulatory regimes).

From the perspective of distribution, the current system imposes all or the majority of costs of contractualization on suppliers, while increasing retailers' control powers.¹³² As a consequence, for example, smallholders located in the south of the world have been marginalized or driven away from global supply chains.¹³³ In addition it reduces local institutional and regulatory capacities and transfer them to the transnational level. These distributional effects have been strongly criticized and several initiatives of governments of developing countries and of the United Nations have been undertaken to modify the distributional consequences of this approach to contractualization.¹³⁴

IV. MONITORING AND SANCTIONING BREACH OF REGULATORY PROVISIONS IN TRANSNATIONAL COMMERCIAL CONTRACTS: RETHINKING THE CONTRACTUAL ARCHITECTURE.

There are two sets of additional questions stemming from the introduction of regulatory provisions in transnational commercial contracts worthy of further examination:

(1) How do the insertion of regulatory provisions and the incorporation of entire regulatory regimes in transnational commercial contracts modify the monitoring of contractual performances along the chain, and what are the consequences on contractual architecture and design?

(2) How do regimes for breach of contract change when the violation triggers simultaneously or sequentially multiple enforcement mechanisms?

The regulatory world is composed of a plethora of actors and regimes. For analytical purposes, in the analysis we assume only one regulator and one certifier, being fully aware that,

132. See U.N. Doc. A/67/268, *supra* note 67; Steven Jaffee & Spencer Henson, *Standards and Agro-Food Exports from Developing Countries: Rebalancing the Debate* (World Bank Policy Research, Working Paper No. 3348, 2004); Renata Clarke, CODEX ALIMENTARIUS COMMISSION, *Private Food Safety Standards: Their Role in Food Safety Regulation and Their Impact*, 24 (2010), <http://www.fao.org/docrep/016/ap236e/ap236e.pdf>.

133. See Henson & Humphrey, *supra* note 101.

134. See, e.g., Final Report of the Special Representative, *supra* note 39, § III art. 12 (in the field of corporate social responsibility); see also U.N. Doc. A/67/268, *supra* note 67, 12–15 (in the field of food).

often, regulatory provisions refer to many regulatory regimes and multiple certifying schemes.

A. Monitoring Contractual Performance of Regulatory Provisions: The Interplay Between Private Regulators and Certifiers

The incorporation of clauses and terms referring to regulatory standards, both public and private, changes the monitoring structure of contract execution and affects the selection of enforcement strategies.¹³⁵ Contractual performance of regulatory provisions may constitute, at the same time, both an obligation owed to the other contractual parties along the chain, and also a duty to implement the regulatory regime of which the party is a member. For example, when a supplier contractually commits to comply with a fair trade or food safety standard, at the same time she assumes a contractual obligation towards the buyer, and a regulatory one to comply with the code of conduct enacted by the organization of which she is a member or whose compliance is imposed by the certification system she has to abide by.¹³⁶

135. See Humphrey & Schmitz, *supra* note 14, at 268–70 (identifying a matrix for parameter setting and enforcement along the chain).

136. At times, the member of the private regulatory body may not be the seller but the buyer (retailer or MNC) who contractually imposes to the seller the obligation to comply with those private standards fulfilling its own regulatory obligation. This happens when the retailer belongs to a trade association that enacts safety standards in a code of conduct and the retailer has to ensure compliance in its relationships with third-parties. See, for example, SUSTAINABLE FOOD TRADE ASSOC., *SFTA Code of Conduct (Draft for Comment)*, http://www.sustainablefoodtrade.org/working-groups/code-of-conduct/sfta-code-of-conduct-11_19_12-v1/ (select “sfta-code-of-conduct-11_19_12-v1”) (last visited Sept. 29, 2013), which any organic business can adopt and use to provide guidance to their supply chain. In the latter hypothesis, there is a dissociation between the party contractually obliged (the seller) and the party who owes a regulatory obligation (the buyer). Violations of the standard may therefore trigger sanctions directed at different parties. See, e.g., COMPASS GRP., *Code of Business Conduct* (Feb. 2011), http://www.compass-group.com/documents/Code_of_Conduct_Feb11v1.pdf (“If you are engaging any third party to act on behalf of Compass, it is your responsibility to ensure that they are made aware of the Code of Business Conduct and that they agree to act in accordance with it. Where possible, you should seek a contractual obligation from them to comply with the Code of Business Conduct and you should actively manage the third party to ensure that they continue to act in accordance with it. Any breaches of the Code of Business Conduct by third parties or examples of behaviour inconsistent with the Compass Values (as set out later) should be reported to your Line Manager. You should seek to eradicate any such behaviour and where necessary, consider terminating the relationship.”). The picture becomes more complicated when certification enters the scene and contractual performance of

A monitoring duty of the final buyer, established by criminal and tort law as part of the standard of care and due diligence is now partly accomplished through the contribution of certifiers linked to the increasing importance of regulatory standards. Adequate monitoring of both product and process standards along the chain is part of due diligence and it is included in many codes of conduct.¹³⁷ In the case of labor and employment standards, human rights organizations or international trade unions may also monitor contractual performances by the suppliers along the chain.¹³⁸ This is especially clear in relation to monitoring provisions in International Framework Agreements;¹³⁹ further, codes of conduct, often attached to the contract, may also provide for such monitoring.¹⁴⁰ In the case of environmental standards,

regulatory provisions by the seller becomes the subject matter of certification contracts. *See, e.g.*, SCOT. SALMON PRODUCERS ORG., *Code of Good Practice for Scottish Finfish Aquaculture* (Jan. 17, 2013), <http://www.thecodeofgoodpractice.co.uk/publish> (offering access to certification schemes).

137. *See, e.g.*, ISEAL Alliance, *Assessing the Impacts of Social and Environmental Standards Systems* art. 6 (2010) [hereinafter ISEAL], http://www.isealalliance.org/sites/default/files/P041_ISEAL_Impacts_Codev1.0.pdf (“Standards systems shall develop, document and implement a monitoring and evaluation programme that is compliant with this Impacts Code.”).

138. *See* Coleman, *supra* note 53, at 601 (discussing International Framework Agreements “IFAs” as they relate to core labor rights.).

139. *See, e.g.*, Fr. Télécom, *Worldwide Agreement on Fundamental Labour Rights Within Our Group* cl. 5, at 6, <http://www.orange.com/en/responsibility/documentation/documentation> (follow “2011 CSR archives” hyperlink; then follow “Worldwide agreement on fundamental labour rights within our group” hyperlink) (last visited Sept. 29, 2013) (“The France Telecom Group’s management and the Worldwide Trade Union Alliance will jointly ensure that this agreement is effectively implemented Monitoring of the agreement and regular progress reports will be provided by the signatories in half-yearly meetings between the France Telecom Group Worldwide Trade Union Alliance-UNI and the Group’s management.”); Int’l Metalworkers Fed’n, *International Framework Agreement on PSA Peugeot Citroën’s Social Responsibility* ch. 8, at 16 (2010) (“The monitoring of this international framework agreement is carried out on two levels. In each of the main countries (over 500 employees), local social observatories are set up, consisting of human resources management and the trade unions.”).

140. *See* Bottler’s Agreement, *Coca-Cola Corp.-PanamcoBajio S.A. DE C.V.*, para. 34, June 1, 2005 (“In addition, the Company in its sole discretion may, through written notice to the Bottler, appoint a third-party as its [sic] representative to ensure that the Bottler carries out its obligations under this Agreement.”); *see also Code of Conduct, HENNES & MAURITZ* cl. 8.2, http://about.hm.com/content/dam/hm/about/documents/en/CSR/codeofconduct/Code%20of%20Conduct_en.pdf (last visited May 28, 2013) [hereinafter *H&M Code of Conduct*] (“We also reserve the right to appoint an

private regulators may monitor contractual performance related to level of emission or carbon footprint to ensure compliance with the codes' rules incorporated by reference in the contracts.¹⁴¹ In the case of product safety, there is reference to both internal and external monitoring.¹⁴²

1. Certifiers and Third-Party Monitoring of Contractual Performances Along the Supply Chain

The informal role of intermediaries has always existed in international trade. The novelty is the diffusion and intensity of the phenomenon and its institutionalized form. In addition to private regulators, whose standards are incorporated into the contract, third-party like certifiers can play an important role in monitoring contractual performances along the chain and providing remedies for contractual breaches.¹⁴³ Certification and quality assurance have become very relevant for food and product safety, labor, social, and environmental standards since they broaden the scope of regulatory obligations and add monitoring agents. Certification primarily refers to process standards whereas quality assurance concerns product standards. Certifiers on the basis of the certification contracts have very detailed inspection powers on the certified and they can sanction breaches.¹⁴⁴

independent third-party of our choice to conduct audits in order to evaluate compliance with our Code of Conduct.”).

141. See ISEAL, *supra* note 137, art. 8.5. See generally Vanderbergh, *supra* note 125.

142. Sometimes the inspection responsibility lies with the manufacturer. See, e.g., Heeling Sourcing Agreement, *supra* note 94, ex. 3 para. 17.4 (“TGB will inspect raw materials . . . and TGB will be responsible for all testing of raw materials and components required to ensure that the finished Product complies with applicable lead-content requirements of the Consumer Product Safety Improvement Act”); Navteq Terms and Conditions, *supra* note 32, para. 9.4 (“Seller shall permit a designated representative of Buyer to visit Seller’s premises to observe and monitor the development and production of the Goods to verify compliance with ISO/TS 16949”). But see H&M Code of Conduct, *supra* note 140, cl. 8.2 (“We also reserve the right to appoint an independent third-party of our choice to conduct audits in order to evaluate compliance with our Code of Conduct.”).

143. See, e.g., Boccaletti & Karantininis, *supra* note 36, at 268; see also Hatanaka et al., *supra* note 36, at 357. See generally McAllister, *supra* note 98 (arguing for greater governmental reliance on private auditors, as well as for heightened regulatory oversight over such auditors).

144. See GlobalGAP, General Regulations art. 5.3 (Feb. 2012), http://www1.globalgap.org/north-america/upload/Standards/IFA/v4_0-1/120206_gg_gr_part_i_eng_v4_0-1.pdf [hereinafter GlobalGAP, General Regulations].

The retailer, as we have seen, often requires the supplier's certification; as a result supplier's performance is at the same time a contractual obligation and a certification-based requirement. Breaches of regulatory provisions by the supplier are often first detected by the certifier, following its own procedure, which generally includes inspection rights and audits on the supplier's premises. The information is then communicated to the buyer, who can undertake the necessary step under contract law to remedy the breach by seeking action from the immediate contractual partner. 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.

Certification transforms the agency relationship between chain leader and suppliers by monitoring performances along supply chains. The transformation of the agency relationship related to monitoring concerns not so much the bilateral relationship between the final buyer and its seller, but rather those between the seller and its suppliers. In the past the final buyer had delegated control over compliance by upstream suppliers to the immediate seller. Now delegation to the seller is complemented by informal delegation to the certifier. Delegation is informal since formally, the certification contract is concluded between the supplier and the certifier, but the principal is the buyer, not the certified party.

Intensity and forms of delegation vary according to the type of certification. Different forms of certification exist from first and second party certification by the supplier or the retailer, to third-party certification, when an independent certifying body, accredited with an accreditation entity, certifies compliance with regulatory standards. The various models can have different effects on contractual architecture and specifically on the monitoring structure.

Usually, the supplier concludes a service contract with the certifier where the former undertakes obligations to comply with

the standards, and the latter is given oversight power over contractual performance associated to the licensing agreement.¹⁴⁵ In some instances this can take the form of a sublicensing agreement between the certifying body and the supplier.¹⁴⁶ The certifier (1) will monitor the supplier's activity, including its relationships with the different tiers along the chain, (2) will provide certification if requirements are met, and (3) is given direct remedial power by the certification contract in case of non-compliance. This power ranges from warning to fining, to suspension or termination, which may result in de-certification.¹⁴⁷ The source of the remedial power is formally the certification contract, but its exercise is limited by the obligations of the certifying body to follow the rules of the accrediting body by which it is bound.¹⁴⁸ The certifier is therefore obliged to use the criteria designed by the scheme and to select the sanctions accordingly. The standard setter (e.g. the accrediting body or the scheme owner) might also retain some power to take direct measures against standard violations; indeed, in some cases the certification contract gives rise to a concurrent direct contractual relation between the certified supplier and the standard setter, empowering the latter with remedial power.¹⁴⁹ Here hierarchical monitoring tends to prevail over peer monitoring.

145. See GlobalGAP, General Regulations, *supra* note 144, art. 3.2.

146. See, e.g., GlobalGAP, Sublicense and Certification Agreement art. 4.13, http://www1.globalgap.org/north-america/upload/CBs/130111_GGNA_CB_Sublicense_and_Certification_Agreement_v1.2.pdf. (last visited Sept. 29, 2013) [hereinafter GlobalGAP, Sublicense and Certification Agreement].

147. See GlobalGAP, General Regulations, *supra* note 144, art. 6.3, at 10–11 (showing that a warning is associated with minor infringements whereas suspension is correlated with major infringements, and that termination of the service contract occurs if, after suspension, corrective action is not promptly taken).

148. The power of the accrediting body is justified by the necessity to protect the brand and reputation.

149. See, e.g., GlobalGAP, Sublicense and Certification Agreement, *supra* note 146, art. 4.13 (“GLOBALGAP reserves the right to enforce all provisions set forth in clause 4 of this Agreement directly.”); *id.* art. 10 (“In the event of . . . willful or negligent infringement of the obligations under the GLOBALGAP System, in particular obligations that CP has contractually undertaken, GLOBALGAP NA shall be permitted to enforce the measures described in the List of Sanctions within the General Regulations in its latest version.”). See generally ISEAL, *supra* note 137 (discussing group certification and the different criteria of evaluation from individual certification). For an example in the context of organic textile production, see Int’l Working Grp. on Global Organic Textile Standards, Labeling Guide cl. 5, at 5 (2008),

A slightly different model is that of group certification where separate legal entities create a group for the purpose of seeking collective certification. This group could be part of a supply chain as might be the case for agricultural cooperatives supplying products to food producers or retailers, or sourcing goods or services from sub-suppliers. Group certification delegates to the group many of the monitoring and remedial actions exercised directly by the certifying body in the previous model.¹⁵⁰ Thus, higher complexity arises when group producers' certification instead of individual certification is in place.¹⁵¹ Group certification implies that a group of producers signs a contract with the certifier and that peer monitoring and coordination, in case of participants' default within the group participants, occurs. Clearly in this instance, there is even greater interference between the certification regime and the contractual practices along the supply chain. Monitoring regulatory compliance is the result of the combined activity of the participants within the group and/or some delegated body and the certifiers. If the group, partly or totally, coincides with the supply chain participants, concurring regimes will be in place. Peer monitoring tends to prevail in this model.

Non-compliance with regulatory provisions is generally followed by an obligation to adopt corrective measures in compliance with regulatory requirements. In case of major and persistent failure, the certifier can proceed to suspension or decertification.¹⁵² Suspension prevents the party from temporarily using the logo.¹⁵³ Decertification is generally linked with a time period where the decertified party cannot resubmit

http://www.ota.com/pics/documents/GOTS_LabelingGuide.pdf ("The IWG and/or the Approved Certifiers will pursue all legal remedies for any unauthorised or misleading use of the GOTS logo on product declarations, in advertisements, catalogues or other contexts, including actions such as corrective and/or legal action and/or publication of the transgression so as to safeguard credibility of the GOTS identification.").

150. *See, e.g.*, GlobalGAP, General Regulations, *supra* note 144, at 5 fig. 2.

151. *See, e.g., id.*; Margaret Will, Deutsche Gesellschaft für Technische Zusammenarbeit, Integrating Smallholders into Global Supply Chains 28, box 17 (Doris Günther ed., 2010), <http://www.giz.de/Themen/en/dokumente/gtz2010-en-globalgap-group-certification.pdf>.

152. *See* GlobalGAP, Sublicense and Certification Agreement, *supra* note 146, art. 12.7 (calling for the annulment of the certification agreement in the event of a "red card sanction").

153. *See id.* art. 12.4.

for an application.¹⁵⁴ Effects of certification breach on the contractual regime may vary. For instance, decertification of the supplier may also constitute a breach of contract, which can give rise to a duty to cure and in case of persistent non-compliance, to termination of the transnational commercial contract.¹⁵⁵

The two contracts, certification and commercial, are linked, but they are separate and often concluded by different parties. The influence of the certification contract over the commercial one may therefore be subject to significant limitations when parties differ, which can have an impact on the effects of monitoring. Before addressing the issue of coordination between the different contracts, it is important to underline how the sale, or more broadly, commercial contracts and the certification contract, may pursue similar objectives by using different logics which affect the consequences of monitoring.

Contract law and certification regimes use different parameters to define compliance with regulatory obligations because they pursue different objectives and may have different priorities. In the field of food safety, certification schemes identify different levels of compliance by using a metric, which correlates the choice of remedies to the seriousness of non-compliance.¹⁵⁶ The indicators are much more detailed and specific than those deployed by courts, which generally use a binary metric to distinguish between material and non-material breach.¹⁵⁷ This difference underlines the diverse priorities of

154. See GlobalGAP, General Regulations, *supra* note 144, art. 6.7 (showing that the certification cycle is twelve months and subject to any sanctions and extensions).

155. See Chiquita Purchase Agreement, *supra* note 32, para. 6.1.5 (“The SELLER and the PRODUCERS commit to maintain the certification under the SA-8000 standard during the term of agreement hereof. If any of these farms were to be decertified, the SELLER and the respective PRODUCER will have six months as of the date 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 the right to suspend the purchase of FRUIT originating from such farms until they regain their respective certifications.”); see also Jill E. Krueger, Farmers’ Legal Action Grp., Inc., If Your Farm is Organic, Must It Be GMO-Free?: Organic Farmers, Genetically Modified Organisms, and the Law 35 (Sept. 2007), http://swroc.cfans.umn.edu/prod/groups/cfans/@pub/@cfans/@swroc/documents/asset/cfans_asset_229665.pdf (referring to this phenomenon).

156. See GlobalGAP, General Regulations, *supra* note 144, art. 6.3; see also Will, *supra* note 151, at 5 (showing that non-compliance may lead to exclusion).

157. For example, in the GlobalGAP regulations the distinction is between major musts (100% compliance), minor musts (95% compliance), and recommendations (no

certification regimes and contract law, as developed in the commercial field, which we will analyze in the next section. These differences do not undermine the agency relationship associated with third-party monitoring by the certifier because the final objective (e.g., ensuring compliance by the supplier) remains the same.

Compliance with contractual performance obligations hence involves third-parties who have to monitor contractual performance and can sanction the breach when it also constitutes a violation of the regulatory schemes they ‘own.’¹⁵⁸ As we have seen, the growing role of third-parties, in particular certifiers, concerns not only the performance of the seller but also compliance with regulatory standards by the upstream suppliers.

Monitoring by third parties may decrease the burden of buyers to detect violations, increase effectiveness and also influence the standard of inspection at time of delivery which in turn affects the allocation of liability between seller, buyer and third parties in case of goods non-conformity.

thresholds). See GlobalGAP, General Regulations, *supra* note 144, at 6.2. An open question remains as to the extent to which judges will refer to the more specific metric of certification regimes and adjust the remedies accordingly if the breach of a regulatory provision is brought to court. See Fabrizio Cafaggi & Paola Iamiceli, *Private Regulation and Industrial Organisation: The Network Approach* (Eur. Univ. Inst., Working Paper No. 21, 2012).

158. See Sandeep Baliga & Tomas Sjöström, *Contracting with Third Parties*, AM. ECON. J.: MICROECONOMICS, Feb. 2009, at 75 (2009) (in economic contract theory, “[m]odels of bilateral contracting, such as the canonical hold-up model, typically assume that third-parties are not available In the literature, the ‘third-party solution’ has been dismissed by arguing that it requires the third-party to be completely honest and incorruptible”). In their paper, Baliga and Sjöström develop a model of contracting with third-parties based on the assumption that all coalitions should have access to the same contracting technology which they refer to as the “symmetry assumption.” For a similar argument in legal contract theory, see Charles R. Knoeber, *An Alternative Mechanism to Assure Contractual Reliability*, 12 J. LEGAL STUD. 333, 336 (1983) (arguing that in addition to legal and market mechanisms to assure contractual reliability, an alternative mechanism whereby contracting parties post default and renegotiation bonds which revert to some third-party should default or renegotiation occur is also be feasible); see also Blair et al., *supra* note 36, at 355–58.

2. External Monitoring by Third-Parties and Internal Monitoring Within the Supply Chain Become Intertwined

Internal monitoring within the supply chain by contracting parties, such as the implementation of HACCP plans in food safety, are regulated by contracts, including duties to take corrective measures, withdraw the product and inform the other parties if hazards emerge and corrective measures have to be taken.¹⁵⁹ With monitoring along the entire chain, the compliance with process standards requires the creation of a governance structure including committees that coordinate the activities of all the participants linked by bilateral contracts.

External monitoring is provided by third-party certifiers linked to one or more suppliers and/or the final producer. In a contract that contains safety, environmental, and social standards, in addition to the final buyer, multiple regulators and potentially one or more certifiers may monitor sellers' contractual performance and the duty to monitor compliance by their own suppliers.

This architecture has important repercussions not only with respect to the regulatory part but also on the more conventional commercial side related to the exchange of goods and services. The buyer, often the chain leader, previously delegated monitoring functions to the seller.¹⁶⁰ More recently the degree of delegation has decreased or *rectius* delegation is now broader because it involves also third parties. The need to retain control over the relationships along the chain requires either direct monitoring or the use of third-parties who can act as buyers'

159. See ISO 22000:2005, *supra* note 86, § 1.4.1.

160. See, e.g., General Terms & Conditions of Purchase of Goods of Unilever ASCC AG, *supra* note 92, art. 1.3 ("The lead supplier warrants to Unilever and each buyer that it has full power and authority to enter into the contract on behalf of each supplier and to bind each of them to perform and comply with the contract. The lead supplier agrees to procure each supplier supplies the products to each buyer on the terms and conditions of the contract as a supplier and fully complies with all obligations of a supplier under the contract. Each supplier accepts that Unilever may exercise the rights of each buyer under this agreement. Each supplier acknowledges and accepts that Unilever supplies the products or products incorporating the materials to other Unilever Group companies who supply them to third parties; each supplier agrees that the losses suffered by any such Unilever Group companies as a result of any breach of this agreement by the supplier shall be deemed to be losses also suffered by UNILEVER.").

agents and be accountable to them.¹⁶¹ These mechanisms do not replace but rather complement delegation to the lead supplier along the chain.¹⁶²

To sum up, multiple actors who operate within separate, yet connected, regimes therefore monitor performance of transnational regulatory provisions in commercial contracts along the supply chain. Compliance with regulatory provisions is subject to first-party monitoring by the buyer, and third-party monitoring by the certifier and/or by the regulatory body, which has promoted or imposed compliance with regulatory regimes defined by the code of conduct, the guidelines, or the framework contract.

In theory, the monitoring of the regulatory part is separated from that of the commercial part, which remains primarily regulated by the more conventional instruments provided by contract law. Clearly, however this separation is artificial and the overall monitoring function results from the interaction among the various involved parties.¹⁶³ Interaction between the regulatory and the 'commercial' sections of the contract does not imply perfect alignment. Parties may have different incentives to sanction breaches and to select the most appropriate remedies in relation to the exchange and the regulatory parts. The logics of commercial exchanges and those of regulatory compliance might sometimes be at odds.¹⁶⁴

161. See Blair et al., *supra* note 36, at 355 (discussing the agency relationship between manufacturers and the buyer).

162. See, e.g., *Unilever's Supplier Code*, <http://www.unilever.com/sustainable-living/customers-suppliers/suppliers/partner-code/index.aspx> (last visited Sept. 29, 2013) ("Unilever's direct suppliers will take responsibility to require adherence to the principles of this Supplier Code from their direct suppliers and exercise diligence in verifying that these principles are being adhered to in their supply chains.").

163. From the business management perspective, it could be argued that the regulated company acts as an agent, both for the buyer and certifier, as principals in transacting with third-parties, i.e. the suppliers. As Daniel F. Spulber observes, such an account "departs from standard economic analyses of the principal-agent problem. Economists usually model the problem as one in which the agent performs a task for the principal such as work requiring costly, but hidden effort or disclosure of information." DANIEL F. SPULBER, *THE MARKET MAKERS: HOW LEADING COMPANIES CREATE AND WIN MARKETS* 164 n.1 (1998). The legal perspective, in contrast, stresses "the role of the agent as an intermediary that negotiates contracts with third parties." *Id.*

164. See Cafaggi & Iamiceli, *supra* note 157, at 4 (comparing the effects of the choice among different regulatory strategies on the structure of the supply chain, in particular as regards to the degree of vertical integration or disintegration, the level of

This complex architecture generated by incorporation of regulatory provisions influences the observability of the seller's performance and its suppliers, increasing monitoring costs but potentially decreasing the risk of default. While the main focus is on the regulatory compliance, clearly the overall contractual performance is subject to more intense monitoring than the ordinary commercial contract.¹⁶⁵ Monitoring affects not only the stage of performance but also the sanctioning, since the main objective of remedies is to restore compliance rather than to provide compensation.¹⁶⁶ Cooperative remedies for regulatory non-compliance may therefore also affect the resolution of strictly commercial disputes. Finally, monitoring in certification permits a comprehensive approach to supply chains that current transnational commercial law does not allow, thereby complementing the contract system. Spillover effects from the regulatory to the commercial parts allow the chain leader to gain much stronger control over the upstream part.

B. Remedies and Sanctions for Regulatory Breaches: Conflicts and Coordination of Different Systems

Breach of regulatory provisions in individual contracts may have wider consequences spilling over the entire chain; the concurrence of multiple remedial systems redefines the incentive structure typically associated with the performance/breach alternative generally focusing on individual contracts. This might render even more problematic the efficient breach theory. Often, regulatory compliance in supply chains is the result of concurring performances and the effects of violations spread across the chain. The breach of regulatory provisions concerning safety may require from all the participants in the supply chain a contribution to remove the hazard and minimize the harmful consequences of the breach

market concentration, and the distribution of power along the chain among the various enterprises).

165. Cf. Armelle Mazé, Eur. Ass'n Agric. Econ., Learning Process and Contract Adaptation with Quality Uncertainty: Some Paradoxes in Retailer-Producer Relationships 1 (2002), <http://ageconsearch.umn.edu/bitstream/24957/1/cp02ma183.pdf> ("The central idea is that explicit contract terms makes it clearer to the transactors what has been agreed upon, thus are decreasing the cost of private enforcement.").

166. See *infra* Part IV.B.

concerning the unsafe products that have or are about to enter the market. Such duties, arising from the provisions of the contracts, may concern non-performances of third-parties who are not in privity within the chain. If B breached the contract with A, violating a safety clause linked to the HACCP system, not only A, his immediate contractual partner, but also D, E, and F may be required to act in order to detect the hazard and remove it further down the chain. The burden of correcting the problems and mitigating its consequences is allocated along the chain with provisions concerning cooperation and claims attributed against the different suppliers.¹⁶⁷ The duty to mitigate via regulatory provisions extends to the full chain given the interdependence among performances and non-performances. This notion differs from that of conventional contract law, which limits the duty to mitigate to parties in privity.¹⁶⁸

Remedies following breach of regulatory provisions reflect the supply chain logic rather than that of individual transactions typical of domestic contract laws. While examining the interplay between the different regimes some tension between the

167. In relation to liability claims, see General Terms & Conditions of Purchase of Goods of Unilever ASCC AG, *supra* note 92, art. 6.6 (“Each supplier shall be liable for and indemnify each Buyer, Unilever and each other Unilever group company against all losses, claims and all other liabilities whatsoever and howsoever caused and whether or not foreseeable, they incur or suffer as a result of or in connection with any breach of the Contract by any Supplier, enforcement of applicable laws, any recall of Products or any recall of goods or products incorporating any Products and any infringement by any supplier or the products of the [intellectual property] of any Third Party.”).

168. The reference to the duty to mitigate is intentional. In general this duty concerns the individual injured party. For the United States, see RESTATEMENT (SECOND) OF CONTRACTS § 350(1) (1981) (“[D]amages are not recoverable for loss that the *injured party* could have avoided without undue risk, burden or humiliation.” (emphasis added)); Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 1011–12 (1983) (until there is a breach, the counterparty can ignore requests for adjustments that might reduce the consequences of nonperformance). Regulatory provisions require a collective effort by the participants and transform the logic of mitigation. Such a transformation has not been internalized into domestic contract laws. See Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice and Doctrine*, 110 COLUM. L. REV. 1377, 1402 (2010) (highlighting that the request of adjustment of contractual duties can be interpreted as a misstep, deterring actions that can invite a counterparty to reciprocate proportionally and informally and which can confirm a party's tastes or character); Robert E. Scott, *In (Partial) Defense of Strict Liability*, 107 MICH. L. REV. 1381, 1387 (2009) (affirming that common law courts do not encourage both parties to take cost-effective precautions that will reduce the expected losses from a contract breach).

traditional contract law logic and that of regulatory regimes and certification regimes will emerge.¹⁶⁹

Remedies addressing regulatory violations may perform multiple functions: (1) ensuring regulatory compliance when violations of regulatory provisions have occurred; (2) redistributing the tasks between enterprises along the chain; and (3) compensating the parties who suffered from the breach.¹⁷⁰ Hence not only third-party monitoring complements first-parties but also multiple remedial regimes have effects on contractual design. When private regulatory regimes are incorporated in contracts, violations can often simultaneously trigger both remedies for breach of contract and remedies provided by the private regime and/or by the certification contract. As suggested in the previous section, we approach the issue from the perspective of complementarity, not of substitution. We contend that the differences among remedial logics can be largely, but not entirely, accommodated into the framework of complementary enforcement mechanisms.

We now examine the relationship between the different remedial systems in cases of violation to infer the potential consequences on contract design. If the violation of regulatory provisions, referring to a code of conduct or a guideline, constitutes, at the same time, a contractual breach of the sale contract, of the certification contract, and a violation of a code, the infringer might face three simultaneous remedial systems for committing a single violation: the one associated with contract law, that with certification, and the one defined by the private regulator in the scheme or code of conduct incorporated in the contract.

169. See Ralf Michaels, *A Fuller Concept of Law Beyond the State? Thoughts on Lon Fuller's Contributions to the Jurisprudence of Transnational Dispute Resolution—A Reply to Thomas Schultz*, 2 J. INTL DISP. SETTLEMENT 417, 417–26 (2011) (exploring Fuller's contributions to the jurisprudence of transnational dispute resolution, drawing on Fuller's writings on customary law, or 'implicit law' in Fuller's terminology).

170. See, e.g., SETSCO Servs. Pte. Ltd., Terms and Conditions for Certification para. 11.6, at 5, <http://www.setsco.com/rmc/setscocertificationbodytermsandconditions.pdf> (last visited May 28, 2013) ("Failure to meet any of the terms of the certification contract or gross breaches of the requirements of the certification criteria and basic standards may result in the suspension and termination of the certification or in the imposition . . . of the following sanctions: . . . [i]mpose additional conditions and insist on corrective action according to a timetable; [i]mpose penalty fees; . . . [s]uspend certification.").

The primary objective of regulatory remedies is to re-establish the correct functioning of the regulatory process and to correct regulatory failures, rather than to compensate the victims of the breach. The primary objective of contract remedies is to compensate the victim and provide the breaching party with incentives to make 'optimal' choices between breach and performance.¹⁷¹ The objective of remedies within a certification system is closer to the regulatory one: ensuring compliance with regulatory requirements along the chain if possible and exclude the party when breaches are too serious to be remedied.

Hence the logics of the three remedial systems differ remarkably.

(1) Conventional remedies in contract law have the objectives of deterring breach and compensating the non-breaching party by putting the victim in the position she would have been had the contract been performed or, in the case of reliance damages, the position she would have been had she not entered into the contractual relationship. Reputational sanctions are often only indirect and do not form part of the conventional menu.

(2) The objectives of the remedial system within private regulatory regimes are multiple but often do not focus on compensation. Sanctions for regulatory breaches are primarily directed at ensuring compliance with the regulatory provisions, and in the case of infringement, at adopting corrective measures to pursue the regulatory objectives, such as safety for consumer protection, lower pollution for environmental protection, and fair labor conditions for employees. Often, in addition to these corrective measures, reputational 'legal' sanctions are adopted to deter wrongful behavior and promote blaming and shaming. These reputational sanctions may target the communities at large or the group of regulatees, subscribing to the regime, or propagate outside that community, to invest the entire market. The effectiveness of reputational sanctions does not affect primarily the seller/breacher but rather the buyer, who is closer

171. See Benjamin E. Hermalin et al., *The Law and Economics of Contracts* 98–99 (Columbia L. & Econ., Working Paper No. 296, 2006) (discussing the breacher's decision to perform or breach), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=907678##).

to the market and indirectly bears consequences on the entire supply chain. In particular, they affect those buyers who are proximate to consumers. Ultimately, breach of regulatory obligations along the chain may turn into exit or boycott strategies by the consumers. Reputational sanctions in regulatory regimes therefore increase the incentives to monitor contractual performances in order to avoid or to mitigate the effects of the breach along the chain.

(3) Certification regimes adopt remedial systems closer to regulatory rather than contractual logic. They originate as ancillary to the regulatory regime in order to ensure higher and better compliance with process standards and, in the case of quality assurance, with product standards. The occurrence of a breach may have different consequences depending on which percentage of standard violation has occurred. There is generally a minimum threshold, an intermediate level, and 100% compliance all within the domain of performance. Below that minimum threshold the party enters the domain of breach. Within the breach there are also degrees of seriousness associated with different remedies. Different remedial actions are called for depending on the level of compliance with the requirements and the seriousness of the breach. When the enterprise is above the threshold remedies are generally aimed at correcting failures; when it is below the minimum threshold, the threat of decertification might arise. The links between the sale and the certification contracts show how relevant the role of the certifier and, in case of collective certification, of the certified body, can be for the single contractual performance.

What are the implications for contractual performance, and more generally for contract design, stemming from combining contractual and regulatory sanctions in transnational commercial contracts? What do sanctions by the certifier add to the governance structure of supply chains?

There are general implications concerning the simultaneous recourse to the double or triple remedial systems, when certification is deployed to ensure regulatory compliance. Transnational commercial contracts, including regulatory provisions, pursue complex objectives that combine exchanges with regulatory goals. This combination translates into contract design and architecture, which modifies rather significantly the

incentive structure to monitor compliance and sanction breaches. Suppliers respond simultaneously to the different regimes included in commercial contracts or linked to them within the certification contract of which they are part. Often regulatory provisions concerning coordination of supply chains allow for the obstacles of commercial contracts related to privity to be overcome, making lead suppliers effectively responsible for monitoring the entire upstream chain. As the example of curing defects shows, while in the commercial context the objective is to solve the specific problem related to the faulty delivered good, in the regulatory context, given repeat interaction among the parties, the goal is to avoid the re-occurrence of the standard's violation. The whole supply chain is involved in the process of correcting failures that may undermine the safety of the final product or its compliance with environmental or social requirements. These implications underline how collective interests, associated with the participants in the supply chain or even broadly with the involved regulatory regimes, may have direct and indirect influence on contractual performance. This feature characterizes repeat interactions in general but they become prominent in relation to regulatory provisions when process standards are involved. As observed earlier, standards of performance by the seller encompass obligations concerning the production process involving the upstream relationships well beyond the limits of bilateral sequential contracts formally associated with the principle of privity of contract. Sanctions for the violation of certification contracts and the regulatory regimes whose standards have been incorporated complement those provided by contract laws.

CONCLUSION

Transnational commercial contracts have become vehicles for the implementation of transnational regulation, giving rise to new contractual architectures combining different logics within a framework of complementarity. The logic of commercial exchanges differs from that of regulatory provisions, both in terms of focus and objectives, as follows: (1) the commercial focuses mainly on products, the regulatory on process; (2) the former is often limited to individual transactions while the latter encompasses a number of linked

transactions focusing on the interdependence of contractual relationships along the chain; and (3) the former aims at redressing the victim of the breach, while the latter tries to restore compliance with regulatory process in order to pursue regulatory objectives and deter future violations.

Transnational commercial contracts represent a remarkable example of global governance of markets if used as vehicles for the implementation of transnational regulation. The insertion of regulatory clauses with incorporation by reference to regulatory regimes implies not only that various regimes concur to define contractual performances, breaches and remedial systems, but also that parties, formally external to the contractual relationship, play an active role in (1) monitoring performance and (2) sanctioning breaches.

Different, and at times even divergent, remedial logics are in place. While remedies in contract are still primarily aimed at compensation for damages related to the breach, regulatory sanctions are directed to ensure compliance with standards all along the supply chain. Thus, they combine a deterrence and sanctioning function focusing on hazard detection and correction. Regulatory provisions impose joint problem-solving procedures that might be at odds with the conventional binary allocation of responsibility between sellers and buyers in more conventional commercial settings. Regulatory sanctions in social, environmental, and safety standards target individual responsibilities for monitoring and mitigating negative consequences stemming from breach. The influence of certification bodies and transnational regulators modifies the incentive structure of parties to enter and to perform contractual obligations, showing that much higher complexity stands behind the perform/breach alternative analyzed in conventional commercial contracts.

This Article has shown the changing structures and functions of transnational commercial contracts due to the inclusion of regulatory provisions. The commercial part remains, but a regulatory section, encompassing several sector-specific regimes, complements it. These contracts include a growing regulatory section, which modifies the scope of contracting and its governance function.

Two important conclusions should be drawn. The conventional divide between contract law as a tool aimed at facilitating exchanges and regulation, both public and private, as a tool to address market failures needs to be rethought. The integration within the same contract of commercial and regulatory provisions poses serious challenges to contract scholarship and to the design of international principles of commercial law that should be taken into due consideration by international institutions like UNIDROIT, UNCITRAL and the ICC. On the other hand, transnational regulatory bodies and human rights organizations should be fully aware both of the potential advantages and shortcomings of using contracts as vehicles for the implementation of regulatory standards.

This Article would reach its objective if it opens a dialogue on the basis of empirical evidence between areas of scholarships which remain separate by fragile and out-dated conceptual fences: international business transactions and transnational regulation.