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## CHAPTER 27

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# COMPLIANCE AS AN EXCHANGE OF LEGITIMACY FOR INFLUENCE

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KISHANTHI PARELLA\*

### 27.1 INTRODUCTION

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AROUND the world, corporations and other business nonstate actors voluntarily abide by rules and guidelines that are nonbinding in nature. Almost one hundred private security companies globally adhere to a nonbinding code of conduct regulating their operations.<sup>1</sup> Bank of America, Citigroup, JP Morgan Chase, and dozens of other financial institutions around the world adopt a framework for determining, assessing, and managing environmental and social risk in projects they fund.<sup>2</sup> Similarly, Acer, Bose, Cisco, IBM, Dell, Intel, and many other electronics companies commit to a set of standards on social, environmental, and ethical issues in their supply chains.<sup>3</sup>

\* I am grateful for feedback from participants at the following workshops and conferences: 2018 ASIL Annual Research Forum, UCLA Law School; William & Mary Law School International Law Workshop; Institute for Global Law & Policy Conference, Harvard Law School; Global Capitalism and Law Colloquium, Northwestern University Buffett Center for Global Studies; YCC annual conference at Case Western University School of Law, and roundtable on international legal theory, annual meeting of the American Society of International Law. I am particularly grateful for detailed feedback from Karen Alter, James Gathii, Laura Dickinson, and Paul Schiff Berman.

<sup>1</sup> “The International Code of Conduct for Private Security Service Providers,” International Code of Conduct Association, [https://www.icoca.ch/en/the\\_icoc](https://www.icoca.ch/en/the_icoc).

<sup>2</sup> *The Equator Principles* (June 2013), [https://equator-principles.com/wp-content/uploads/2017/03/equator\\_principles\\_III.pdf](https://equator-principles.com/wp-content/uploads/2017/03/equator_principles_III.pdf).

<sup>3</sup> Responsible Business Alliance, *RBA Code of Conduct 6.0* (Jan. 1, 2018).

None of these international codes or agreements is legally binding; corporations are only bound if they choose those bonds themselves.<sup>4</sup> So the compliance we observe presents a mystery: why comply in the absence of legal obligation? Compliance is particularly surprising when the conventional wisdom holds that corporations resist regulation and frequently evade rules that are *legally* binding. So why comply with rules that are not?

This chapter explains how corporate compliance with nonbinding international institutions results from an exchange of legitimacy for influence. Actors outside a corporation bestow legitimacy upon a corporation in exchange for influence over that corporation's practices or policies.<sup>5</sup> In this exchange, a corporation gains legitimacy and the external actor gains influence over the corporation.<sup>6</sup> This dynamic immediately prompts three essential questions explained in this chapter: (1) *why* would a corporation permit such influence, (2) *what* types of actors wield such influence, and (3) *how* is this influence exercised?

Corporations are not self-sufficient; they require certain resources to compete effectively in the marketplace.<sup>7</sup> Legitimacy is such a resource.<sup>8</sup> Legitimacy is not fixed but varies based on its circumstances. Corporate legitimacy may be particularly low following a corporate crisis, such as a financial scandal or product accident, because of

<sup>4</sup> A number of scholars have investigated compliance by *state* actors with institutions usually dubbed "soft law," a term that generally refers to "any written international instrument, other than a treaty, containing principles, norms, standards, or other statements of expected behavior" that are not legally binding. Dinah Shelton, "Soft Law," in *Routledge Handbook of International Law*, ed. David Armstrong (New York: Routledge Press, 2009), 69. Classic types of soft law include "normative resolutions of international organizations, concluding texts of summit meetings or international conferences, recommendations of treaty bodies overseeing compliance with treaty obligations, bilateral or multilateral memoranda of understanding, executive political agreements, and guidelines or codes of conduct adopted in a variety of contexts." *Ibid.*, 4. The essential characteristic of these various institutions is that they are not legally binding; actors are only bound to the norms contained within if actors choose to comply.

<sup>5</sup> Jeffrey Pfeffer and Gerald R. Salanick, *The External Control of Organizations: A Resource Dependence Approach* (New York: Harper & Row, 1978), 43. This chapter incorporates the insight of a branch of organizational studies known as "resource dependence theory" by applying lessons from this classic text.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.* ("The key to organizational survival is the ability to acquire and maintain resources . . . . However, no organization is completely self-contained. Organizations are embedded in an environment comprised of other organizations. They depend on those other for the many resources they themselves require. Organizations are linked to environments by federations, associations, customer-supplier relationships, competitive relationships, and a social-legal apparatus defining and controlling the nature and limits of these relationships. Organizations must transact with other elements in their environment to acquire needed resources.").

<sup>8</sup> See Brayden G. King and David A. Whetten, "Rethinking the Relationship Between Reputation and Legitimacy: A Social Actor Conceptualization," *Corporate Reputation Review* 11, no. 3 (2008): 192–207, 192 ("Reputation and legitimacy represent intangible assets that firms rely on to enhance their performance and chances of survival."); Craig Deegan, "The Legitimising Effect of Social and Environmental Disclosures—A Theoretical Foundation," *Accounting, Auditing & Accountability Journal* 15, no. 3 (2002): 282–311, 296; David Hess and Thomas W. Dunfee, "The Kasky-Nike Threat to Corporate Social Reporting: Implementing a Standard of Optimal Truthful Disclosure as a Solution," *Business Ethics Quarterly* 17, no. 1 (Jan. 2007): 5–32, 8.

the reputational damage caused by the crisis.<sup>9</sup> It is at these moments that a corporation will seek out an external actor that enjoys greater legitimacy than itself, hoping to improve its own legitimacy through association.<sup>10</sup> An external actor can improve the legitimacy of a corporation through endorsements, certifications, partnerships, and awards, among other acts.<sup>11</sup> But nothing comes for free. In exchange for bestowing legitimacy, the external actor will want influence over the corporation.

This type of influence need not be direct; external actors do not necessarily join a corporation's board of directors or occupy other governance roles in order to exercise their influence. Instead, their influence is exercised through *institutions*. Institutions are "the humanly devised constraints that shape human interaction" and "include any form of constraint that human beings devise to shape human interaction."<sup>12</sup> In the words of Nobel Laureate Douglass North, institutions provide the "rules of the game."<sup>13</sup> Our institutions also tell us how we should treat neighbors versus strangers, what constitutes fairness in commercial practices, or when waging war is appropriate. In order to gain legitimacy from an external actor, a corporation adopts the institutions associated with that actor and conforms its policies and practices to that institution's norms.

The types of external actors that can wield such influence are ones that enjoy high levels of social legitimacy. While the list varies by context, prime examples include charities and nonprofit societies, international humanitarian organizations, nongovernmental organizations, and universities. These organizations may have few sources of leverage over a corporation; what they do possess is legitimacy. It is this legitimacy that attracts a corporation to them and gives the former influence over the latter.

In this story, the chain of events begins with a reputational crisis; it is therefore important to inquire into the various origins of such crises. Familiar examples include product accidents, poor customer relations, fraudulent practices, and harmful environmental effects or labor practices. Violations of legal norms can also generate reputational effects. Unsurprisingly, breaking the law can produce negative reputational consequences for a company. Additionally, a proposed binding institution can also cause reputational

<sup>9</sup> Kishanthi Parella, "Improving Social Compliance in Supply Chains," *Notre Dame Law Review*, 95, no. 2 (forthcoming).

<sup>10</sup> *Ibid.*; Pfeffer and Salanick, *supra* note 5, at 196 ("[T]he organization attempts to have its operations redefined as legitimate by associating them with other generally accepted legitimate objectives, institutions or individuals."). This is among other acts a corporation will undertake to enhance its legitimacy following a reputational crisis. See Hess and Dunfee, *supra* note 8, at 8 ("Greater stakeholder awareness of any particular firm's negative social performance leads to the need for that firm to engage in legitimacy maintenance activities, which include disclosure.").

<sup>11</sup> See Hayagreeva Rao, "The Social Construction of Reputation: Certification Contests, Legitimation, and the Survival of Organizations in the American Automobile Industry: 1895–1912," *Strategic Management Journal* 15, no. S1 (Winter 1994): 29–44, 40 ("[C]apabilities become *social facts* when organizations receive endorsement from credentialing mechanisms (such as certification contests) that embody institutionalized rules."); W. Richard Scott, "The Adolescence of Institutional Theory," *Administrative Science Quarterly* 32, no. 4 (Dec. 1987): 493–511, 502–503.

<sup>12</sup> Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), 4–5.

<sup>13</sup> *Ibid.*

effects by the spotlight it shines and the resistance it invites. It is this resistance that attracts attention and potentially results in reputational damage for those resisting. For example, this chapter explains how resistance by international business associations, such as the International Chamber of Commerce, to the proposed 2003 UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights (Norms) led to reputational damage for these organizations. The Norms were defeated but not without cost to the reputation of the transnational business sector concerning human rights.

Finally, this chapter also explains how even nonbinding institutions can generate information effects that produce reputational consequences for a company, with a focus on the various information effects produced by the UN Global Compact. It is at such moments of crisis when a corporation's need for legitimacy is especially acute. This need for legitimacy primes corporations for change—change that they may otherwise dismiss or resist except that a legitimacy crisis requires it of them. It is the need for legitimacy that makes an organization susceptible to external influence and change.

The time is ripe to explore the incentives behind corporate compliance with nonbinding institutions. Corporate conduct has attracted significant policy and academic attention over the past few years as the social and environmental consequences of global capitalism are more fully revealed.

While we may desire more traditional hallmarks of public policymaking in the area of global business and human rights, such as treaties, international tribunals, domestic legislation, and even civil litigation, we should not neglect the potential of the rich array of informal, nonbinding international institutions that address this policy area, including recommendations for prevention and guidance on remedies.<sup>14</sup> The difficulty is that these institutions are voluntary; transnational corporations are only bound to these institutions if they choose those bonds. It is therefore vital to understand what factors may drive them to do so.

## 27.2 USING LEGAL INSTITUTIONS TO DE-LEGITIMIZE AND RE-LEGITIMIZE: A FRAMEWORK

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This section explains how one institution can affect compliance with another.<sup>15</sup> In order to understand the interaction of these external mechanisms, it is important to distinguish

<sup>14</sup> See, e.g., Organisation for Economic Co-operation and Development, *OECD Guidelines for Multinational Enterprises* (2011), <http://www.oecd.org/daf/inv/mne/48004323.pdf>; Human Rights Council, U.N. Doc. A/HRC/17/31, Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework (Mar. 21, 2011); International Labour Organization, *ILO Declaration on Fundamental Principles and Rights at Work* (June 18, 1998), <https://www.ilo.org/declaration/thedeclaration/textdeclaration/lang—en/index.htm>.

<sup>15</sup> Parella, *supra* note 9.

between two different institutions: the *focal* institution and the *external* institution. The focal institution is the one whose compliance we want to encourage; the external institution creates the conditions that make that compliance more likely. Two caveats are offered here. First, in the discussion that follows, the focal institution is a nonbinding institution, and the external institution is a binding one. However, similar reputational dynamics can still result if the reverse were true or if both institutions were the same type. Second, this analysis simplified the process to discuss the unidirectional effects of an external institution on a focal institution, but an organization's interactions with the latter institution may also have consequences for the former. Additionally, an organization's institutional environment may contain several external institutions, each creating information effects, reputational consequences, and subsequent incentives for corporate compliance with a focal institution.<sup>16</sup>

Legal institutions release information into the public space concerning the practices of various actors in our society. While some legal institutions have an explicit information disclosure function, many others release information as part of their regular operation. In the latter situation, information effects are often incidental to functions that these institutions are designed to serve. For example, news of a criminal conviction inform us of illegal conduct by individuals or organizations; even news of a government investigation or indictment put us on notice of harmful practices that could place us at risk. Civil lawsuits also inform us of particular misdeeds or patterns of misdeeds that potentially jeopardize others besides the plaintiff. Legislative or administrative action similarly create information effects, particularly by drawing attention to a problem with the status quo.

These information effects are further heightened by the role of the media in disseminating the information that legal institutions release. Journalists' verification methods often privilege legal documents, increasing the likelihood that a lawsuit, for example, may receive media attention.<sup>17</sup> Together, legal institutions and the news media transmit information about individual or organizational behavior.

Information effects have consequences for the actors involved. Specifically, these effects can affect the beliefs of various stakeholders—investors, employees, local residents, policymakers—concerning an actor. Reputation is a product of those beliefs. Stakeholders make two critical reputational judgments about business actors: what businesses can do (capability) and what businesses would likely do (character).<sup>18</sup> The first reputational judgment concerns the “quality and performance characteristics of a

<sup>16</sup> Laura A. Dickinson, “Organizational Structure and Culture in an Era of Privatization: The Case of U.S. Military and Security Contractors,” in *Comparative Administrative Law*, eds. Susan Rose-Ackerman and Peter Lindseth, 2nd ed. (Edward Elgar, 2017), 571, 576.

<sup>17</sup> Bill Kovach and Tom Rosenstiel, *The Elements of Journalism: What Newspeople Should Know and the Public Should Expect*, rev. ed. (New York: Three Rivers Press, 2007), 71.

<sup>18</sup> Yuri Mishina, Emily S. Block, and Michael J. Mannor, “The Path Dependence of Organizational Reputation: How Social Judgment Influences Assessments of Capability & Character,” *Strategic Management Journal* 33, no. 5 (May 2012): 459–77, 460.

particular firm,”<sup>19</sup> whereas character judgments are used by stakeholders to address uncertainty regarding whether they expect a business actor to treat them in an opportunistic or otherwise unfavorable manner.<sup>20</sup> Both types of evaluations have consequences for a business because they influence whether a stakeholder will want to associate or exchange with that actor. As such, a firm’s reputation has significant consequences for it including its ability to signal its worth to outside actors with whom the business may want to exchange. The information released by legal institutions and the media influence the capacity and character judgments of stakeholders.

Information effects can cause a reputational crisis for a corporation because revelations of poor regulatory compliance, financial misconduct, or other harmful practices can compromise a business’s reputation in the eyes of the public; these reputational consequences are then accompanied by financial and nonfinancial consequences for the corporation.

It is therefore not surprising that a corporation will often seek reputational repair following a reputational crisis.<sup>21</sup> Repair strategies are various, including media campaigns, philanthropic gifts, and organizational change. This section explores this last strategy of organizational change whereby an organization attempts to repair its image by demonstrating to the public that it has “turned over a new leaf,” reducing the likelihood that it will return to its previous practices. Self-proclamations of change are rarely credible. A better strategy is to enlist the endorsement of another actor who can confirm those changes. Therefore, a disgraced organization will attempt to improve its own reputation by seeking association with another organization that can provide this *endorsement* function.

There are two additional reasons why an organization may look to another to redeem its own image. The first is *education*: even if an organization wants to improve, it may not know how. Institutional scholars Paul DiMaggio and Walter Powell explain that one organization may imitate another when they confront uncertainty, often “model[ing] themselves after similar organizations in their field that they perceive as more legitimate or successful.”<sup>22</sup> The second is *legitimacy*: organizations also copy each other in order to appear more legitimate because of pressure from other organizations or societal expectations for legitimacy.<sup>23</sup> Social legitimacy is also a resource for which organizations compete.<sup>24</sup> When an external institution compromises that legitimacy, an organization

<sup>19</sup> Ibid.; E. Geoffrey Love and Matthew Kraatz, “Character, Conformity, or the Bottom Line? How and Why Downsizing Affected Corporate Reputation,” *The Academy of Management Journal* 52, no. 2 (Apr. 2009): 314–35, 316.

<sup>20</sup> Mishina et al., *supra* note 18, at 460.

<sup>21</sup> Hess and Dunfee, *supra* note 8, at 5, 8 (“If a firm fails to meet society’s expectations, then it must act to re-establish its legitimacy to fend off social sanctions.”).

<sup>22</sup> Paul J. DiMaggio and Walter W. Powell, eds., “The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields,” in *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991), 70.

<sup>23</sup> Ibid., 67.

<sup>24</sup> Ibid., 66; John W. Meyer and Brian Rowan, “Institutionalized Organizations: Formal Structure as Myth and Ceremony,” *American Journal of Sociology* 83, no. 2 (Sept. 1977): 340–63, 340–41; Deegan,

may borrow legitimacy from its associates in a form of “legitimacy transfer.” For example, Pfeffer and Salanick explain that “[w]hile legitimacy is ultimately conferred from outside the organization . . . the organization attempts to have its operations redefined as legitimate by associating them with other generally *accepted legitimate objectives, institutions, or individuals*.”<sup>25</sup> By keeping company with organizations respected more than itself, a disgraced corporation improves its own legitimacy and reputation through its association.

These three functions—endorsement, education, and legitimacy transfer—can help us predict the actor to which a disgraced organization will turn. This is important because a reputational crisis may only prime an organization for change; there is no guarantee that the resulting change will be a socially desirable one. An organization can model itself on one of its equally problematic peers or adopt counterproductive policies. The three functions identified here increase the likelihood that an organization will turn toward actors with high levels of public legitimacy and proven capacity to address the types of issues that led to an organization sustaining reputational damage.<sup>26</sup>

Superficial association with another organization may prove insufficient for obtaining the three functions identified earlier. Instead, a disgraced organization may only obtain these functions by adopting institutions (even nonbinding institutions) associated with the organization, such as its standards, guidelines, codes of conduct, or declarations. By adopting the associated institutions, a disgraced organization is better poised to achieve those three functions. For example, external organizations may withhold endorsements unless a disgraced organization proves change; the former may be better capable of gauging change when it is made according to its own familiar institutions. Conversely, a disgraced organization may benefit educationally from adopting the institutions of the other organization because of the latter’s expertise in a policy area.

Finally, by adopting the institutions of the other, an organization begins to resemble the organization with which it associates. Shared institutions can lead a disgraced organization to adopt the attributes that provide its model with public legitimacy.<sup>27</sup> This does not mean that, somehow, stakeholders will be fooled into believing that two organizations are now the same or even that legitimacy between the two are equal. Instead, this is the more modest point that organizational change through institutional transfer may result in a disgraced organization adopting the attributes that stakeholders admire and respect, thereby allowing it to establish its legitimacy independent of its association with another organization.

Through de-legitimization, one institution drives an organization toward another. These processes are especially important when the institution to which a disgraced

*supra* note 8, at 293 (“Legitimacy is considered to be a resource on which an organization is dependent for survival.”).

<sup>25</sup> Pfeffer and Salanick, *supra* note 5, at 196 (emphasis added).

<sup>26</sup> See *ibid.*, at 53 (explaining that the “potential for one organization’s influencing another derives from its discretionary control over the resources needed by that other and the other’s dependence on the resource and lack of countervailing resources or access to alternative resources.”).

<sup>27</sup> See DiMaggio and Powell, *supra* note 22, at 66.



organization turns is a nonbinding one because it and its associated organizations may otherwise lack the ability to make an organization comply.<sup>28</sup>

### 27.3 EXCHANGING LEGITIMACY FOR INFLUENCE IN PRACTICE: THE INFORMATION EFFECTS OF INTERNATIONAL AGREEMENTS

This section explains how policy development concerning a *different* international institution can create significant consequences for the focal institution. Specifically, conflict regarding a different institution can create external reputational mechanisms that make the focal institution more attractive to corporate actors.

The regulatory history of business and human rights is one of oscillation.<sup>29</sup> Different regulatory strategies were used over the past few decades—some voluntary and non-binding, others not. Table 27.1 identifies three significant institutions in recent history, although several other institutions, both domestic and international, also occupy the policy space of business and human rights.

The important lesson is not the success of any particular institution on business and human rights but the interaction of these institutions. Specifically, the reactions—and critically, resistance—by industry actors to some of these institutions created reputational consequences for those actors demonstrating resistance. These reputational consequences created a need for reputational repair concerning these actors' practices toward human rights. That reputational repair took the form of adherence to another international human rights institution that the resisting actors found more acceptable; resistance to one institution drove the resisting parties toward another. Binding institu-

**Table 27.1. Legally Binding and Nonbinding International Institutions on BHR**

Key International Institutions Addressing Business & Human Rights 1999–Present

Institution	Type
U.N. Norms on the Responsibilities of Transnational Corporations	Mandatory
U.N. Guiding Principles	Nonbinding
Consultations concerning prospective treaty on business & human rights	Binding

<sup>28</sup> Pfeffer and Salanick, *supra* note 5, at 43.

<sup>29</sup> Kishanthe Parella, "Treaty Penumbra," *University of Pennsylvania Journal of International Law* 38 (2017): 275–333.

tions invited resistance and subsequent *reputational damage*; nonbinding institutions promised *reputational repair*.

The Norms were drafted by a working group of the UN Sub-Commission on the Protection and Promotion of Human Rights.<sup>30</sup> The Norms addressed the human rights obligations of transnational corporations and these obligations were presented as mandatory—not subject to voluntary adherence—and would be backed up by enforcement mechanisms.<sup>31</sup>

The Norms were opposed by several prominent members of the transnational business community on both sides of the Atlantic.<sup>32</sup> The common strain of their opposition concerned the “privatization of human rights.”<sup>33</sup> By this phrase, the industry actors feared that the Norms would displace human rights duties from national governments to private actors, such as transnational corporations.<sup>34</sup> Industry actors also objected to

<sup>30</sup> David Weissbrodt and Maria Kruger, “Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights,” *American Journal of International Law* 97 (2003): 901–22, 905.

<sup>31</sup> UN Sub-commission on the Promotion and Protection of Human Right, E/CN.4/Sub.2/2003/12/Rev.2, Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights (Aug. 13, 2003) ¶ 15, <https://digitallibrary.un.org/record/501576>.

<sup>32</sup> Jonathan Birchall, “Annan Urges Commitment to Ethical Business,” *Financial Times*, June 25, 2004 (“The norms, which raise the possibility of legal enforcement of corporate human rights obligations, have been attacked by many in the business community.”); Alison Maitland, “Business and Activists Are Beginning to Find Common Ground,” *Financial Times*, Nov. 29, 2004 (“Business groups have strongly resisted the draft UN norms, particularly the suggestion that companies’ compliance with human rights obligations might be monitored by outside bodies.”). The Norms were not opposed by all business actors. For example, the Business Leaders Initiative on Human Rights consisted of seven large companies that stated their willingness to work with the Norms. Alison Maitland, “Companies Set to Work with UN Ethics Code,” *Financial Times*, Dec. 9, 2003; Alison Maitland, “Amnesty Hits Back at CBI Stance on Human Rights Plans,” *Financial Times*, Mar. 9, 2004.

<sup>33</sup> Maria Livanos Cattai, Secretary General of the International Chamber of Commerce, to Dzidek Kedzia, Office of the High Commissioner for Human Rights, September 7, 2004, 5 (“[The] ICC cannot accept the approach taken by the draft developed by the Sub-Commission. It is simply not feasible to transfer the responsibilities of the State with regards to human rights onto business because of governments’ unwillingness and/or lack of capacity to meet their responsibilities effectively. No initiative or standard with regard to business and human rights can replace the primary role of the State and national laws in this area.”).

<sup>34</sup> Thomas Niles, “UN Code No Help to Companies,” *Financial Times*, Dec. 17, 2003; International Chamber of Commerce [ICC] and International Organization of Employers [IOE], “Joint Views of the IOE and ICC on the Draft Norms,” 2 (“The Sub-Commission’s draft Norms is an extreme case of the ‘privatization of human rights.’ Among other things, it shifts human rights duties from States to civil society actors.”); Maitland, “Amnesty hits Back,” *supra* note 32; John Eaglesham, “Business Calls for Action on Human Rights Liability Plan,” *Financial Times*, Mar. 8, 2004. The IOE and ICC emphatically stressed this concern even though Paragraph 1 of the Norms recognizes the distinct and separate roles of government versus business actors. “States have the primary responsibility to promote, secure the fulfilment of, respect, ensure respect of, and protect human rights recognised in international as well as national law, including assuring that transnational corporations and other business enterprises respect human rights. Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of, and protect human rights recognized in international as well as national law.” UN Transnational Norms, *supra* note 31, ¶ 1.

the way the Norms attempted to impose direct obligations on corporations. In the words of Shell Vice President Robin Aram, “It’s the packaging that business doesn’t like . . . . The problem is the legalistic form that has been used in drafting the Norms.”<sup>35</sup>

The debate over the Norms ended in April 2004 with the decision of the UN Commission on Human Rights to subject the Norms to additional study.<sup>36</sup> The Commission requested the Office of the Human Rights Commissioner “to consult with all the relevant stakeholders, and to compile a report analysing the Norms in light of the various existing initiatives and standards on business and human rights.”<sup>37</sup>

The 2004 decision of the UN Commission on Human Rights may have marked the end of the Norms but not the end of the business and human rights agenda. An interesting feature of the post-Commission decision period is that the business actors that were set on ending the Norms adopted a more cooperative attitude toward voluntary regulation initiatives that were already in place or emerging.

After the UN Commission on Human Rights tabled the Norms, the UN Secretary General appointed John Ruggie as a Special Representative on Business & Human Rights.<sup>38</sup> Ruggie’s mandate was to “‘identify and clarify’ international standards and policies in relation to business and human rights and to submit ‘views and recommendations’ for consideration by the commission.”<sup>39</sup>

In contrast to their hostility to the Norms, the International Chamber of Commerce (ICC) and the International Organisation of Employers (IOE) sought to engage with Ruggie on his mandate. These same trade associations that had opposed the Norms, fearing UN regulation over business affairs, were now engaging with the UN’s Special Representative on Business & Human Rights.<sup>40</sup> They even offered their assistance on the work of the UN Special Representative, supporting the idea of survey data of companies on current practices, identifying companies willing to share experiences, and identifying and disseminating good practices through business organization networks.<sup>41</sup>

<sup>35</sup> John Elkington, “In the Hot Seat: Shell’s VP Robin Aram,” *Greenbiz*, June 21, 2004.

<sup>36</sup> David Kinley et al., “The Politics of Corporate Social Responsibility: Reflections on the United Nations Human Rights Norms for Corporations,” *Company & Securities Law Journal*, 25 (2007): 30–42, 32.

<sup>37</sup> *Ibid.*

<sup>38</sup> Giovanni Mantilla, “Emerging International Human Rights Norms for Transnational Corporations,” *Global Governance*, 15 (Apr.–June 2009): 279–98, 289.

<sup>39</sup> *Ibid.*

<sup>40</sup> In their initial reactions to the mandate of the UN Special Representative, the IOE and ICC stressed the importance of consultation with the business community. ICC and IOE, “Initial IOE-ICC Views on the Mandate of the UN Special Representative on ‘Business and Human Rights,’” Oct. 14, 2005, 1 [hereinafter “Initial IOE-ICC Views on the Mandate of the UN Special Representative on ‘Business and Human Rights’”]. The IOE and the ICC were not the only ones adopting a different attitude to voluntary initiatives. One commentator notes that many of the governments that opposed the Norms are also staunch supporters of the most important voluntary initiatives on business and human rights. Mantilla, *supra* note 38, at 289 (noting the support of the governments of the United States and the United Kingdom for the Voluntary Principles on Security and Human Rights, as well as South Africa’s role in the Kimberley Process).

<sup>41</sup> ICC and IOE, “Initial IOE-ICC Views on the Mandate of the UN Special Representative on ‘Business and Human Rights,’” *supra* note 40, 3–4.

In 2008, the UN Special Representative introduced his tripartite framework for business and human rights known as the “Protect, Respect, and Remedy Framework.”<sup>42</sup> In 2011, he reinforced the 2008 framework with the Guiding Principles that were intended to operationalize and promote the framework.<sup>43</sup> Despite the identification of corporate responsibilities, the ICC and IOE did not oppose the Ruggie Framework as they had with the Norms.<sup>44</sup> Joined by the Business and Industry Advisory Committee to the OECD (BIAC), they supported the due diligence approach to human rights,<sup>45</sup> even offering to identify a group of companies that could serve as a resource for the UN Special Representative on due diligence issues.<sup>46</sup> This is an interesting position because these organizations previously rejected the Norms that contained analogous requirements to assess human rights impacts of business activities.<sup>47</sup>

In these and other ways, the business organizations that had fought the Norms embraced the Guiding Principles. One explanation for this engagement is the reputational damage that resistance wrought. According to Shell Vice President Aram, “This episode . . . has not been without damage to business. It has linked business with a perception of hostility to human rights.”<sup>48</sup> After sustaining reputational damage by resisting one institution, business actors may have lacked sufficient reputational capital to fight off yet another human rights institution without appearing hostile to human rights. The Guiding Principles were a more acceptable institution and offered an opportunity for business actors to repair their image concerning human rights in the wake of the battle over the Norms.

In 2018, another battle was brewing concerning business and human rights. A few years earlier, the UN Human Rights Council adopted a resolution “to establish an open-ended intergovernmental working group with the mandate to elaborate an international

<sup>42</sup> Human Rights Council, 189 U.N. Doc. A/HRC/8/5, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises: Protect, Respect and Remedy: A Framework for Business and Human Rights (Apr. 7, 2008) [hereinafter “Framework”].

<sup>43</sup> Human Rights Council, U.N. Doc. A/HRC/17/31, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises: Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect, and Remedy” Framework (Mar. 21, 2011).

<sup>44</sup> ICC and IOE, “Joint Initial Views of the International Organisation of Employers (IOE), the International Chamber of Commerce (ICC) and the Business and Industry Advisory Committee to the OECD (BIAC) to the Eighth Session of the Human Rights Council on the Third Report of the Special Representative of the UN Secretary-General on Business and Human Rights,” May 1, 2008.

<sup>45</sup> *Ibid.*

<sup>46</sup> ICC and IOE, “Joint Views of the International Organisation of Employers, the International Chamber of Commerce and the Business and Industry Advisory Committee to the OECD to the Special Representative of the UN Secretary-General on Business and Human Rights,” Mar. 1, 2009.

<sup>47</sup> “[T]ransnational corporations and other businesses enterprises shall conduct periodic evaluations concerning the impact of their own activities on human rights under these Norms.” UN Subcommission on the Promotion and Protection of Human Rights, E/CN.4/Sub.2/2003/12/Rev.2, Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights (Aug. 13, 2003) ¶ 16, <https://digitallibrary.un.org/record/501576>.

<sup>48</sup> Elkington, *supra* note 35.

legally binding instrument on Transnational Corporations and Other Business Enterprises with respect to human rights.”<sup>49</sup> Once again, a binding institution was back on the table and this time in the form of an international treaty.

Cognizant of the potential reputational damage, business associations couched their concern regarding a prospective treaty with their commitment—and the commitment of their millions of members—to voluntary regulation under the Guiding Principles.<sup>50</sup> In subsequent comments to the treaty process, industry associations such as the ICC and IOE reiterated that the “treaty should strengthen the implementation of the UN Guiding Principles on Business & Human Rights.”<sup>51</sup> The comments emphasized that “[h]uman rights are a high priority for the international business community” and that “[e]ach of the[] representative organizations have endorsed the UN Guiding Principles on Business & Human Rights and continue to be active in promoting and disseminating the UN Guiding Principles and related implementation guidance among their membership and associated networks.”<sup>52</sup> According to these actors, “[m]uch progress has been already achieved in the last five years with regards to the up-take of the UN Guiding Principle at the political level and the company level... and BIAC [Business at OECD], ICC [International Chamber of Commerce], IOE [International Organization of Employers], and WBCSD will continue to promote further up-take and implementation of the UN Guiding Principles.”<sup>53</sup>

One interpretation of these statements is that business associations are attempting to obviate the need for a new international (binding) institution by demonstrating the effectiveness of an existing, nonbinding one, saying, in effect, “there is no regulatory

<sup>49</sup> Human Rights Council, U.N. Doc. A/HRC/26/L.22/Rev.1, *Elaboration of an International Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with respect to Human Rights* (June 24, 2014).

<sup>50</sup> “ICC Disappointed by Ecuador Initiative Adoption,” *International Chamber of Commerce*, June 30, 2014, <https://iccwbo.org/media-wall/news-speeches/icc-disappointed-by-ecuador-initiative-adoption/>; International Chamber of Commerce et al., “UN Treaty Process on Business and Human Rights: Response of the International Business Community to the ‘Elements’ for a Draft Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with respect to Human Rights,” Oct. 20, 2017, 2, <https://www.ohchr.org/Documents/HRBodies/HRCouncil/WGTransCorp/Session3/BIAC-FTA-BSCI-ICC-IOE.pdf> (“[O]ur opposition to the ‘elements’ paper does not diminish our commitment to helping to advance the business and human rights agenda. We continue to endorse, promote and disseminate the UN Guiding Principles on Business and Human Rights (“UNGPs”)... among our members and networks. We also actively help businesses of all sizes to meet their responsibility to respect human rights in line with the UNGPs.”).

<sup>51</sup> International Chamber of Commerce et al., “UN Treaty Process on Business & Human Rights: Further Considerations by the International Business Community on a Way Forward,” Sept. 29, 2016, <https://cdn.iccwbo.org/content/uploads/sites/3/2017/10/icc-ioe-biac-wbcds-un-treaty-business-human-rights-further-considerations.pdf>; Linda Kromjong, Secretary General, International Organisation of Employers, “Intergovt. Working Group on Proposed Treaty Needs to Have an Inclusive & Consultative Process,” *Business & Human Rights* (blog), <https://business-humanrights.org/en/intergovt-working-group-on-proposed-treaty-needs-to-have-an-inclusive-consultative-process> (arguing that “[t]he UN treaty process should strengthen the implementation of the UN Guiding Principles,” especially concerning the obligations of State actors).

<sup>52</sup> International Chamber of Commerce et al., “Further Considerations,” *supra* note 51.

<sup>53</sup> *Ibid.*

problem that needs fixing.”<sup>54</sup> Industry actors also relied on one institution, the Guiding Principles, to resist another, a binding treaty.<sup>55</sup> Pleading policy coherence, business actors identified policy divergences between the recently proposed elements of a binding treaty and the approach of the Guiding Principles, even relying on provisions of the latter, its commentaries, and other nonbinding institutions to fend off proposals for a different approach under a treaty.<sup>56</sup>

The bookends of this story are mandatory or legally binding institutions. The first one failed, and the second one may share the same fate. But the value of these institutions is not limited to their own success; instead, they are important because they facilitate fidelity to *nonbinding* institutions. As discussed, these binding institutions create external reputational mechanisms that increase the likelihood that business actors will adopt and adhere to the Guiding Principles and other nonbinding institutions addressing business and human rights.

## 27.4 THE INFORMATION EFFECTS OF NONBINDING INSTITUTIONS

The previous sections discussed the information effects of binding institutions and the implications of those effects for organizational change. Specifically, the information effects produced by legal institutions, often incidentally to their primary operation, can create reputational consequences for organizational actors. These actors may then gravitate toward nonbinding institutions in an effort to repair their reputations.

It is important to note that nonbinding institutions also create information effects of their own. For example, consider the UN Global Compact (UNGC), a voluntary corporate sustainability initiative that includes thousands of companies across the globe.<sup>57</sup> As a nonbinding institution, the UNGC creates three different types of information effects:

<sup>54</sup> See, e.g., John W. Maxwell et al., “Self-Regulation and Social Welfare: The Political Economy of Corporate Environmentalism,” *Journal of Law & Economics*, 43 (Oct. 2000): 583–617.

<sup>55</sup> International Chamber of Commerce et al., “Response of the International Business Community,” *supra* note 50, at 1 (“[T]he international business community does not support the ‘elements’ because they represent a big step backwards and they jeopardise the crucial consensus achieved by the UNGPs, whose spirit and wording they undermine.”); see also Greg Shaffer and Mark A. Pollack, “Hard vs. Soft Law: Alternatives, Complements and Antagonists in International Governance,” *Minnesota Law Review* 94 (2010): 706–99, 744 (“[I]ndividual states (or other actors) may deliberately use soft-law instruments to undermine hard-law rules to which they object, or vice-versa, creating an antagonistic relationship between these legal instruments.”).

<sup>56</sup> International Chamber of Commerce et al., “Further Considerations,” *supra* note 51 (relying on commentaries to Principle 22 of the Guiding Principles, as well as the Organisation for Economic Co-operation and Development (OECD) Guidelines on MNEs); International Chamber of Commerce et al., “Response of the International Business Community,” *supra* note 50 (relying on Principle 17 of the Guiding Principles).

<sup>57</sup> United Nations Global Compact, “Who We Are,” <https://www.unglobalcompact.org/what-is-gc>.

*membership, participation, and delisting.* These effects depend on the nature of the interaction between a company and the UNGC. First, when a company joins the UNGC, its membership in the voluntary initiative communicates information about its commitment to sustainability. This information effect may be particularly salient because the UNGC is voluntary and signals conduct that the company is not otherwise obligated to undertake. Compliance that is obligated under binding law may not result in similar information effects and associated reputational rewards. Second, a participating company is required to report annually on its progress toward sustainability goals; this disclosure also generates information effects. Finally, a company's failure to disclose can result in its downgrading or delisting from the UNGC that also produces information effects for the company. Each type of information effect is discussed in the following.

The UNGC is a global sustainability initiative that encourages companies to "align strategies and operations with universal principles on human rights, labour, environment and anti-corruption, and take actions that advance societal goals."<sup>58</sup> Participating companies commit to ten core sustainability principles concerning human rights, labor, the environment and anticorruption that are derived from the "Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption."<sup>59</sup>

Given that the UNGC is voluntary, the question is: why would a company join it and commit to the principles and accompanying expectations? According to the UNGC annual implementation survey, the top three reasons companies participate are: "[i]ncrease[d] trust in the company through a commitment to sustainability," the "[u]niversal nature of the principles," and it "[p]romotes action on sustainability within the company."<sup>60</sup> To this list, we can add one more: reputational repair. As discussed earlier, we can imagine how a reputational crisis may lead a company to join the UNGC. Here, the UNGC functions as a focal institution. An external institution, such as a lawsuit or government investigation, releases information about a company's conduct in its supply chain, causing the company to sustain reputational damage. As a means of repairing its reputation, the company may gravitate toward the UNGC to appease skeptics and to adopt institutional norms that may prevent a future crisis. While the information produced by the external institution may drive a company toward the UNGC, the UNGC also produces information of its own when a company joins it. Specifically, it signals that the company's chief executive officer (with support from the board) commits to aligning the company's operations according to the UNGC's core principles and to reporting annually on its efforts and progress.<sup>61</sup> Based on the earlier discussion, it is

<sup>58</sup> Ibid.

<sup>59</sup> United Nations Global Compact, "The Ten Principles of the UN Global Compact," <https://www.unglobalcompact.org/what-is-gc/mission/principles>.

<sup>60</sup> United Nations Global Compact, "Participation," <https://www.unglobalcompact.org/participation/join/benefits>.

<sup>61</sup> United Nations Global Compact, "Participation," <https://www.unglobalcompact.org/participation/join/commitment>.

this information effect that may persuade companies to join the UNGC following a reputational crisis.

Participation also generates information effects. Specifically, each participating company is required to produce a communication on progress (CoP) annually that must meet the following three requirements:

- “A statement by the chief executive expressing continued support for the Global Compact and renewing the participant's ongoing commitment to the initiative and its principles.”
- “A description of practical actions (i.e., disclosure of any relevant policies, procedures, activities) that the company has taken (or plans to undertake) to implement the Global Compact principles in each of the four issue areas (human rights, labour, environment, anti-corruption). . . .”
- “A measurement of outcomes (i.e., degree to which targets/performance indicators were met, or other qualitative or quantitative measurements of results).”<sup>62</sup>

The CoP submitted by each company is published on the website of the UNGC. This approach to information disclosure illustrates two different types of information effects produced by the UNGC. First, it requires that participating companies share information that they might not otherwise disclose to the public. By requiring the production of an annual CoP, the UNGC collects and disseminates information about the sustainability practices of thousands of companies around the world. Second, the UNGC publishes these statements on its website so that consumers and other stakeholders can more easily locate company CoP statements. By collecting and posting these statements, the UNGC also enables comparisons between the various CoPs produced by companies so that interested stakeholders can analyze how these companies perform against each other.

Finally, the UNGC produces information effects by downgrading or delisting companies that fail to communicate progress in accordance with the CoP policy.<sup>63</sup> This is the primary means by which the UNGC enforces the commitments that companies adopt when they join the UNGC. The risks posed by downgraded status and potential public expulsion should encourage companies to abide by their commitments. The UNGC website lists thousands of companies that have been delisted over the years.<sup>64</sup> This delisting is also a type of information effect that communicates that a company is no longer abiding by its membership commitments and has been expelled from the UNGC. We can imagine that this information effect may create a reputational crisis similar to the ones described earlier. This time, however, the information producing institution is a nonbinding one. The reputational crisis accompanying delisting may then drive the

<sup>62</sup> United Nations Global Compact, “UN Global Compact Policy on Communicating Progress” (Mar. 1, 2013), [https://www.unglobalcompact.org/docs/communication\\_on\\_progress/COP\\_Policy.pdf](https://www.unglobalcompact.org/docs/communication_on_progress/COP_Policy.pdf).

<sup>63</sup> Ibid.

<sup>64</sup> United Nations Global Compact, “De-Listed Participants,” <https://www.unglobalcompact.org/participation/report/cop/create-and-submit/expelled>.



expelled company to adopt organizational changes as a means of addressing the reputational consequences associated with expulsion.

Based on this discussion of reputational dynamics, we can imagine two different scenarios that reflect responsive organizational change. In the first scenario, the UNGC serves as an external institution that drives a company toward another nonbinding institution. This is because the information effects of delisting create negative reputational consequences for the delisted company that it attempts to address by promising change. One avenue to demonstrate that change is by joining an institution that embodies the values that the company commits to uphold in the future. This is the type of associational repair that was discussed earlier, but, in this scenario, it is one nonbinding institution (UNGC) that drives a company to associate with another nonbinding association.

In a second scenario, the UNGC also serves as an external institution that creates reputational effects for the company. However, instead of gravitating toward another nonbinding institution, the company reinforces its commitment to the UNGC. For example, expulsion from the UNGC is a phased process. If a company fails to submit its CoP within the required deadlines, it will be designated as “non-communicating” on the UNGC website.<sup>65</sup> This public designation produces information effects that may motivate the company to improve its CoP compliance in the future. Another incentive for improvement is the prospect of expulsion, which will occur if it fails to submit a COP that meets all COP requirements within a year of becoming noncommunicating.<sup>66</sup> Finally, an expelled company must reapply if they wish to rejoin the initiative, and readmission may necessitate organizational change on the part of the company.<sup>67</sup> In each of these different ways, the UNGC produces information effects that create pressure for improved compliance with its own principles.

However, these dynamics do not occur within a vacuum. Certain conditions may need to occur for these information effects to encourage organizational change. First, information requires publicity to generate reputational consequences. Both binding and nonbinding institutions rely on intermediaries—such as the media—to publicize the information they provide. However, nonbinding institutions may be particularly dependent on information intermediaries because the information that these institutions provide may not “stand out” as easily without the involvement of news media or industry alerts.

Second, information intermediaries are also useful for presenting information in narratives that are salient to stakeholders of companies that participate in the UNGC. The disclosed information may need context and explanation in order for stakeholders to appreciate the significance of the information received. Stakeholders also need meaningful comparisons of performance in order to evaluate companies. The UNGC aligns with the Global Reporting Initiative in order to harmonize metrics for information disclosure by companies. Additionally, by collecting and publishing all reports in one database, the UNGC facilitates the ability of information intermediaries to locate a

<sup>65</sup> UN Global Compact Policy on Communicating Progress, *supra* note 62, at 3.

<sup>67</sup> *Ibid.*

<sup>66</sup> *Ibid.*

company-specific disclosure or compare the practices of several companies. Information intermediaries can then analyze these practices and disseminate their analyses to stakeholders.

Finally, the information effects encourage organizational change when these effects can cause reputational damage. In other words, for these effects to matter, a company's stakeholders must care about the information disclosed and be willing to provide adjust their relationship with the company based on the information provided. According to the UNGC, stakeholders do care about company sustainability practices. The UNGC website explains, "[r]ecent growth—both in terms of the sheer number of CoPs submitted and their sophistication—is largely driven by demand from key stakeholders including investors, civil society, Governments and consumers. CoPs provide stakeholders with information to make informed choices about the companies they interact with and stakeholder vetting is a cornerstone of transparency and disclosure as a means of driving performance."<sup>68</sup> Stakeholder participation is an important element for making these reputational dynamics effective.

## 27.5 CONCLUSION

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This chapter explains that business actors comply with legally nonbinding institutions because of an exchange between legitimacy and influence. Specifically, the information effects produced by both binding and nonbinding institutions can cause reputational damage to a company. To regain its legitimacy, that company associates itself with a more reputable organization than itself, regaining legitimacy through that association. However, that association often comes at a price. In exchange for conferring legitimacy, the external organization will promote its own institutions for the company's adoption. Companies therefore adopt these institutions in order to credibly signal the quality of their association with the external organization and maximize legitimacy gains. This analysis is applicable to the wide array of nonbinding guidelines, declarations, codes of conduct, principles, and other international institutions that increasingly govern the global conduct of corporations and other business nonstate actors.

<sup>68</sup> United Nations Global Compact, "The Communication in Progress (CoP) in Brief," <https://www.unglobalcompact.org/participation/report/cop>.

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