

When Voluntary is not really

Voluntary

Contractual Aspects of
Voluntary Codes*

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1 D. Cohen, "Voluntary Codes: The Role of the Canadian State in a Privatized Regulatory Environment" (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished]. See also: K. Webb, "Thumbs, Fingers and Pushing on String: Legal Accountability in the use of Federal Financial Incentives" (1993) 31 Alta. L. Rev. 501 at 502.

2 Office of Consumer Affairs, Industry Canada, "Description of Process and Approach" (Foreword to the materials for the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

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Introduction

Virtually every consumer transaction is governed by a voluntary code of some sort. Some of these codes are simple and apply only to one store or company – for example Zellers’ promise that the “lowest price is the law.” Other codes are complex and can involve multiple firms in a sector. An illustration is the banking industry, where the Canadian Bankers’ Association has a code governing the protection of private information. But what happens when a business purporting to adhere to a code fails to honour it? Does the customer have any legal recourse if Zellers refuses to match the price of a competitor? Does the customer have any recourse if her bank neglects to protect her privacy? The law of contract addresses these questions. It appears that a consumer who relied on a voluntary code, whatever his other options, will have an action in contract against the offending party.

Regulation can be viewed as a system of organization which is intended to influence behaviour within a society through mechanisms such as laws, constitutions, social conventions, cultural norms, tax policy and penal sanctions.¹ Although most regulatory instruments are utilized solely by the state, there are some private regulatory instruments. One such private instrument is the voluntary code – a system which is based upon a series of commitments made by one or more private actors to adhere to a set of rules.²

Until recently it was commonly thought that offensive behaviour could be defined by law and punished through sanctions. Professor David Cohen theorizes that the relatively small number of offenses enabled everyone to know the law, respect for the law was high and the social stigma of being labelled a transgressor was sufficient to ensure that people generally followed the laws.³ As society evolved, the state’s ability to control private actors through command and control mechanisms diminished. In particular, the proliferation of regulations coupled with an enlarged enforcement bureaucracy made command and control mechanisms increasingly expensive to maintain – a consideration exacerbated by the near universal shift toward fiscal restraint amongst governments of all political stripes. The retrenchment of the state prompted by these factors led to the increasing development of private instruments of regulation, particularly voluntary codes.⁴

As stated earlier, voluntary codes have many variations. Voluntary codes can be used to address virtually any sort of concern including protection of privacy,⁵ customer service,⁶ safety,⁷ and labour standards.⁸

In addition to being less costly to the state, voluntary codes offer two key benefits to firms operating in the current economic climate:

- Efficiency: Unlike regulations, voluntary codes do not need to go through a long and formal development and implementation process. As a result they can be more easily developed, implemented and amended than government regulations. In addition, they can be created and applied with more flexibility than regulations, and can be easily tailored to a specific industry, or to address particular concerns.⁹

3 Cohen, see note 1.

4 Cohen, see note 1.

5 C. Bennett, “Privacy Codes of the Canadian Bankers’ Association and the Canadian Standards Association” (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

6 A. McChesney, “Voluntary Standards and Dispute Resolution in Canada’s Cable Television Industry” (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

7 F. Bregha and J. Moffet, “Canadian Chemical Producers’ Association Responsible Care Program” (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

8 G.T. Rhone, “The Gap Inc. Sourcing Guidelines and Principles” (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

...Where a vendor purports to adhere to the terms of a voluntary code, yet subsequently violates this code, a breach of contract occurs.

9 It should be noted that some voluntary codes have longer and more complex development processes than laws. For example, the new Sustainable Forest Management code developed by the Canadian Standards Association took nearly three years to develop due to the extensive consultation undertaken by the CSA. G.T. Rhone, "Canadian Standards Association Sustainable Forest Management Certification System" (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

10 For more information on the strengths and weaknesses of voluntary codes see: K. Webb and A. Morrison, "Legal Aspects of Voluntary Codes: In the Shadow of the Law" (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

11 The existence of a voluntary code can affect those who do not voluntarily agree to comply. For example, in tort law where a voluntary code has been adopted by the majority of an industry the court might use this code to determine the standard of care a non-adherent must exercise.

12 It is important to note that not all "associations" are juristic persons. In some cases an association may be simply be formed by a loose agreement among actors with a similar interest. In this situation the contractual relationship is not between the association and the members, but between each of the signatories to the agreement.

- Trans-jurisdictional: Unlike regulations, which can only apply within a given territory, voluntary codes recognize no jurisdictional boundaries. In a North American context, this allows a nation-wide industry to adhere to a voluntary code which, if it was in the form of legislation, could trigger constitutional wrangling. Furthermore, voluntary codes provide a mechanism for multi-national industries to develop standards which can apply across territorial boundaries – a critical concern in an increasingly global economy. Finally, in an era of increasing trade liberalization many government standards can be considered non-tariff barriers. Voluntary arrangements allow a domestic industry to set national standards without trade concerns.

However, despite the proliferation of voluntary codes one should not presume that they have no disadvantages. Critics of voluntary codes have commonly mentioned the following drawbacks:

- Free-riders: Voluntary codes by definition cannot be applied to unwilling parties. Therefore, free-riders can emerge and absorb the industry-wide benefits of the code without adhering or contributing to it.
- Sanctions: The limited sanctioning options available in many voluntary codes may prevent adherents or associations from being able to compel transgressing members to comply with the code.
- Window dressing: Some industries will use voluntary codes as "window dressing" to improve their public image, without addressing the true problems within the industry.¹⁰

One of the most underappreciated aspects of voluntary codes is that despite being voluntary, they have profound legal ramifications for both adherents and non-adherents.¹¹ Legal issues raised by the existence of voluntary codes can be found in competition law, tort law and administrative law. This paper will focus on the contract law aspects of voluntary codes.

The key difference between regulatory regimes and voluntary regimes is that regulatory regimes are imposed on a population regardless of whether those affected by the regulation want to be bound by it, while voluntary regimes are adopted only with the consent of those affected. Voluntary codes are based in contract. The customer contracts with the vendor and the manufacturer, the vendor with its supplier, and the association with its members.¹² These contracts lead to legal rights and obligations which are ultimately enforceable in court. This paper will explore the contractual relationships which can be derived from voluntary code regimes.

1) Consumers and Vendors

For consumers, a voluntary code is a commitment made by a firm, or group of firms, to comply with certain guidelines on their behaviour, provided that the consumers meet certain conditions. This flows from the line of cases, beginning with *Carlill v. Carbolic Smoke Ball Co.*,¹³ which deal with offers made to the public. These cases state that where an offer is made to the public and accepted, it must be honoured. If the vendor refuses to honour its offer, the consumer could bring an action for breach of contract, and if successful, obtain damages.

In the context of voluntary codes, where a vendor purports to adhere to the terms of a voluntary code, yet subsequently violates this code, a breach of contract occurs. For instance, many stores promise the consumer that they will match the price of their competitors. This can be viewed as a voluntary code adopted by the store. If the store were to violate this code, an aggrieved customer could sue the store in contract since the offer made to the public – that it would match the price of its competitor – was not honoured.

The consumer's case becomes even stronger where the consumer has essentially bargained for the terms contained in the code by paying a higher price than would be demanded by a competitor who did not follow a similar code. For example, the Gap, an international clothing chain, follows a voluntary code pertaining to the labour standards of its Latin American suppliers.¹⁴ The code includes measures designed to ensure that all of the Gap's clothing is produced in a manner which is humane and not exploitive of the textile workers. If a Gap customer, who paid a higher price for an item of clothing than he would have at a department store where no sourcing code was in effect, were later to discover that the clothing he purchased was in fact manufactured contrary to the Gap's code, then the customer would have a strong action for breach of contract.

Where a vendor intentionally or negligently misleads the customer into believing that it adheres to a voluntary code when in fact it does not, the customer may have legal recourses other than contract-based actions. These would include a private action under a provincial consumer protection act for misleading advertising, as well as a tort action for deceit or negligent misrepresentation.¹⁵ In particular, private actions under a provincial consumer protection act such as the British Columbia Trade Practice Act¹⁶ or the Ontario Business Practices Act¹⁷ might be an effective means for consumers to take action against a company which violates a voluntary code; many of these provincial acts are broadly written and provide for a lower evidentiary burden than in a tort or contract action.¹⁸

Although the consumer has a contractual action available to her, in many cases it is not practical to actually launch a suit for the violation of a voluntary code. The aggrieved customer in the Gap situation, for example, is unlikely to sue the Gap for the cost of an item of clothing – even in small-claims court the fees and effort required would likely make the necessary action impractical. A potential solution to this problem is the class-action lawsuit, which is statutorily permitted in three Canadian jurisdictions.¹⁹ This type of lawsuit enables a group of aggrieved consumers, customers of the Gap or a bank for example, to join together and create an efficient method of obtaining redress. Another benefit of the class-action suit is that it addresses the problem of the lack of sanctions in voluntary codes. The fear of a large class-action damage award could serve to encourage code adherents to comply with their obligations.²⁰ Furthermore, a class-action lawyer, motivated by a potentially large contingency fee, would have a substantial incentive to monitor compliance with voluntary codes.

2) Consumers and Manufacturers

Most consumers do not purchase goods directly from the manufacturer, but

13 *Carill v. Carbolite Smoke Ball Co.* [1893] 1 Queen's Bench Division 256 (Court of Appeal).

14 Rhone, see note 8.

15 For more information see: L.N. Klar, *Tort Law* (Toronto: Carswell, 1991) 425-433.

16 *Trade Practice Act* ("T.P.A."), R.S.B.C. 1979, c.406, ss.1, 3, 22.

17 *Business Practices Act*, R.S.O. 1990, c.B-18, ss. 1, 2, 3, 4.

18 See especially: T.P.A., see note 16, s.1 "supplier" which does not require privity of contract between the consumer and the party accused of the breach, and s.3 which broadly defines "deceptive acts or practices" without any requirement of intent to deceive.

19 In Canada these jurisdictions are Quebec (*Act respecting the Class Action*, R.S.Q. 1977, c. R-2.1.), Ontario (*Class Proceedings Act*, S.O. 1992, c. 6.) and British Columbia (*Class Proceedings Act*, S.B.C. 1995, c. 21.). Class-action lawsuits are common in the United States.

It is also important to note that there may be some circumstances in which both the vendor and manufacturer may be involved in voluntary arrangements which attract contractual liability.

instead buy them from a vendor. This means that there is no conventional contractual relationship between the manufacturer and the consumer – the manufacturer has a contract with the vendor, and the consumer has a contract with the vendor, but the manufacturer and the consumer have no such oral or written contract. The doctrine of privity of contract suggests that where there is no contractual relationship between the aggrieved party and a defendant, there can be no action in contract against that defendant.²¹ However, where manufacturers make claims about their products which cannot be fulfilled, the courts may find that an implied contract exists between the consumer and the manufacturer – this is known as a “collateral contract”²² or a “collateral warranty.”

This approach is demonstrated in *Murray v. Sperry Rand Corporation*²³ where the manufacturer of farm machinery produced a brochure which contained statements about the performance quality of the machine. The brochure was promotional in nature, and was not simply a description of the machine. The court ruled that a potential customer reading the brochure would reasonably conclude that the manufacturer was promising that the described performance quality was also the actual performance quality of the machine. Even though the machine was purchased through a distributor, the court found the manufacturer liable to the consumer since its promises had induced the consumer to purchase the machine.

The potential for the court to find a collateral contract between a manufacturer and a consumer has important ramifications in the context of voluntary codes since it enables consumers to sue a manufacturer in contract where the manufacturer has advertised its adherence to a voluntary code, yet has not lived up to the promise. For example, a manufacturer of bicycle helmets may advertise that its helmets conform to the standards of the Snell Foundation, the Canadian Standards Association or the American National Standards Institute.²⁴ The consumer may purchase the helmet in reliance on this statement since adherence to a standard would suggest that the helmet is safe. Even if the consumer purchased the helmet at a sporting goods store, rather than directly through the manufacturer, the court could imply a contract between the consumer and the manufacturer so that the consumer could maintain an action in contract.

A consumer’s ability to sue the manufacturer in contract is significant for several reasons. First, the manufacturer’s awareness of its potential liability encourages adherence to the code. Second, it allows the consumer to obtain compensation where the retailer is not blameworthy. The consumer may not want to sue the local store when the more blameworthy party is a large manufacturer.²⁵ Third, the consumer may prefer to sue the manufacturer where the vendor does not have sufficient assets to make the action worthwhile. Fourth, in some cases the consumer may wish to sue the manufacturer rather than the vendor where the transaction with the vendor involved an exclusion of liability clause. It is also important to note that there may be some circumstances in which both the vendor and manufacturer may be involved in voluntary arrangements which attract contractual liability.

A consumer who wants to launch an action against a manufacturer also has several non-contract based options. In particular, in situations where it is unlikely the

20 For more information regarding the merits of class-action litigation see: M. Cochrane, *Class Actions: A Guide to the Class Proceedings Act, 1992* (Toronto: Canada Law Book, 1993.)

21 *Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co. Ltd.* [1915] Appeal Cases 847 (House of Lords) per Viscount Haldane L.C. at 853: “...in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it.” See also: G.H.L. Fridman, *The Law of Contract in Canada*, 2d ed. (Toronto: Carswell, 1986) 170-176.

22 Fridman, see note 21 at 477-481. See also: S.M. Waddams, *The Law of Contracts*, 3d ed. (Toronto: Canada Law Book, 1993) at pp424-426.

23 *Murray v. Sperry Rand Corporation et al.* (1979) 23 Ontario Reports (2d) 456 (Ontario High Court), see also: *Traders Finance Corp. Ltd. v. Haley* (1966), 57 Dominion Law Reports (2d) 15 (Alberta Supreme Court, Appellate Division).

court will find a collateral contract to exist, the consumer might prefer to commence an action under a provincial consumer protection act. Many such acts are broadly written and some specifically eliminate the need for privity of contract. For example, the British Columbia Trade Practice Act defines a “supplier” as anyone who promotes or is involved in a consumer transaction, “whether or not privity of contract exists between that person and the consumer...”²⁶ This broadly written definition enables a consumer to sue a manufacturer directly for its “deceptive acts”²⁷ even though the consumer has no contract with the manufacturer.

3) Firms and Suppliers

Firms which adhere to a voluntary code may impose these rules on their suppliers as a term of a contract. For instance, a term of the Gap’s code regarding the labour practices of their Latin American suppliers enables the Gap to terminate a contract with the supplier if the code is violated. Requiring a supplier to adhere to a voluntary code adopted by the purchasing firm is not uncommon; what is rare is where a firm requires its customers to adhere to these same terms. An example of this latter requirement is the Canadian Chemical Producers’ Association (CCPA) “Responsible Care” code.²⁸ The Responsible Care program has been in place since the mid-1980’s and has successfully increased safety within the chemical industry. It is currently embarking on a stewardship program which would extend the principles of Responsible Care downstream to its customers. Although this facet of Responsible Care has received positive reactions from many CCPA customers, Brian Wastle, President of the CCPA acknowledges that the stewardship issue is an ongoing challenge.²⁹

Predictably, there are a number of concerns with the feasibility of imposing a voluntary code on one’s customers – how is the customer’s compliance monitored and how does one construct incentives which discourage selling to inappropriate customers? The Responsible Care code may be able to overcome these potential problems for two reasons. First, the CCPA’s members are primarily large chemical companies which can afford to turn away some inappropriate customers. Second, its customers are mainly established companies which are easier to monitor. In contrast, requiring customers to adhere to a voluntary code would be far more difficult if the firm was not easily able to turn away inappropriate customers, if the firm sold to the public, or if the firm had a large number of customers.

By requiring that suppliers or customers adhere to a voluntary code endorsed by them, firms could potentially work towards attaining public policy goals.³⁰ For example, the CCPA, by using its market muscle to encourage its customers to abide by the principles of the Responsible Care code, could help improve safety in the manufacturing industry which is regulated at great expense by the state. The imposition of the Gap’s labour standards code on its Latin American suppliers is even more interesting since it uses the Gap’s market power to impose North American style labour standards on suppliers in Latin American jurisdictions notorious for their abysmal working conditions. Thus the Gap, through the use of market pressures, has achieved something that North American governments have not – the improvement of working conditions in Latin America.³¹

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24 These are organizations which develop and administer bicycle helmet standards. See also, J. Buchanan, A. Morrison and K. Webb, “Bicycle Helmet Standards and Hockey Helmet Regulations: Two Approaches to Safety Protection” (Paper presented to the Exploring Voluntary Codes in the Marketplace Symposium, Ottawa, September 1996) [unpublished].

25 Although in practice many lawyers might advise such a consumer to sue the local vendor and allow the vendor to join the manufacturer as a “third party”.

26 T.P.A., see note 16, s.1 “supplier”.

27 T.P.A., see note 16, s.3.

28 Bregha and Moffet, see note 7.

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It is worth noting that just as imposing the terms of a voluntary code on suppliers and customers can achieve positive public policy goals, this practice could also be used in the self-interest of an industry association. For example, in *R. v. British Columbia Fruit Growers' Association et al*³² the BCFGAs was charged with an offence under the Combines Investigation Act when it used its market influence to prevent storage facilities from offering their services to non-members. This action effectively limited non-members to selling their products fresh. The fact that the BCFGAs imposed the terms of its voluntary code on its suppliers in order to protect its own interests should be cause for some concern. However, the BCFGAs was acquitted at trial since the court found that the non-members were not prevented from selling their fruit.

4) Industry Associations and Member Firms

Perhaps the most obvious contractual relationship created by a voluntary code regime is between industry associations and their members. Generally, when a member firm joins an industry association the member must pay a membership fee and agree to abide by the rules and standards imposed by the association. In exchange the member can advertise their affiliation with the association and gain access to services or benefits provided by the association. The failure by a member to adhere to the association's code can result in harm to the reputation of both the association and its members in good standing. As a result the association will often take legal action against the offending member for breach of contract. Conversely, a member firm could sue the association if it failed to provide the services and benefits bargained for in the contract.

An example of an association taking action against a member is found in the Nova Scotia Court of Appeal case, *Ripley v. Investment Dealers' Association*.³³ In this case a member of the Association violated the standards imposed by the Investment Dealers' Association (IDA) and was subsequently disciplined by its Business Conduct Committee. Ripley admitted that he was familiar with the standards set by the IDA and the sanctions which could be imposed for breaching them, but argued that the association should not be able to sanction him since it would violate his s. 7 and 11 rights under the Canadian Charter of Rights and Freedoms. The court disagreed with this argument noting that:

It may be inferred that members of the securities industry contract to regulate themselves because it is to their advantage to do so. An obvious benefit is the avoidance of the need for government regulation in a field where the need for protection of the public might otherwise attract it. A party to such a contract cannot have it both ways; if he enjoys benefits from a contract which excludes government intervention from his profession, he cannot claim Charter protection when he is accused of breaching the conditions of his contract.³⁴

The court's decision in *Ripley* confirms the rights of industry associations to enforce standards, as contractual terms, against offending members. Ultimately, actions of this sort resemble enforcement actions by regulatory agencies against regulated parties. However, there is an important distinction which must be made clear: industry associations can only maintain actions for breach of contract against those who have agreed to abide by the association's standards – their members. Those firms or individuals which choose not to join the association cannot be sued in

30 Provided that these goals are still in the "best interest of the corporation". See: *Dodge v. Ford Motor Company* 170 Northwestern Reporter 668 (Supreme Court of Michigan, 1919), and *Parke v. Daily News Ltd.* [1962] 1 Chancery Division 927, [1962] 2 All England Law Reports, 929 (Chancery Division).

31 Rhone, see note 8.

32 *R. v. British Columbia Fruit Growers' Association et al* (1986) 11 Canadian Patent Reporter (3d) 183 (British Columbia Supreme Court).

33 *Ripley v. Investment Dealers Association of Canada et al.* (No. 2), [1991] 108 Nova Scotia Reports (2d) 38 (Nova Scotia Supreme Court Appeal Division).

contract if they fail to adhere to the association's standards.³⁵

One danger which stems from an industry association's ability to set and enforce standards is that the association could set its standards so as to impede competition within the industry. When standards (or regulations) are followed by an entire industry, the level of competition amongst firms in the industry will be reduced simply because no firm can choose to operate below the minimum standards. However, this is not nearly as pressing a concern as when an industry association intentionally erects standards which act to injure competitors. Perhaps the best example of this is found in the American case, *Hydrolevel Corp. v. American Society of Mechanical Engineers (ASME)*.³⁶ In that case, the jury found that influential individual members of ASME, a standards setting body, had acted to protect their companies from competition by falsely suggesting, on behalf of ASME that their competitor's products were unsafe. This sort of situation is quite rare, and it should be noted that the Competition Bureau is aware of the potential anti-competitive effects of voluntary code arrangements. In fact, a recent Competition Bureau paper addresses these issues and notes that where voluntary arrangements are anti-competitive the Competition Bureau will take action to remedy the situation.³⁷

Conclusion

Despite their voluntary nature, voluntary codes are not immune to legal actions. At the heart of every voluntary code is a series of contractual relationships, each of which could be subject to an action in contract. The increasing emergence of voluntary codes could serve to empower consumers and public interest litigants by providing an alternative method of obtaining redress. At the same time, one should not overestimate the impact that a greater understanding of the contractual aspects of voluntary codes will have. Although contract law provides another potential avenue for redress, there remain a number of factors which militate against individual consumers bringing actions in contract. Most commonly cited is the imbalance of power between firms and individuals. Firms often have the resources to determine whether a contractual term is being violated and to hire skilled lawyers to fight the individual's action. In contrast, individual consumers may lack the resources to launch an action, may be intimidated by the court processes, and may lack knowledge of the law. Furthermore, damage to the individual consumer from the violation of a voluntary code may simply be too small to merit a legal action – an especially disturbing point since the aggregate damage to consumers as a whole may be significant.

However, in provinces with class proceedings legislation, all of the above factors are mitigated. Consumers may join together to claim their aggregate damages with the assistance of a lawyer motivated by the potentially large contingency fees of a class-action suit. Furthermore, lawyers may have a substantial economic incentive to monitor and help enforce voluntary codes. Overall, there is reason to believe that the contractual relationships derived from voluntary codes will become an increasingly important aspect of the law.

The increasing emergence of voluntary codes could serve to empower consumers and public interest litigants by providing an alternative method of obtaining redress.

³⁴ Ripley, see note 33 at 47.

³⁵ However, it is important to note that although non-members cannot be sued in contract, they could be sued in tort. This risk of liability might prompt non-members to join an industry association or to adhere to the association's standards.

³⁶ *Hydrolevel Corp. v. American Society of Mechanical Engineers* 635 Federal Reporter 2d. 118 (United States Court of Appeals, 2d Circuit. 1980).

³⁷ Director of Investigation and Research, *Strategic Alliances Under the Competition Act* (Hull: Ministry of Supply and Services, 1995).