Feasibility analysis of using contract law to improve social corporate responsibility in global supply chains

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Abstract. This study critically discusses the role of contract law in improving corporate social responsibility issues in supply chains. It shows that the use of contract law by multinational companies at the top of the supply chain to transfer CSR to their suppliers is widespread and has serious consequences. Moreover, multinational companies are less likely to draft contracts to protect the interests of those at the bottom of the supply chain, making it difficult for contract law to become a more powerful tool for improving CSR in global supply chains.

1. INTRODUCTION

A tragic factory collapse in Bangladesh has brought media attention to the role and responsibility of Western multinational corporations in this tragedy [1]. As a result, corporate social responsibility (CSR) has gained widespread attention. However, multinational companies have not taken on CSR in substance, but have transferred CSR to their suppliers through contract law. Based on a critical discussion of various studies, this paper examines the current status of CSR transfer by multinational corporations (MNcs) and the shortcomings in CSR clauses. It also points out the limitations of the current contract law through the analysis of the CSR clauses of Vodafone, Unilever and GlaxoSmithKline, and suggests improvements to the issue of the assumption of CSR by MNCs.

2. IMPORTANCE OF CONTRACT LAW

With the acceleration of economic globalization, trade between countries around has become more frequent, and due to the different economic structures of each country, many multinational companies and transnational supply chains have been created. The production activities of developed countries in developing countries have created many social and human rights issues, and thus the issue of corporate social responsibility has arisen. In order to solve the social and human rights problems in developing countries, multinational companies act more effectively than the governments in developing countries [2], and therefore CSR is a social responsibility that multinational companies should take. More importantly, CSR can widen the gap between companies and is more conducive to winning in the market competition [3]. In addition, CSR failures can pose economic and reputational risks to a company and can lead to significant financial losses or even bankruptcy. For example, Takata, once a major Japanese automobile supplier, recalled its cars after airbags that caused six deaths and over 100 injuries, which eventually led to corporate bankruptcy and a US$1 billion fine[4]. Therefore, it is inevitable to undertake CSR, both in terms of social responsibility and the development of the company itself.

The inclusion of CSR in contracts means that the nonbinding CSR is given legal force[5], transforming the commitment to CSR from a consciousness of multinational companies into a legal constraint. However, the status quo is not as rosy as envisaged. In this section, we critically discuss the current situation where contract law has become a tool for MNcs to transfer CSR to their suppliers and analyse why contract law has been criticized so widely in addressing CSR in the supply chain.

3. SHORTCOMINGS IN IMPROVING CSR IN THE SUPPLY CHAIN THROUGH CONTRACT LAW

Louise Vytopil's research shows that in three representative civilized countries - California, the United Kingdom and the Netherlands - the third party, the real beneficiary of CSR clauses in contracts between multinational companies and their suppliers, has difficulty in taking legal action against multinational companies to assert their individual rights[6]. The relativity of the contract is the main reason that prevents the third party from bringing a lawsuit, which will be discussed in the following paragraphs. At the same time, multinational companies must be aware that they are not fully committed to CSR. In other words, as before the introduction of contract law, the assumption of CSR relies almost entirely on the consciousness of multinational companies. The act of introducing CSR

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into contracts has not been an effective incentive for multinational companies to take on CSR and has had a very little binding effect on the behaviour of multinational companies. The quality of the CSR clause determines how binding it is on the supplier, and it is therefore reasonable to condemn MNCs for shirking their CSR responsibilities. Although not all multinational companies may actively shirk their corporate social responsibility, it is undeniable that they consciously or undoubtedly avoid taking responsibility and risk for CSR. This paper identifies two main shortcomings in improving CSR in the supply chain through contract law. The first is the privity of contract doctrine, and the second is the opacity of contracts. Both of these shortcomings are due to the nature of the contract itself, which is an advantage in the field of private law, but conflicts with the improvement of the CSR assumption problem.

Firstly, the privity of contract doctrine means that CSR contracts between multinational companies and first-tier suppliers cannot effectively bind the sub-suppliers. Since the sub-suppliers are not parties to the contract[7], the contract has no right to bind the sub-suppliers directly. It is unreasonable to make a third party a non-party in a contract[8], i.e., a contract on CSR between a multinational and a first-tier supplier cannot stipulate that the sub-suppliers also have to comply with the contractual obligations on CSR. Similarly, if a sub-supplier violates CSR, the MNC is not entitled to sue the sub-suppliers under the CSR contract between the MNC and the first-tier suppliers. In response, many companies have begun to impose stricter requirements on first-tier suppliers, for example, Vodafone, which encourages its suppliers to use the same CSR standards as Vodafone internally, and Rio Tinto, which prohibits suppliers from subcontracting without permission[9]. Such practices may seem perfect, however, as multinational companies increase their product range and refine their production steps, the more layers of suppliers there are, the more difficult it becomes to control the achievement of CSR through contracts[10]. The privity of contract doctrine, in addition to creating a natural barrier between the multinational and the sub-suppliers, also results in the third party being easily excluded from the contract. In English law with the Contracts (Rights of Third Parties) Act 1999, the first section provides that a third party can breach the privity of contract doctrine if the terms of the contract confer an interest on him or if the contract expressly provides that he may doctrine, and a third party must be specifically described in the contract[11]. However, as quoted earlier, the right granted to a third party by the Contracts (Rights of Third Parties) Act 1999 to break through the privity of contract doctrine is not unlimited. It is perfectly legal for a multinational or first-tier supplier to expressly exclude the third party's rights[12]. Moreover, in the UK jurisdictions, most contracts on CSR lack obligations to the multinational, but only to the supplier, so that when the third party claims in relation to the contract, the multinational will not suffer any actual loss due to the lack of assumption of CSR[13].

The second shortcoming of contract law in addressing CSR in the supply chain is due to the non-transparency of contracts. The non-transparent nature of the contract hinders the third party from asserting its rights and the promotion and learning of effective CSR clauses. Currently, the law does not have a clear requirement for the disclosure of specific details of contracts entered into by multinational companies with their suppliers. Therefore, it is up to the parties to the contract to decide whether or not to disclose the contract. When a multinational company simply wants to use the contract to avoid liability for CSR, the company can certainly choose not to disclose the contents of the contract. When the third party does not know exactly which rights the contract protects, asserting rights against the multinational becomes almost impossible to accomplish. In addition, the opaque nature of the contract means that there is an asymmetry of information. Even if a multinational company ensures its CSR commitment by signing a contract with its suppliers, it is difficult for other companies to improve themselves by referring to that contract. This is because CSR contracts, as part of the contractual terms between multinational companies and its suppliers, are inevitably related to trade secrets. In addition, Moreover, as mentioned before, the assumption of CSR contributes to market competition[3]. Therefore, in order to maximize their profits, multinational companies are often reluctant to disclose the CSR clauses in their contracts.

A stricter approach to drafting CSR clauses in contracts by multinational companies would not have a strong effect on the resolution of the issue. This article argues that there are two reasons for this situation. First, multinational companies do not undertake CSR for the sake of human, environmental or labor rights, but for their own benefits. The second reason is that the cost of CSR is enormous. Vodafone tries to contractually require first-tier suppliers to bind their sub-suppliers to comply with CSR, but its attitude is so weak that 'encourage' means that the binding of sub-suppliers is entirely dependent on the decision of first-tier suppliers. It can be argued that Vodafone does not have any real constraints on sub-suppliers.

Both versions of Unilever's suppliers code have stronger requirements for sub-suppliers than Vodafone, but a closer analysis of the two codes shows that Unilever's attitude is more favorable to itself than Vodafone's. The former version of the code stipulates that first-tier suppliers are required to comply with and fulfil their CSR obligations towards sub-suppliers, but Unilever does not give any rights or obligations to this provision[9]. Rather than being a binding provision for sub-suppliers, this provision is more of a slogan to shirk CSR for its interests. The latter version of the supplier code appears to include mandatory requirements, but in fact, Unilever introduces a new concept, claiming that "achieving best practice will take time"[9]. The interpretation of this length of time rests entirely with Unilever and, as with the previous version of the code, this provision has minimal binding effect on sub-suppliers and even has a negative effect on sub-suppliers' compliance with CSR.

GlaxoSmithKline has set out detailed CSR provisions that it expects its suppliers to comply with, which appears to be strict enough to serve as a basis for third-party to claim rights. However, such clauses do not relate to

the main obligations of the contract and are more like innominate terms than a condition or warranty[14]. Therefore, the breach of such a clause does not impair the main rights and obligations of the contract (generally supply and purchase). Since the obligations of the contract are assumed by the suppliers, the consequence of the breach of the CSR is that the company obtains the compensation and does not prevent the relationship between the rights and obligations of purchase and supply[14].

Vodafone and Unilever's binding of sub-suppliers appears to be an effective attempt to improve the contractual regulation of CSR in the supply chain, however, the company's own interest in binding sub-suppliers is more of a slogan than real binding power. GlaxoSmithKline has made every effort to avoid the impact of CSR violations on the company's interests. All three companies appear to have taken the initiative to assume CSR, but the real aim is to protect their own interests. This is not an effective way to improve the protection of the environment, human rights and labour rights in the countries where the suppliers operate. In addition, while CSR brings benefits to companies, it also requires them to bear significant costs. In the supply chain, the most direct cost is the additional input from suppliers, as companies have transferred their responsibilities to suppliers through CSR provisions. Unfortunately, however, consumers can not detect from the products whether multinational companies and their supply chains have taken reasonable steps to assume CSR[15]. Moreover, the benefits of CSR to companies are long term, and until a competitor's scandal emerges, there is no difference between a company that strictly undertakes CSR and one that claims to do so. But CSR assumption implies a significant cost to the company. As profit is the main objective of a company, the cost of CSR may eventually be passed on to consumers through price, or the reduction in investment in other areas may lead to a less competitive product, both of which ultimately point to a failure to compete in the market. The cost of maintaining CSR and the profitability attributes of the business, as well as the absence of relevant legislation, inevitably lead to multinational companies being unlikely to adopt a more stringent way when entering into CSR contractual terms with their suppliers. If they do, it is only superficially strict, as in the case of Vodafone, GlaxoSmithKline and Unilever's code. Even if directors of multinational companies want their companies to take on CSR, they are limited by the “Duty to promote the success of the company[16]” under S 172. It is true that CSR is in the long-term interest of the company, but it is impossible to expect multinational companies to assume CSR when most of the responsibility and risk of CSR can be shirked through contracts with suppliers.

4. ROLE OF CONTRACT LAW AND THE DIRECTIONS FOR IM-PROVEMENT

It is also not possible to make multinational companies assume corporate social responsibility in their supply chains using only contract law adjustments. That is to say, addressing the problem of multinational companies shirking social responsibility in their supply chains requires a concerted effort from domestic laws such as contract law, company law, consumer protection law, and even international law. However, this does not mean that the role of contract law as an instrument to regulate the assumption of CSR by multinational companies should be denied. In English law, multinational companies have strong bargaining power as buyers in contract negotiations[17]. This ability has the potential to make CSR a reality at all levels of the supply chain. However, currently, multinational companies shift all CSR to the supply chain. If the law provides for the CSR commitment of multinational companies in the supply chain, multinational companies can offer a lower purchase price in exchange for the transfer of CSR, and the contract can achieve a balance of interests between suppliers and multinational companies through their bargaining power.

Based on above, this study suggests that the contract law should make new provisions for the CSR commitment of multinational companies in the supply chain. Firstly, as it is currently difficult for the third party to bring a lawsuit or arbitration against a multinational company at the international level, it is necessary for contract law to develop an accountability framework[18]. Secondly, a standard, referenceable and enforceable framework for CSR should also be provided in contract law. Last but not least, contract law must be more actively regulated, as there is a gap between contract and regulation[19], and the CSR of multinational companies in CSR provisions can only be better managed if there is more regulation in contract law. In addition, the ultimate aim of the multinational company's commitment to CSR is to give relief to the third party whose interests have been damaged, so it is also important to improve domestic laws that can protect human, environmental and labor rights in the countries where suppliers are located. This does not mean that multinational companies that violate CSR are not held accountable, but only that the third party whose rights have been violated is provided with better remedies.

5. CONCLUSION

This study critically discusses the role of contract law in improving CSR issues in the supply chain. The study first critically analyzes the use of contract law by multinational corporations (MNCs) at the top of global supply chains to transfer CSR to their suppliers and avoid compliance with CSR, and shows that the use of contract law to address MNCs' evasion of CSR is limited by the relativity and the opaqueness of contracts. Then, the CSR clauses of three representative companies with different levels of intensity and detail of CSR provisions are analyzed. The study points out that multinational companies design CSR provisions with the ultimate goal of safeguarding their own interests, and it is difficult to see significant benefits from the long-term costs of maintaining CSR. As a result, the likelihood of MNCs taking the initiative to draft clauses in a more restrictive

manner is low, and contract law is hardly a more powerful tool for improving CSR in global supply chains. Finally, the study critically discusses the role of contract law and the directions for improvement, noting that correspondence with the domestic laws of the supplier's country is beneficial in safeguarding the infringed interests.

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