

CORPORATE SOCIAL RESPONSIBILITY: CREATING AND IMPLEMENTING SUPPLIER CODES OF CONDUCT

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Economic globalization and the increased scrutiny of transnational and multinational corporations over the past few decades has given rise to the present climate of opinion, with its widespread aversion to the "soulless corporation". Today, the responsibility of business is arguably not simply to increase profits but to achieve profit-maximization through corporate social responsibility and the advantages that come with being regarded as an "ethical" brand. Now, more than ever, corporations are looking at how they can modify, control, report, police and sanction behaviour that may jeopardize their status as an ethical brand with customers and shareholders. Accordingly, many corporations have taken to the practice of developing and implementing supplier codes of conduct that set minimum performance standards for their suppliers both at home and abroad. This paper summarizes the key components of supplier codes of conduct and analyzes the legal risks associated with the creation and implementation of such codes.

Key Components of Supplier Codes of Conduct

Like other private sector initiatives, supplier codes of conduct are not created in a vacuum, but are developed and negotiated against a backdrop of national and international laws and regulations. Therefore, determining the appropriate scope, content, implementation and enforcement mechanisms are pivotal considerations for transnational and multinational corporations drafting and implementing supplier codes of conduct.

(a) Scope

The selection of issues covered (and avoided) is a key element of any supplier code of conduct. When defining the scope, corporations must first determine whether they will adopt universal standards for all suppliers or whether they will develop separate jurisdiction-specific supplier codes of conduct that accord with local laws and customs. While some businesspeople have the belief that the only way to build a global corporation is with a single global standard of business conduct, the practical reality is that some employment laws and human rights issues, like gender orientation, equal pay, equal treatment, attitude about gifts, and discrimination manifest themselves differently throughout the world in different legal systems. For instance, if a corporation does business in certain countries in which the governments have imposed legislation outlawing same-sex

relationships, enforcing a supplier code of conduct prohibiting discrimination on the basis of sexual orientation may be problematic and untenable.

At a minimum, however, supplier codes of conduct should consider referring to the core labour standards identified in the conventions of the International Labour Organization (ILO), a United Nations agency, which include:

- Freedom of Association
- Right to Collective Bargaining
- No Forced Labour
- Minimum Age
- No Discrimination
- Equal Remuneration

The most comprehensive supplier codes of conduct will also refer to a number of other aspects of employment and workplace conditions, such as provisions for health and safety, maximum hours of work and rest periods, wages, and security of employment.

(b) Coverage

Once a corporation has determined the scope of its supplier code of conduct, a further question for consideration is to whom should the code apply? While the answer to this question may appear self-evident — the supplier code of conduct will apply to the corporation's suppliers — in many industries multiple subcontracting relationships are common. In practice, large amounts of "supplier" work is in fact carried out by subcontractors and sub-subcontractors. Accordingly, corporations must decide how far down the supply chain the obligations set out in the supplier code of conduct apply. Will the supplier code of conduct only apply to the corporation's direct suppliers or will the corporation insist that its direct suppliers only do business with subcontractors who agree to be bound by the term of the supplier code of conduct? Moreover, there is also the issue of whether the supplier code of conduct will only apply to enterprises, or whether it also includes "homeworkers", who provide services to suppliers from their homes as sub-subcontractors.

(c) Implementation and Enforcement

For a supplier code of conduct to be meaningful, it must have clear methods of implementation and enforcement to ensure that suppliers are conducting business in accordance with its terms. In one study, the ILO estimated that 80 per cent of supplier codes of conduct were really statements about general business ethics that had no implementation methods. In order to ensure that the adoption of a supplier code of conduct is more than a public relations ploy, corporations must include reasonable and realistic implementation and

enforcement mechanisms. Therefore, a corporation's decisions with respect to the scope and coverage of its supplier code of conduct are inextricably connected to and impacted by the implementation and enforcement mechanisms the corporation is prepared to undertake.

The most comprehensive supplier codes of conduct will include both auditing mechanisms and grievance and complaint procedures.

Auditing Compliance with Supplier Codes of Conduct

Since suppliers are in the business of profit-maximization and, generally speaking, operate in highly competitive markets far removed from the western "ethical" brand cachet, suppliers cannot be permitted to self-report compliance with the corporation's supplier code of conduct. In order to ensure compliance, corporations or third parties engaged on their behalf must: (1) negotiate audit rights into contracts with suppliers; (2) regularly conduct on-site visits of supplier facilities; and (3) require and review supplier records.

If and when the corporation's audit uncovers a violation of the supplier code of conduct, the corporation must be prepared to penalize the offending supplier. To ensure a culture of non-compliance does not develop among suppliers, corporations should adopt an approach that penalizes non-compliant suppliers in a meaningful way, commensurate with the degree of their non-compliance. Penal provisions in a supplier code of conduct may include, providing the supplier with a rectification period, publically reporting non-compliance, the imposition of fines, and a reduction in business from the corporation to the supplier up to and including cancellation of the contract.

However, as it is ultimately not in the corporation's interest to uncover or publicize its business relationships with non-compliant suppliers, in practice, the implementation and enforcement of supplier codes of conduct can only be guaranteed where there is an element of independent monitoring. The independent monitoring of compliance with supplier codes of conduct often proves to be a contentious issue as corporations are reluctant to accept such arrangements and, even where there is a commitment in principle to independent monitoring, different stakeholders may differ as to what they consider "independent" in this context. Nonetheless, the most comprehensive supplier codes of conduct will provide for auditing to be conducted by the corporation or an independent third party.

Grievances, Complaints and Whistle-Blowing

A complicated and contentious issue in respect of supplier codes of conduct is whether or not corporations should oversee grievances and complaint procedures when an employee of the supplier files a complaint related to an alleged breach of obligation set out in the supplier code of conduct.

Corporations that do oversee such grievances and complaint procedures should carefully manage the legal

risks that may arise from their involvement, including the risk of being deemed a co-employer of the supplier's employees. Although the law differs by jurisdiction, even the most comprehensive supplier code of conduct should not eliminate the supplier as the intermediary between the corporation and the supplier's employees, thereby preventing the supplier from abnegating its responsibilities under the supplier code of conduct.

At a minimum, however, supplier codes of conduct should contain provisions that trigger reporting obligations from the supplier to the corporation upon the filing of a complaint or grievance by an employee of the supplier related to the supplier's obligations under the code. Such reporting obligations keep the corporation abreast of the employee relations in the supplier's organization and alert the corporation to potential red-flag conduct by the supplier without the corporation assuming the liability for the supplier's misdeeds.

Further, some supplier codes of conduct also include a mechanism for employees of the supplier to anonymously report violations of the supplier code of conduct to the corporation. These "whistle-blower" provisions may then trigger the corporation's right to audit the supplier for compliance with the supplier code of conduct.

Risks Associated with Supplier Codes of Conduct and Recommendations

As is evident from the foregoing, when a corporation is contemplating the scope, content, implementation and enforcement mechanisms for its supplier code of conduct, the corporation must be careful to strike a balance between two extremes.

First, if a corporation adopts a supplier code of conduct that is very limited in scope and content, the corporation risks being criticized for taking a non-committal approach to the unethical business conduct of its suppliers by customers, shareholders, and other stakeholders, which may in turn detract from its status as an "ethical brand". While supplier codes of conduct that are limited in scope and content may be easier to implement and enforce, they may also be viewed by stakeholders as a public relations ploy that changes very little "on the ground".

Second, if a corporation adopts a comprehensive supplier code of conduct but fails to adequately implement and enforce it, the corporation also risks the reputational and financial harm associated with their diminished public image in the event that breaches of the supplier code of conduct are publicized. In such cases, corporations risk being accused of hypocrisy when egregious breaches of the supplier code of conduct are publicized. There are also potential legal considerations which may include: (1) negligence; (2) breach of fiduciary duty; (3) securities law class actions; and (4) damage to reputation.

To minimize the reputational as well as the financial risks associated with supplier codes of conduct, corporations that draft such codes should: (1) carry out a pre-screening verification during approval processes

with suppliers; (2) conduct initial on-site audits at some supplier facilities; (3) apply the "Eyes Always Open" approach when visiting suppliers for any reason; (4) conduct periodic follow-up to monitor supplier performance; and (5) enforce the penal provisions of the supplier code of conduct if a supplier's performance creates an unreasonable reputational or financial risk to the corporation.

Moreover, a corporation's best public relations insurance against reputational and financial harm is to have clear enforcement mechanisms that both deter suppliers from breaching the terms of the corporation's supplier code of conduct and enable the corporation to take swift and meaningful action in the event of a breach. Accordingly, corporations should not only include stringent penal provisions in their supplier codes of conduct but they should also integrate those enforcement mechanisms into the commercial agreements they enter into with their suppliers. Corporations should therefore: (1) explicitly state in their commercial agreements with suppliers that non-compliance with the supplier code of conduct is a material breach of the commercial agreement; (2) reserve the right to terminate the commercial agreement in the event of supplier non-compliance with the code; and (3) be prepared to terminate the commercial agreement in the event that a significant breach of the supplier code of conduct is publicized, thereby creating an unreasonable reputational or financial risk to the corporation.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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