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Tendencies in contractual governance to promote human and labour rights in transnational supply chains

Katerina Mitkidis

Department of Law, Aarhus University, Denmark

Sonja Perkovic

Department of Management, Aarhus University, Denmark and Centre for Decision Research, University of Leeds, UK

Panagiotis Mitkidis

Department of Management, Aarhus University, Denmark and Center for Advanced Hindsight, Duke University, USA

Abstract:

This article analyses contractual governance practices within the value chains of large companies based in the USA and Europe between 2012 and 2017 with focus on human and labour rights. In line with the existing scholarship, we find that the use of contractual governance for safeguarding human and labour rights is best practice among large American and European businesses. The results show that value chain contractual governance should be studied in an interdisciplinary environment taking both legal and non-legal aspects into consideration. Moreover, we detect a general positive impact of the business and human rights regulatory wave of 2010-2011 on sustainable contractual governance practices.

Key words:

Business and Human Rights; contractual governance; sustainable procurement practices; quantitative analysis; longitudinal study

Introduction

Under the pressure of economic globalization, human and labour rights in global value chains are often compromised in order to keep production costs down.¹ While international law in the areas of human and labour rights is almost globally applicable, it is not globally enforced.² In other words, compliance with the international law at the national level is not secured equally by states. One reason for uneven enforcement between states is the competition of countries for international investment, especially by developing countries (UN HRC, 2008: para. 14). The uneven compliance with and enforcement of international human and labour rights law by states is then exacerbated by the legal vacuum in which companies with transnational value chains operate. Scholarship and legal practice have long recognized the existence of a legal vacuum with respect to transnational value chains (e.g. de Jonge, 2011: 67-68), where international law is not applicable to private parties, while the application of national law is geographically limited. Such a legal vacuum creates a governance gap allowing outsourcing companies to take the advantage of low human and labour rights protection in countries with weak regulation. For example, a USA-based branded computer producer outsources assembling of its products to South Korea. In this case, American labour law does not apply to the relationship between the Korean supplier and its workers, while South Korea enforces its international obligations with respect to labour conditions only leniently (Electronics Watch, 2014). The result is that the Korean workers are trapped in a governance gap without effective protection of labour law.

One response to this governance gap has been the adoption of an increasing amount of global Business and Human Rights (BHR) regulation. This body of regulation is of both public and private

nature but has been predominately soft (non-binding) in character.³ A major wave came in years 2010-2011, with the adoption of the United Nations (UN) Guiding Principles on Business and Human Rights (UNGPs), the revision of the OECD Guidelines for Multinational Enterprises (OECD Guidelines) and the release of the International Standardization Organisation 26000 Social Responsibility Guidance Standard (ISO 26000) being among the most widely discussed and implemented throughout the corporate world (we refer to these together as the ‘regulatory wave of 2010-2011’).

These soft regulations aim not only at improving the protection of human and labour rights (among other issues), but also at reconceptualizing the division of responsibility for the protection of these rights between states and private entities. For example, the UNGPs “Protect, Respect and Remedy” framework describes a responsibility of business entities to respect human rights, including labour rights. The approach to the businesses’ responsibility to human and labour rights adopted by the UNGPs differs from what the concept of corporate social responsibility, in that the UNGPs do not rely on companies’ voluntary initiatives above and beyond compliance, but require them to observe law and social expectations in order to be considered responsible business (Buhmann 2018a: 53-54).

However, while the regulatory wave of 2010-2011 has shaken the traditional legal categorization between national and international, between private and public, and between soft and hard law, it has not been able to escape it; we seem to be locked in this conceptualisation of law (Teubner, 1998). On the one hand, all the soft law instruments from the regulatory wave of 2010-2011 recommend that buyers set expectations for their suppliers with respect to human and labour rights and work with suppliers to achieve compliance. This includes the adoption of various management tools (primarily risk-based due diligence). On the other hand, they also extensively rely on contract termination as the ultimate tool to exert influence over suppliers’ behaviour (Peterkova Mitkidis, 2015: 152), as is further investigated below. This indicates that while soft international standards strive for a more collaborative, relational and organization-like relationships in transnational value chains, it is hard contract law adopted by states that is used as the final security of safeguarding human and labour rights. As Adar and Gelbard (2011: 405) write ‘[e]ven parties to a fully functioning relational contract may act, consciously or un-consciously, under the influence of the implicit threat of being exposed to a legal sanction (i.e., a legal remedy) for failing to comply with one’s contractual obligations.’

Still, contractual governance of transnational value chains has received only limited (yet growing) attention of legal scholars. Below we review the major approaches of legal scholars as a preface to our research on the use of contracts to protect human and labour rights between 2012 and 2017. We conducted an empirical study of selected companies’ disclosure about the use of contractual governance within their value chains to secure protection of human and labour rights. In particular, we investigated whether companies’ jurisdictional and sector characteristics have an effect on this contractual practice and whether the changes in global norms in 2010-2011 in the area of Business and Human Rights have had an impact on the use of contractual governance throughout transnational value chains of selected companies. The results allow us to understand how companies communicate to operationalize soft law instruments through the use of private law tool of contract. Moreover, as we report data from 2012 and 2017, we trace the impact of the regulatory wave of 2010-2011 on the companies’ sustainable procurement practices and hypothesize about other drivers of change.

Literature review

By incorporating human and labour rights provisions into their commercial contracts, companies secure (partial) compliance with relevant soft and hard laws which emerged during the regulatory wave of 2010-2011; in other words, contracts attempt to operationalize the new legal obligations. An

example of such a provision can be found in provision 3.5 of Deutsche Telekom's Supplier Code of Conduct that is incorporated into the company's Standard Terms and Conditions by reference. The provision reads:

'Working hours, including overtime, shall comply with applicable local laws. Where no national legal standards exist, ILO standards shall apply. The Supplier shall respect the individual worker's need for recovery and secure that all workers have the right to adequate leave from work with pay.'⁴

In addition to operationalizing respect for rights, it has been argued that by including these issues in supply chain contracts, companies signal to the regulators that no more hard law and its public enforcement is necessary to protect human and labour rights as the problems are taken care of by the companies; in other words, the public regulatory gap is being filled by private governance (Bair and Palpacuer, 2015: S2). It is this varied interaction between public and private corporate social responsibility (CSR) standards and law on the one side and supply commercial contracts on the other that has sparked increased attention of legal scholars in this area. The use of contractual governance has been gaining momentum as a link between various soft and hard legal solutions for achieving sustainability within transnational value chains and as the missing piece in the global sustainability regulatory puzzle. The increasing body of scholarship has been complementing the well-established research on private regulatory governance in the CSR area (e.g. McBarnet, Voiculescu and Campbell (eds), 2007; Crane et al. (eds), 2008).

Most legal scholarship in this area is theoretical. One stream of literature has identified supply chain contracts as hardening both public (Kocher, 2002: 266; Cafaggi, 2011; Cotterrell, 2012: 500–524) and private CSR (Sobczak, 2006; Vytopil, 2015: 107) soft standards. The leading idea here is that soft law has an important role to play in achieving global sustainability but is (directly) unenforceable through courts. It becomes enforceable (hardened) once it is inserted in or referred to by a commercial contract. In this respect, legal scholars have discussed the applicability of traditional international law of contracts remedies, such as specific performance, damages and contract termination. While some argue that awarding of damages and contract termination is plausible at least in respect to 'basic ethical standards' (Schwenzer and Leisinger, 2007: 268; Schwenzer, 2017), others are more cautious, maintaining that enforceability depends on the wording of a specific clause and the behaviour of the parties (Mitkidis, 2015: 221–230).

Most authors agree that enforcement of contractual provisions aiming at protection of human and labour rights through courts is not their primary purpose. Instead, the main purpose is twofold: to manage relevant risks (Mitkidis, 2015: 172–173, 232–233) and to achieve suppliers' behavioural change (Scheltema, 2014). Some scholars even argue that enforcement through courts may have detrimental effects on human and labour rights in transnational value chains (Kawakami, 2017). Kawakami (2017: 161–174) suggests that focusing on formal sanctions might result in crowding out non-legal or social norms as well as reducing the intrinsic motivations of companies to be socially responsible. Relational and collaborative remedies thus might be more appropriate. Such relational and collaborative remedies include, among others, development of corrective action plans, educational events provided by buyers to their suppliers, and naming and shaming strategies.

The discourse on the applicability of contract law remedies for breaches of human and labour rights-related contractual provisions reveals the incongruities that occur if a private law tool is used to protect public law interests. Cafaggi (2013: 1611–1616) discusses the tensions between the different logics of contractual remedies on the one side, and regulatory and certification remedies on the other side. Cafaggi and Iamiceli (2013) elaborate on this and conclude that a combination of contractual and regulatory remedies seems most effective in achieving both transactional and regulatory goals of these contractual provisions. Due to this double aim of inserting human and labour

rights-related provisions into commercial contracts, companies in fact partially substitute and complement states in this area of regulation. This happens through various mechanisms. First, the ‘hardening’ effect discussed above lends otherwise soft standards which states may not have legislated domestically the nature of enforceable legal obligation through private legal action. Second, consistent inclusion of human and labour rights-related provisions into supply chain contracts may amount to international trade usage in line with Article 9(2) of the United Nations Convention on Contracts for the International Sale of Goods (CISG) and similar provisions in national legal systems (Schwenzer and Leisinger, 2007: 249), thus becoming binding on the contractual parties.⁵ However, this ‘law’ creation avenue is limited, as the question may be raised whether it is the inclusion of those provisions itself or their effective enforcement that becomes the trade usage (Ramberg, 2015: 71). Moreover, the practice seems to be more prevalent in certain jurisdictions and industries (Butler, 2017; Thorlaksona, de Zegherb and Lambin, 2018). Third, another avenue of regulatory effects of supply chain contracts is the idea of ‘spill-over’ effect (Alhambra, ter Haar and Kun, 2011: 354–355). Private regulation through contract may inspire the adoption of a hard regulation at the national level applicable to international supply chains. Fourth, human and labour rights provisions in international supply chain contracts have been described as legal transplants, transferring rules and values from developed countries to developing countries (Lin, 2009).

While the legal theoretical mapping of using private contracts to secure human and labour rights in transnational value chains is rather comprehensive, the empirical evidence of the same remains sparse. Methodological challenges are the primary explanation for this (Affolder, 2018: 5-6). The access to the text of supply chain contracts is limited or impossible in most cases due to their private and confidential character. Still, legal scholars have developed various tactics to overcome these difficulties and used various datasets including: a limited number of contracts provided by companies (Vytopil, 2015; Cafaggi, 2012); public databases of contracts, such as the U.S. Security and Exchange Commission filings (Vandenberg, 2007); other publicly available information, such as companies’ CSR reports or standard terms and conditions (Mitkidis, 2015); data from a case study (Kenny, 2007); and data obtained through interviews (McBarnet and Kurkchian, 2007; Vytopil, 2015).

To date, legal empirical studies suggest that inclusion of sustainability provisions, including human and labour rights-related provisions, into supply chain contracts is a widespread practice (Pace University and IACCM, 2010; EcoVadis and Affectio Mutandi, 2018). The studies also agree that it is the best practice among companies to adopt a mixed approach to monitoring and enforcement of these contractual provisions, combining relational (such as suppliers’ self-assessment, action plans and collaborative capacity building) and contractual (the sanction of contract termination) tools (Pace University and IACCM, 2010). The selection of strategies to be combined in a particular contract may depend on the jurisdiction (Mitkidis, 2015), which can be explained among others by differences in contract interpretation style.

Empirical studies of corporate sustainable procurement processes appear in other disciplines as well. These include various fields of business administration and, primarily, supply chain management (e.g. Thorlaksona, de Zegherb and Lambin, 2018; Meehan and Bryde, 2011; Islam et al., 2017). Walker et al. (2012) have documented the growing interest of management studies into sustainable procurement. However, those studies focus on corporate sustainable procurement processes in general and not on contracts in particular. Furthermore, they focus more often on environmental rather than social sustainability issues. They also study sustainable procurement from the companies’ perspective, aiming to document and conceptualize the processes and to possibly deliver advice with respect to corporate practice. Thus, the perspective is primarily internal, while the dynamics of external regulatory framework are mostly not considered.

Our empirical research focuses on the use of contracts, and relevant monitoring and enforcement tools. It is a longitudinal study, involving analysis of corporate communication on the

use of contracts to protect human and labour rights in 2012 and 2017. This is a novel addition to the existing scholarship as we are able to observe the development of the practice and hypothesize about the possible drivers of change. In this paper, commercial supply contracts are considered to be used for the protection of human and labour rights when they include a provision requiring suppliers to address human and/or labour rights in general or any human and/or labour right in particular within their operation. The tested hypotheses were developed based on the literature review and a review of the use of contracts and contractual governance throughout the instruments of the regulatory wave of 2010-2011.

BHR regulation and contracts – hypotheses

While companies may benefit from the governance gap with respect to the protection of human and labour rights through, for example, lower factor inputs arising from wage competition, they are also under growing pressure from society (consumers, NGOs and investors) and law to exert influence throughout their value chains to ensure responsible behaviour. The regulatory wave of 2010-2011 gave companies a new tool through which to control and exercise the influence: risk-based due diligence (DD). Although the text of the soft law instruments offer limited guidance on how such risk-based DD should be operationalized, there is a certain amount of description found in principles 17-22 and the accompanying commentary of the UNGPs. According to the UNGPs, the aim of the process-oriented risk-based DD is to identify, prevent and mitigate negative impacts of businesses on human rights through their operations, including indirect negative impacts within their value chains. Therefore, engagement with business partners regarding human rights area is of paramount importance. Companies are, among other things, advised to start the risk-based DD process already in the pre-contractual stage, use internal and external expertise to assess any negative impacts, carefully consider organisational issues in order to incorporate the process throughout their company, and use qualitative and quantitative measures to monitor any negative impacts. The risk-based DD process is guided by the principles of transparency, prevention and ongoing re-evaluation (Buhmann, 2015; Buhmann, 2018b). The tool of risk-based DD has been further developed with respect to the OECD Guidelines (OECD, 2018). While risk-based DD can be praised as one of few practical tools available to companies for operationalisation of human and labour rights-related requirements throughout their business activities, it has also been noted that focusing on the process rather than the substance of the requirement may undermine its ethical foundations (Fasterling and Demuijnck, 2013).

Taking inspiration from these soft law instruments, several national legislative acts were adopted in recent years. The Dutch parliament adopted Child Labour Due Diligence Law in 2017 (currently within the senate).⁶ France followed the same year with adopting the Due Diligence law aiming to prevent serious human rights abuses in supply chains.⁷ Moreover, reporting laws requiring companies to disclose their policies, activities and results in respect to human and labour rights interact with the soft law instruments. These laws include the California Transparency in Supply Chains Act of 2010, the UK Modern Slavery Act 2015 (and namely its Transparency in Supply Chain Provisions), and, more generally, national non-financial reporting laws, for example in France (2001), the UK (2006), Denmark (2008) and Spain (2011), and the EU Directive 2014/95/EU establishing the rules on disclosure of non-financial information by large companies (followed by national implementation of the same). Moreover, disclosure laws exist in respect to specific industries, such as timber and paper (US Lacey Act; Regulation (EU) No 995/2010) or conflict minerals (US Dodd-Frank Act, section 1502).⁸

Companies have to operate in the applicable legal framework. Any non-compliance with applicable law constitutes a risk, both legal and economic. For example, if a French company covered

by the Due Diligence Law does not live up to the risk-based DD obligation and does not publish the required vigilance plan, it becomes vulnerable to negative press, which may adversely influence its bottom line, as well as expose it to possible litigation. Therefore, being under hard national or supranational law obligation to conduct risk-based DD and/or report on non-financial aspects of business would presumably push companies to implement more (and more stringent) corporate tools and processes to manage the impact of business on human and labour rights (Buhmann 2013). One of the available tools through which to operationalize this is contractual governance. Its usage is expressly and implicitly recommended by most of the national and supranational non-financial reporting and risk-based DD laws. For example, the EU Commission Guidelines on non-financial reporting (2017) include the following passage:

‘Companies should consider making material disclosures on human rights DD, and on processes and arrangements implemented to prevent human rights abuses. This may include, for instance, how a company’s contracts with businesses in its supply chain deal with human rights issues ...’

The regulator thus makes a direct link between DD processes and supply chain contracts. Therefore, an increase in the use of contractual provisions aiming to safeguard human and labour rights is expected as a result of the national and supranational legislative activity between 2010 and 2017. We thus formulate our first hypothesis as follows:

H1: The use of contracts to pursue human and labour rights’ protection is more likely by companies headquartered in jurisdictions where a reporting or risk-based DD law is applicable.

Except for the regulatory framework, the protection of human and labour rights by businesses also depends on the combination of other companies’ attributes, such as size or industry. BHR regulation recognizes that these attributes necessarily impact on the level of engagement as well as feasibility of companies’ actions in this area. For example, the OECD Guidelines state that enterprises should ‘[c]arry out human rights DD as appropriate to their size, the nature and context of operations and the severity of the risks of adverse human rights impacts.’ (OECD Guidelines, 2011: 31) These attributes have been discussed in detail in some aspects of corporate sustainable practices, particularly in respect to non-financial reporting (Hahn and Kühnen, 2013). However, they have not been systematically studied in respect to the use of contractual governance in the area. We aim to explore two selected attributes – closeness to consumers and jurisdiction - in the next three hypotheses.

The position of a company in the value chain has been identified as influencing the engagement of companies in non-financial reporting (Hahn and Kühnen, 2013: 12-13). The idea is that companies closer to market are more sensitive to consumers’ pressure to conduct business in a responsible manner (Haddock-Fraser and Fraser, 2008). We presume that the closeness to market may equally influence the uptake of contractual governance in companies’ supply chains. In our analysis, we distinguish in line with Haddock-Fraser and Fraser (2008) business-to-business (B2B) and close-to-market (C2M) companies. We add one category of close-to-market companies where consumers are limited in the possibility to choose the product/service and where the public discourse on human and labour rights in international supply chains has not been so strong (XC2M). We include pharmaceuticals and airlines in this category. In respect to pharmaceuticals, consumers’ choice of product is limited when speaking about prescription-only products. Moreover, the safety and efficacy aspects of medicines and the relevant advice by dispensing subjects (pharmacies) mainly affects consumers’ choice. In relation to airlines, the selection of airline by consumers is primarily determined by issues of availability (which airline connects the desired destinations) and price. Moreover, in the sustainability discourse, airlines are mainly questioned in respect to their environmental performance, due to their large carbon emissions levels, while human and labour rights

conditions in their value chains (such as health and safety standards at their garment suppliers) attract much less attention. Therefore, we formulate our second hypothesis as follows:

H 2: The use of contracts to pursue human and labour rights' protection is most likely by companies from close-to-consumers industries.

The location of business is not only relevant because of the scope of applicable law, but also because it influences how applicable law is interpreted and applied. Here the distinction between common law (caselaw-based system) and civil law (codification-based system) countries become relevant (Pejovic 2001: 819). Contract interpretation style in common law countries is characterized by objectivism and formalism (Movsesian, 2006). Moreover, the establishment of the contractual content, i.e. which rights and obligations form the contract, is governed by the *parol evidence rule*. Under this rule, when parties aim to conclude a completely integrated contract, extrinsic evidence cannot be used to add, alter or contradict the actual contractual text. In such situation, any kind of pre-contractual or ancillary documents (such as suppliers' codes of conduct) would not be taken into consideration when determining the rights and obligations of the parties. On the other hand, civil law countries are characterized by a subjective style of contract interpretation. The main purpose is to find the contractual parties' intention. In order to do that, any kind of extrinsic evidence is in general acceptable. This means that companies from civil law countries may consider pre-contractual commitments and ancillary documents as binding, although they are not incorporated in the actual text of the contract. Our third and fourth hypotheses reflect this difference between civil and common law countries.

H 3: Companies headquartered in common law countries are less likely to use a written pre-contractual commitment regarding human and labour rights' protection than those headquartered in civil law countries.

H 4: Companies headquartered in common law countries are more likely to use contracts to pursue human and labour rights' protection than those headquartered in civil law countries.

The next five hypotheses aim to illustrate the effect of the regulatory wave of 2010-2011 on the use of contractual governance for safeguarding human and labour rights as disclosed by the sample companies. BHR regulation of 2010-2011 rely extensively on contracts as an implementation tool. Moreover, it connects it at many places with the newly introduced process to manage businesses' negative impacts on human and labour rights in transnational value chains: risk-based DD.

First, risk-based DD is an inherent part of contractual process, and may already be affecting the contracting decision. Potential suppliers are to be screened for their social performance. For example, the Commentary to General policies of the OECD Guidelines states: '... enterprises can also influence suppliers through contractual arrangements such as ... pre-qualification requirements for potential suppliers ...' (OECD Guidelines, 2011: 24). Both UNGP (2011: 16) and ISO 26000 (2010: 5.2.3) contain a similar guidance, stressing the parties' contractual freedom to decide with whom they will conduct business and on what terms. Based on this pre-contractual assessment, the contract may or may not be awarded. The decision to award a contract is to be used as a tool of influence, ISO 26000 in this respect in its provision 6.3.5.2 states: '... organization should not enter into a formal or informal partnership or contractual relationship with a partner that commits human rights abuses in the context of the partnership or in the execution of the contracted work.'

Secondly, the insertion of adequate provisions into contractual text is considered as a necessary step in risk-based DD practice by regulators and industries alike (ISO 26000, 2010: 7.3.3.2

and 6.4.3.2). However, although reliance on mere contractual provisions is considered insufficient for effective protection of human and labour rights in international supply chains (SRSG, 2010: 2), it arguably has some positive effects on suppliers' behavioural change (Peterkova Mitkidis, 2015: 242-253). Contractual provisions serve in this context not only the purpose of binding suppliers to specific conduct, but also as a tool to communicate a buyer's values and principles to its suppliers (UN Global Compact Office and BSR, 2010: 26). The purpose of contractual provisions for protection of human and labour rights is thus twofold: manage business and legal risks, and regulate suppliers' behaviour.

Both these aims can be achieved if suppliers comply with relevant (contractual) requirements imposed on them by buyers. The dual purpose is reflected in the mix of management tools, and legal and non-legal remedies applied in case of suppliers' non-compliance. Optimally, those should have both remedial and deterrent function. However, much hard and soft law stresses the importance of collaborative efforts between companies and their suppliers. This seems also to be the attitude of companies who might feel limited in respect to the influence they can exert over their suppliers as well as the suppliers' actual capabilities to deal with human and labour rights issues. Moreover, some research argues that relational enforcement and assistance, such as collaboratively developed action plans to tackle any supplier's non-compliance, and technical and/or organizational assistance, is more effective in achieving suppliers' compliance (Gunningham, Kagan and Thornton, 2006; Locke and Romis, 2007). Three-step corporate best practice in securing compliance with human and labour rights provisions has thus developed. This includes: internal and/or external on-site audits, corrective action plans and potential contract termination. This core best practice is then accompanied by pre-contractual and post-award tools, such as suppliers' self-assessment and positive/negative rewards to suppliers based on their sustainable performance.

Finally, this definition of best practice shows that while companies make efforts to positively influence the protection of human and labour rights in their supply chains through relational and other non-legal tools, they rely on the legal tool of contract termination as the last step in the monitoring and enforcement procedure. Arguably, this is also recommended by BHR regulation in case of suppliers' inability/unwillingness to comply. Two options are available to companies, if they become aware of an actual or potential negative impact on human or labour rights caused by their suppliers: to mitigate the negative impact or to terminate the relationship. Termination of a business relationship basically means termination of the relevant contract; however, this cannot be done in every situation, because of difficulties to prove that a breach of human and labour rights-related contractual provisions amounts to a fundamental breach of the contract (Peterkova Mitkidis, 2015: 221-226). As such, the sanction of contract termination is most often executed outside of any formal enforcement proceedings. Still, the possibility of losing the business relationship has a strong deterrent function and serves as a backdrop to any mitigation efforts. The OECD Guidelines make this clear while stating:

‘Appropriate responses [*to suppliers non-compliance*] with regard to the business relationship may include continuation of the relationship with a supplier throughout the course of risk mitigation efforts; temporary suspension of the relationship while pursuing ongoing risk mitigation; or, **as a last resort, disengagement with the supplier** either after failed attempts at mitigation, or where the enterprise deems mitigation not feasible, or because of the severity of the adverse impact.’(emphasis added) (OECD Guidelines, 2011: 27)

The process of human and labour rights protection also does not stop at the supply chain first tier but ideally extends throughout the whole supply chains. This ideal is nevertheless hard to achieve, as not only companies may not know all their sub-suppliers, but also because a direct legal link between a company and its sub-suppliers is lacking. These practical and legal obstacles are recognized within BHR regulation. For example, the Commentary to the Principle 17 of the UNGP states:

‘Where business enterprises have large numbers of entities in their value chains it may be unreasonably difficult to conduct due diligence for adverse human rights impacts across them all. If so, business enterprises should identify general areas where the risk of adverse human rights impacts is most significant ...’

Therefore, the general recommendation is to exercise influence over further tiers of supply chain when feasible (OECD, 2011: 20). This is translated into companies’ sustainable supply chain contracting, when it becomes best practice to require suppliers to flow human and labour rights requirements up their value chains (Vytopil, 2012: 161).

Moreover, companies are encouraged to pool and share data with respect to suppliers’ auditing in order to save economic resources and avoid suppliers’ audit fatigue (EcoVadis, 2016). In this respect the Commentary to the OECD Guidelines states:

‘... enterprises are encouraged ... to participate in industry-wide collaborative efforts with other enterprises with which they share common suppliers to coordinate supply chain policies and risk management strategies, including through information-sharing’ (OECD Guidelines, 2011: 25)

Given the foregoing, we hypothesize that the regulatory wave of 2010-2011 has had the following impacts on companies’ use of contractual governance within their supply chains:

H 5: The uptake of human and labour rights provisions by supply chain contracts has raised significantly from 2012 to 2017.

H 6: Suppliers screening for human and labour rights performance in the pre-contractual phase has increased significantly from 2012 to 2017.

H 7: Suppliers’ compliance auditing in respect to human and labour rights requirements has shifted from internal to external auditing from 2012 to 2017.

H 8: The amount of companies using a complete monitoring and enforcement procedure in respect to human and labour rights requirements has increased significantly from 2012 to 2017.

H 9: Companies attempt to reach beyond their first-tier suppliers in respect to human and labour rights compliance has increased significantly from 2012 to 2017.

Empirical study design

In order to test our hypotheses, we conducted an empirical study of selected companies’ disclosure about the use of contractual governance within their value chains to secure the protection of human and labour rights.⁹ Relying on companies’ disclosure is one of the methodological strategies to avoid the practical problem of accessing the texts of commercial contracts (Affolder, 2018). We acknowledge the limitations of this approach, particularly, that the measure used in the analysis is one of disclosure of information on the use of contractual governance, not the actual use of the contractual governance (similarly Haddock-Fraser and Fraser, 2008: 144).

For this part of our research, we have chosen to use the content analysis research method (Krippendorff, 2004). This approach is popular in social science research and widely used in the area of corporate social responsibility characterized by a large amount of publicly available documents and communication (e.g. Thorlaksona, de Zegherb and Lambin, 2018). The defining features of content analysis research method are that it is objective, systematic and quantitative (in the sense that quantitative methods may be used to analyse the data) (Kassarjian, 1977).

The population for our study encompasses companies based in the USA and Europe. All studied companies appear on both the 2012 and 2017 Fortune Global 500 lists.¹⁰ Companies represented on the 2012 list but falling out as of 2017 were excluded from the analysis. The sample is a convenience sample, meaning that it is not randomized. This is due to the distinct focus on the largest multinational enterprises based in the USA and Europe. For our analysis, we have selected companies from 7 industry sectors (companies being classified according to their primary type of business), those being chosen from industries having at least five US and European companies represented on the 2012 Fortune Global 500 list and representing a reasonably even balance between B2B, C2M and XC2M sectors, and between companies based in common and civil law jurisdictions. Within the sample, companies based in the USA or the UK are classified as based in a common law jurisdiction; companies based in continental Europe are then classified as based in civil law jurisdiction (Zweigert and Kotz, 1998). The final independent variable – existence of DD and/or non-financial reporting legal obligation – was not considered when selecting the sample, as significant development was known to be expected from 2012 to 2017. However, in order to determine whether a company is under such legal obligation, national and supranational laws on non-financial reporting and risk-based DD mentioned in section ‘BHR regulation and contracts – hypotheses’ above as well as other such national and supranational laws generally applicable across industries were taken into consideration. The sample thus includes the following industry sectors: communication (n = 9)¹¹, chemicals (n = 4)¹², metals (n = 4)¹³, airlines (n = 5)¹⁴, pharmaceuticals (n = 9)¹⁵, aerospace and defence (n = 8)¹⁶, and beverages and food – consumer products (n = 7)¹⁷. The total sample size amounts to n = 46.

The selected industries do not pose equal threats to human and labour rights in their supply chains. However, possible human and/or labour rights abuses are relevant in each of them. The communication sector can, for example, pose a threat to private property rights when land is acquired to build a network infrastructure. The chemical industry naturally involves issues of occupational health and safety in the production processes. The metals industry is commonly associated with labour violations in resource extraction activities. Airlines are less intuitively connected to human and/or labour rights issues in their supply chains. However, for example, as large buyers of textiles, they face an issue of possible child labour in their supply chains. The pharmaceutical industry is often associated with the ethics of clinical trials and labour conditions in production facilities based in developing countries, particularly India. Aerospace and defence industry face questions about sourcing of materials, spareparts and natural resources, not least with respect to labour conditions, such as the right to freedom of association. Finally, with respect to beverages and food, the consumer products industry is one of the most exposed industries to criticism with respect to the human and labour conditions in their supply chains, not least allegations of child labour in cocoa plantations or the right to water of local communities in the vicinity of production sites in developing countries.

Although, human and labour rights are an issue in supply chain of all the studied industries, the uptake of contractual governance to mitigate negative impacts differ across them. For each company, information regarding the communication about the use of contractual governance for the purpose of protection human and labour rights within their supply chains was gathered from the companies’ latest sustainability reports available as of September 2012 and March 2018 respectively.¹⁸ When a report referred to a publicly available corporate policy (e.g. Suppliers Code of Conduct), this policy was included into the analysis. The studied documents were gathered online from the companies’ websites. The corporate documents were each coded by two coders according to a codebook developed for this purpose (Saldaña 2016: 27-28). The gathered data were organized into three categories including the variables specified below. The data do not include within variable examination, which is an obvious limitation of the article and a type of research that could provide more nuanced understanding of the use of contractual governance for human and labour rights’ protection in future. Moreover, we do not primarily test for causality in our paper, but for change in

the use of contractual governance over time. We then hypothesise and discuss what the causes of the observed changes could be.

Observed variables:

(i) information on the company and report

This group of variables serves as general information about the respective company, its sustainability reporting activity and availability of corporate policies relevant for the studied subject. The variables include: the name and country of the headquarters of the company; whether the company is headquartered in common or civil law country, USA or Europe, and whether there is an applicable legal requirement with respect to CSR reporting and/or risk-based DD in the respective jurisdiction; the industry branch or the primary type of business (we followed the classification of the Fortune Global 500 list); whether the company issues a sustainability report and the year of the latest available report; and whether the company's sustainability report refers to other corporate policies and eventually their availability.

(ii) information on the type and form of (contractual) commitment

These variables document whether companies report to use commercial contracts and/or written pre-contractual commitment in order to ensure the protection of human and labour rights within their supply chains. These variables were not tied to any specific human and/or labour right(s), rather a general mentions of human and/or labour were traced. Furthermore, we checked for the disclosure about whether companies impose any such requirements beyond their first-tier suppliers.

(iii) information on the monitoring and enforcement procedures

In this set of variables, we gather data on companies' disclosure regarding their monitoring and enforcement processes, namely whether they employ internal and/or external on-site audits, corrective action plans and contract termination. We have furthermore coded these data to find out which companies report use of the full monitoring and enforcement process, namely which companies report to use all three steps.

Results and discussion

Hypotheses H₁, H₂, H₃ and H₄

In hypotheses H1-H4 we test the influence of companies' two attributes on the reported use of contracts, meaning imposing specific contractual provisions on their suppliers, to safeguard human and labour rights in their supply chains. We look namely into the effect of their headquarters' location and their position within the supply chain. Concerning the location of companies' headquarters, we focus on the jurisdiction. We distinguish between common and civil law countries and look into whether there is an applicable non-financial reporting and/or risk-based DD legal requirement the companies must comply with. In Table I. below, we report the description of the data for H1-H4. We note that the amount of companies subjected to hard legal requirements have raised from 2012 to 2017, which reflects the adoption wave of soft regulations that inspired increase in relevant hard law requirements.

	Common law	Civil law	Reporting and/or DD legal requirement	No reporting and/or DD legal requirement	B2B	C2M	XC2M
2012	26	20	5	41	15	18	13
2017	26	20	21	25	14	18	14

Table 1. Jurisdictional and sector characteristics of the studied companies and their change in the sample from 2012 to 2017 (numbers indicate the number of companies for each attribute).

To explore the dependence between different predictor and outcome variables, we used Fisher's exact test. We run the test on the 2017 data. We found no significant difference regarding the use of contracts to pursue human and labour rights' protection between the companies headquartered in jurisdictions where a non-financial reporting or DD national or supranational hard law is applicable versus the companies which are not under national or supranational legal obligation to report on non-financial aspects of their business or to conduct risk-based DD ($p = .205$, odds ratio = 0.41); no significant difference between the use of contracts to pursue human and labour rights' protection between the companies from close-to-consumers industries compared to other types of companies applicable ($p = .277$); significant difference regarding the use of a written pre-contractual commitment between the companies headquartered in common law countries compared to those headquartered in civil law countries ($p = .046$, odds ratio = 0.23) and no significant difference regarding the use of contracts between the companies headquartered in common law countries compared to those headquartered in civil law countries ($p = .780$, odds ratio = 1.33).

Soft and hard law regulate together to create a regulatory pressure on companies and steer their behaviour in the desired direction. It may thus be surprising that companies headquartered in countries with applicable hard law on non-financial reporting and/or risk-based DD do not use more contracts to regulate suppliers' behaviour in the human and labour rights area than companies headquartered in countries without such hard law. However, the results are not unanticipated when considering the time lapse between a law's adoption and its entry into effect. For example, while the EU non-financial reporting directive (2014/95/EU) came into effect in 2014, according to its article 4, Member States had to implement it only until 6 December 2016 EU, and companies are first obliged to apply the rules in 2018 for the reporting year 2017. An explanation of the insignificant effect thus can be that the influence of the applicable hard law is not yet observed in practice. Nevertheless, companies are usually proactive, implementing the upcoming legislation before the date of its effectiveness. This may indicate that additional hard law requirements do not impact on companies' responsible behaviour already regulated by soft legal instruments. In order to assert which explanation holds true, the study should be repeated after the new hard law is effective for a longer time.

We do not find a significant effect of a company's position in the supply chain. This may be the consequence of the fact that companies' non-financial reporting is more sensitive to consumers' and public scrutiny (Hahn and Kühnen, 2013: 12-13) than the use of often confidential commercial contracts. Moreover, while one could expect that B2B companies, not exposed to consumer' pressure, are less interested into their negative impacts in supply chains, they in fact are under the same requirements imposed by soft and hard law as C2M companies and can also expect possible benefits from responsible behaviour on their relationships with investors (Haddock-Fraser and Fraser, 2008: 153). Still, some differences between sectors were observed in regard to the unification of the practices. For example, all pharmaceutical companies in the sample are members of the

Pharmaceutical Supply Chain Initiative setting up expectations for sustainable procurement.¹⁹ The consequence of companies' participation in such industrial collaborations on contractual governance in transnational value chains could be explored by future studies.

The effect of the headquarters' location in civil v. common law jurisdiction has a significant impact on the use of written pre-contractual commitments. This finding supports our expectation that differences in contract interpretation styles impact on the form of commitment companies require from their suppliers. While this finding seems natural in the legal world, it serves as a reminder for other fields of research that business processes must be seen in relation to the applicable legal framework.

Finally, hypothesis 4 is not supported. We presumed that while the sample companies in civil law countries used more frequently pre-contractual written commitments, the use of contracts would be equally decreased, as the companies would not feel the need to repeat the commitment also in the contractual text. However, the results show that companies based in civil law countries use contracts regardless of whether they already used pre-contractual written commitment. We speculate that they do it for the sake of clarity in respect to the strength and seriousness of the commitment.

Hypotheses H₅, H₆, H₇, H₈ and H₉

In Hypotheses 5-9, we investigate the change in selected variables from 2012 to 2017. Six variables are tested and the results are also described in percentages in the following Table 2 and Figure 2.

	Contract (%)	Screening criteria (%)	Beyond 2 nd tier (%)	Internal audit (%)	External audit (%)	Termination (%)	Full monitoring and enforcement procedure (%)
2012	52.17	63.04	58.70	52.17	45.65	56.52	39.13
2017	71.74	73.91	73.91	73.91	71.74	73.91	63.04

Table 2. Change in dependent variables from 2012 to 2017 expressed in percentages.

(InsertFigure1)

Figure 1. Change in dependent variables from 2012 to 2017.

We used McNemar's chi-squared test to explore the differences between the selected variables in years 2012 and 2017. We found marginal significant difference regarding the uptake of human and labour rights provisions by supply chain contracts from 2012 to 2017 ($\chi^2(1, 92) = 3.52, p = .061$, odds ratio = 1.49) with more companies using the contracts in 2017; no significant difference regarding suppliers screening for human and labour rights performance in the pre-contractual phase from 2012 to 2017 ($\chi^2(1, 92) = 1.09, p = .297$, odds ratio = 1.24); significant difference between the amount of companies using a complete monitoring and enforcement procedure from 2012 to 2017 ($\chi^2(1, 92) = 5.26, p = .022$, odds ratio = 1.63) with the companies attempt being more pronounced in 2017; no significant difference regarding the companies attempt to reach beyond their first-tier suppliers in respect to human and labour rights compliance from 2012 to 2017 ($\chi^2(1, 92) = 2.13, p = .114$, odds ratio = 1.36). Finally, to explore whether suppliers' compliance auditing shifted from internal to

external auditing from 2012 to 2017, we conducted two McNemar's chi-squared tests. More specifically, we assessed whether internal auditing has decreased and external auditing has increased from 2012 to 2017. The results show significant difference for both the use of internal auditing ($\chi^2(1, 92) = 4.35, p = .037$, odds ratio = 1.56) and the use of external auditing from 2012 to 2017 ($\chi^2(1, 92) = 6.26, p = .012$, odds ratio = 1.71). However, the use of both internal and external auditing has increased from 2012 to 2017. One must note that all these results should be interpreted with caution because of the small sample size; in our analysis we consider both the results of the chi-squared test and descriptive statistics.

The marginal significant increase in the use of contracts to safeguard human and labour rights in companies' supply chain over the past five years is an expected result, as there has been increased focus on contracts in all regulatory, business and scholar areas. In fact, imposing a written requirement in this respect on suppliers seems to amount to best practice, with 80.43 % of the studied companies using contracts and/or written pre-contractual commitments. This finding is consistent with previous literature (Pace University and IACCM, 2010). These results should also be seen in connection to the H1 results (the effect of hard national and supranational law requirements on the uptake of contracts for safeguarding human and labour rights in supply chains.) In relation to our first hypothesis, we do not find a significant effect of national and/supranational hard law mandating non-financial reporting or risk-based DD on the use of contracts. Thus, we may assume that the increase in the use of contracts is rather an effect of soft law and other non-legal drivers than national and supranational hard law.

What might come as a surprise is that we do not see a significant increase in the suppliers' pre-contractual screening. One explanation for the statistically non-significant increase might be that the pre-contractual suppliers' screening is steered by non-legal rather than legal pressures and that financial and business risks are considered higher than legal risks. In other words, the regulatory wave of 2010-2011 followed up by the adoption of various national non-financial reporting and risk-based DD laws mostly 'codified' what has already developed in practice. Another explanation might be that companies in their 2011 reports already reflected on the upcoming soft and hard risk-based DD regulation (also taking into account that the requirement to conduct risk-based DD was in general terms introduced already in 2008 by John Ruggie in the 'Protect, respect and remedy' framework), and by adopting new corporate processes and reporting on them managed related risks. Yet again, this explanation must be considered together with explanations of H1 results, where it seems that companies were not proactive enough in adapting to upcoming legislation.

We find a significant increase in the uptake of full monitoring and enforcement procedures. This is an expected result documenting the spread of best practice in the corporate world regardless of jurisdictional or geographical boundaries or industry specifics. This process has been arguably accelerated by the regulatory development, where all the instruments of the regulatory wave of 2010-2011 work with the combination of relational and contractual monitoring and enforcement tools. This reinforcing impact of soft law on corporate best practice may justify adoption of these rules that some might find as superfluous.

We do not observe a significant change in companies' effort to reach beyond their first-tier suppliers via contractual governance. The discourse on human and labour rights in transnational value chains has long pointed out that managing direct suppliers is simply not sufficient. Unethical behaviour may be pushed up the value chain and thus become (more) obscure. Multinational companies have also faced critique for the conduct of their sub-suppliers in recent years.²⁰ Responding to those pressures, companies' reporting on the use of contractual governance to reach into further levels of their value chain was already rather high in 2011 (c.a. 60%). However, the gap between reporting and practice comes to mind. It is rather easy to require your suppliers to pass the human and labour rights-related requirements throughout their own value chain, but more difficult to

monitor if and how this is done in practice. However, we should be careful not to assume business is taking inadequate action, because no better way has been identified so far.

Finally, a significant increase in both internal and external on-site audits is observed. While we expected to find an increase only in external audits due to pooling of companies' resources and information, we expected a decrease in internal audits. The fact that both auditing is still increasing shows that there is a space for a more intense business cooperation in this area, which could possibly lead to financial savings (EcoVadis, 2016). Moreover, the general increase in auditing practice can be seen as a response to the regulatory development, namely the introduction of the risk-based DD. On-site auditing is also a measure that can be easily quantified for the reporting purposes and as such represent an opportunity for companies to evidence their efforts.

Summary and conclusion

In this paper, we analyse the use of contractual governance to drive responsible behaviour in supply chains of large USA and Europe-based companies and the change in the practice from 2012 to 2017. We review legal scholarship in this area and conduct an empirical study to test nine hypotheses. Through statistical analysis we identify several interesting results.

We confirm that using contracts to steer suppliers towards responsible behavioural in respect to human rights and labour is best practice among large companies based in the USA and Europe. We also confirm that the broader legislative framework of contract law influences the form of the commitment, namely that companies headquartered in civil law countries use pre-contractual written commitments instead of, or together, with contracts. However, we do not see an effect of recent hard reporting and/or risk-based DD laws on the use of contract for safeguarding human and labour rights in value chains, despite the fact that the laws rely on contracts as the ultimate tool to exercise influence throughout transnational value chains. Several explanations are possible; we hypothesize that the effects of these laws have not yet materialized as the laws have only recently become effective or are becoming effective in near future.

By exploring the changes in the use of contractual governance for safeguarding human and labour rights from 2012 to 2017, we aim to detect whether the regulatory wave of 2010-2011 impacted on the practice. Through statistical analyses, we observed that during the last five years, companies report the use supply chain contracts to steer their suppliers' performance in the area of human and labour rights more frequently, an increase in the implementation of the complete monitoring and enforcement procedure, and an intensification of both internal and external on-site auditing efforts. Surprisingly, we have not found statistically significant evidence that suppliers' pre-contractual screening or their efforts to reach into further tiers of their supply chains would also be on increase. Yet, the data disclose a rising trend. The results thus suggest a generally positive impact of the regulatory wave of 2010-2011 on the supply chain contractual governance in the area of human and labour rights. What can also be observed is a different contextualization of contractual practices, now being considered as a part of corporate human rights DD required by soft and, in some jurisdictions also hard law, as opposed to a merely voluntary CSR tool. However, we have not investigated other reasons of change, such as market drivers, ongoing court litigation and judicial decisions, or media attention to unethical behaviour in transnational value chains of branded companies.

Our research contributes to the understanding of sustainable procurement processes of large USA and Europe-based companies. It adds to the existing (legal) scholarship by empirically elucidating contractual governance of human and labour rights-related performance in transnational value chains that stays traditionally opaque to the public eye and by doing that on a longitudinal basis. To understand the contractual processes and the effect of soft and hard law on them further, we suggest that the analysis could be repeated after several years on a larger and richer data set. Also, other methods, such as experimental studies, should be applied to better understand the mechanisms

of the interactions between the formal characteristics of suppliers' commitments, and the combination of various contractual and relational monitoring and enforcement tools. Such methods would also respond to the critique that there is a gap between companies' reporting and their behaviour. While this is indisputably true, we should not assume that branded companies are not willing to make efforts to truly change the situation in their supply chains, but rather that there are often limitations on what they can achieve. These limitations are both practical and legal. In order to overcome these, future research should identify the limitations and study them in an interdisciplinary setting taking into account both legal and non-legal factors.

Supplementary material:

Data on file with the corresponding author, available upon request.

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¹ The authors acknowledge that labour rights are important human rights incorporated in core human rights international conventions, including the International Covenant on Civil and Political Rights (1966) and the Convention on the Rights of the Child (1989). Yet, in the text both human and labour rights are referred to as distinct in line with the distinction made within major global corporate social responsibility initiatives, such as the UN Global Compact, see UNGC, The Ten Principles of the UN Global Compact, available at <https://www.unglobalcompact.org/what-is-gc/mission/principles> (accessed 17 December 2018).

² The term ‘enforcement’ is further developed in the context of contracts and contractual governance, where both legal and relational enforcement is discussed.

³ Soft law is understood here as non-binding sets of norms in accordance with work of Shelton (2000).

⁴ Deutsche Telekom AG, Supplier Code of Conduct, Version 2018, available at <https://www.telekom.com/en/company/global-procurement/topics/compliance-and-sustainability-525982> and General Terms and Conditions for Purchasing by the Deutsche Telekom Group (AEB), Version: July 2018, available at <https://www.telekom.com/en/company/global-procurement/topics/purchase-conditions-525980> (both last accessed 17 December 2018).

⁵ Article 9(2) CISG: ‘The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.’

⁶ Wet Zorplicht Kinderarbeid. Information on the legislative process available at:

www.eerstekamer.nl/wetsvoorstel/34506_initiatiefvoorstel_van_laar (accessed 17 December 2018).

⁷ Loi no. 2017-399 du 27 Mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre.

⁸ Only generally applicable sustainability disclosure and due diligence laws are considered in this article.

⁹ NB, we do not study the individual and specific rights, but trace the mentions of human and/or labour rights in general.

¹⁰ 2012 Fortune Global 500 list available at: <http://fortune.com/global500/2012/> (accessed 11 June 2018). 2017 Fortune Global 500 list available at: <http://fortune.com/global500/list/> (accessed 11 June 2018).

¹¹ The number of companies in this sector dropped from 10 in 2012 to 9 in 2017.

¹² The number of companies in this sector dropped due to a move of one company from the chemicals to pharmaceuticals sector from 5 in 2012 to 4 in 2017.

¹³ The number of companies in this sector dropped from 5 in 2012 to 4 in 2017.

¹⁴ The number of companies in this sector dropped due to a merger of two airlines companies into the International Airlines Group from 7 in 2012 to 6 in 2017. We have excluded those companies from the analysis for balance reasons, in order to keep the sample from 2012 and 2017 comparable.

¹⁵ The number of pharmaceutical companies stayed 9 in both years. One company dropped from the Fortune Global 500 list in 2017, however, one other company that in 2012 had a primary business in chemicals has been moved to pharmaceuticals in 2017.

¹⁶ The number of companies in this sector dropped from 9 in 2012 to 8 in 2017.

¹⁷ The number of companies in this sector raised due to business split of Kraft Foods from 8 in 2012 to 9 in 2017. However, due to balance reasons, we have excluded these companies from the analysis in order to keep the sample from 2012 and 2017 comparable.

¹⁸ The term 'sustainability report' is used as a general term encompassing various CSR, sustainability and business ethics reports as well as companies' integrated reports, when used.

¹⁹ <https://pscinitiative.org/home> (accessed 11 June 2018).

²⁰ For example, after the deadly fire in the Tazreen Fashions factory in 2011, Walmart was pilloried although the company distanced itself from the disaster, stating that its supplier contracted the factory as a sub-supplier in direct violation of Walmart's policy.