PROSKAUER ROSE LLP

International HR Best Practices

Tip of the Month

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A monthly "best practices" alert for multinationals confronting the challenges of the global workplace

This Month's Challenge

Employees of manufacturers in developing countries have tried to hold U.S. companies liable in U.S. courts for failure to enforce their supplier codes of conduct.

Best Practice Tip of the Month

Although the courts have recently rejected efforts to hold U.S. companies liable for not forcing their suppliers to improve their labor conditions, further efforts can be expected, and prudence dictates that multinational companies maintain credible and effective enforcement mechanisms for their supplier codes of conduct.

Law & The Workplace™

Wal-Mart Not Liable for Claims of Labor Law Violations Brought by Employees of Foreign Suppliers

As previously reported (*see* the International HR Best Practices Tip of the Month for December 2005 and May 2007), the retail giant Wal-Mart was sued in federal district court in California in 2005 by a labor rights organization, on behalf of individuals in Bangladesh, China, Indonesia, Nicaragua and Swaziland, for alleged abuses of workers in factories in those countries supplying goods for Wal-Mart stores in the U.S. The gravamen of the suit in *Doe v. Wal-Mart* was that Wal-Mart should be liable to these workers for its failure to enforce its own Supplier Code of Conduct, under which Wal-Mart committed to ensuring that its suppliers maintained minimum labor standards for their employees. Although Wal-Mart's contracts with its foreign suppliers included a commitment by the suppliers to adhere to local standards regarding basic worker rights (including minimum wage, maximum hours, overtime, forced labor, child labor and discrimination), and specifically provided for Wal-Mart's right to inspect the factories and cancel the contracts for noncompliance with labor standards, the plaintiffs alleged that Wal-Mart failed to enforce these standards, maintained an inadequate and ineffective monitoring program, overlooked suppliers' violations of labor standards and effectively compelled the suppliers to violate the minimum labor standards by setting such short deadlines and low prices in its supply contracts that the suppliers had to violate the workers' rights in order to satisfy the contracts.

In 2007, the district court dismissed the complaint on the grounds that even if the allegations in the complaint were true, they didn't amount to a legally recognizable claim that Wal-Mart had committed any legal wrongdoing against these plaintiffs. The case went up on appeal to the Ninth Circuit Court of Appeals, and that court decided recently that the district court was right. The fight to improve worker conditions in developing countries will doubtless continue, but the likelihood of the U.S. courts being used as a club to beat multinational companies into spearheading that effort grows increasingly dim.

The Ninth Circuit decision was written by Judge Ronald M. Gould, a Clinton appointee, and joined by Judges Betty B. Fletcher and Raymond C. Fisher, appointed by Presidents Carter and Clinton, respectively. Judge Gould enumerated four legal theories urged by the plaintiffs, and rejected each of them.

First, the workers argued that Wal-Mart's Supplier Code of Conduct constituted a promise by Wal-Mart intended for their benefit, which they were entitled to enforce as third-party beneficiaries. The problem with this argument, the court held, is that Wal-Mart did not promise anything. Under the supply contracts, the suppliers promised to maintain minimum labor standards, and the suppliers agreed that Wal-Mart had the right under the contracts to inspect their operations and cancel the contracts if they failed to live up to this commitment. Wal-Mart did not, however, assume any duty to the suppliers to conduct such inspections. The suppliers clearly could not have sued Wal-Mart for failing to inspect them often enough or thoroughly enough. Accordingly, there was no promise by Wal-Mart for the suppliers' employees to enforce against Wal-Mart as third-party beneficiaries.

The workers' second argument was that Wal-Mart was a joint-employer, along with the foreign supplier, and so could be sued for violation of the employees' labor rights. Finding no indication that Wal-Mart possessed any right to direct and control these workers, Judge Gould dismissed this claim. The employees pointed to Wal-Mart's right to inspect their factories as evidence of Wal-Mart's control over their daily activities, but the court responded that Wal-Mart had no obligation to conduct any inspections, and that inspections, when they occurred, were for the purpose of monitoring the supplier's compliance with Wal-Mart's code of conduct, not to direct the daily activities of the suppliers' employees.

The third theory put forward by the plaintiffs was that Wal-Mart acted negligently in conducting (or not conducting) inspections and supervising (or not supervising) the suppliers, for which Wal-Mart could be held accountable by the workers who claimed to have been injured by Wal-Mart's conduct. Here, again, Judge Gould found the absence of any duty owed by Wal-Mart to these workers to constitute a fatal flaw in plaintiffs' theory.

Finally, the plaintiffs claimed that Wal-Mart had been unjustly enriched at their expense, "by profiting from relationships with suppliers that Wal-Mart knew were engaged in substandard labor practices." Unjust enrichment does not apply in this case, Judge Gould wrote, because the connection between Wal-Mart and the suppliers' employees is too weak and indirect to support a claim that the profits earned by Wal-Mart should properly belong to the workers.

Barring reversal by the Supreme Court, which hardly seems likely, the ambitious effort to use the U.S. courts to force Wal-Mart and others like it to use their economic clout to effectuate changes in working conditions in the developing world has slowed to a standstill. At the moment, there is no legal theory that has been demonstrated to work for those who want to pursue this tactic. Almost certainly, however, the issue will not disappear entirely. New avenues (including political and economic pressure) and new legal theories will emerge. Already, there have been some initial efforts to see if America's bilateral free trade

agreements offer a wedge to pry up the labor conditions in third-world countries. More can be expected in the future. For the moment, however, the focus on the American judicial system has waned.

International Labor and Employment Law Practice Group

Proskauer Rose LLP's International Labor and Employment Law Practice Group counsels companies doing business globally in connection with the employment issues they face in their workplaces around the world.

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