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Accountability in International Project Finance: The Equator Principles and the Creation of Third-Party-Beneficiary Status for Project-Affected Communities

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Abstract

The creation of a third-party-beneficiary interest is a method to police the actions of entities doing business abroad. This Note discusses the viability of gleaning from the Principles a third-party-beneficiary right for project-affected communities to ensure compliance with the Industry's social and environmental standards. Part I defines project finance, discusses the emergence of social and environmental standards, such as the Principles, and describes the requirements of each of the ten individual Principles. Part II provides real world examples of the lack of effectiveness of the Principles in practice and explains some of the forces contributing to this practical failure. Part II also provides an overview of third-party-beneficiary rights in US law, describes three relevant cases involving third-party-beneficiary rights, and explains barriers to enforcement of a third-party- beneficiary claim. Finally, Part III analyzes the viability of enforcing compliance with the Principles through third-party- beneficiary rights under US contract law.

NOTES

ACCOUNTABILITY IN INTERNATIONAL PROJECT FINANCE: THE EQUATOR PRINCIPLES AND THE CREATION OF THIRD-PARTY-BENEFICIARY STATUS FOR PROJECT-AFFECTED COMMUNITIES

Marissa Marco *

INTRODUCTION

The recent emergence of social and environmental standards in the project finance industry ("Industry") has changed the way most major international financial institutions ("IFIs") approach project finance.[1] Project finance is a method of financing often used to create large infrastructure projects, in which the borrower is a company specially formed for the creation of the infrastructure facility and the lender is repaid

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1. *See* Paul Watchman, *Banks, Business and Human Rights*, 2 BUTTERWORTHS J. INT'L BANKING & FIN. L. 46, 46 (2006) ("Global banks and international businesses have now reached a tipping point on environmental, social and human rights issues whereby we can now characterise 21st century international business as being at the dawn of a New Enlightenment based on responsible banking . . . ."); *see also* Kevin Godier, *The Changing View of Governance*, *in* SUSTAINABLE INVESTMENT 24 (2004) (quoting an International Finance Corporation ("IFC") senior advisor stating that the Equator Principles ("Principles") are "the market standard for new project finance business"); *About the Equator Principles*, THE EQUATOR PRINCIPLES, http://www.equator-principles.com/documents/AbouttheEquatorPrinciples.pdf (last visited Jan. 5, 2011) (describing the Principles as the "gold standard" for sustainable project finance and a "huge step forward for the industry"). *See generally* Ryan Hansen, The Impact of the Equator Principles on Lender Liability: Risks of Responsible Lending (unpublished LL.M dissertation, London Sch. of Econ. & Pol. Sci., Nov. 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=948228 (detailing the effect on lenders of greater responsibility for sustainable practices).

primarily from the cash flow and value of the facility itself.[2] The major lenders are IFIs, such as the World Bank and large private commercial banks.[3] As a result of public outcry against the negative impacts of projects around the globe,[4] IFIs have created social and environmental standards by which the projects they fund must be governed.[5] The Equator Principles ("Principles") are a set of voluntary guidelines adopted by private commercial banks to ensure sustainable social and environmental practices as a condition to obtaining funding for project finance deals.[6]

Even for projects that promise to abide by these standards, however, noncompliance continues[7] as investors try to maximize profit and shirk their contractual responsibilities in project-

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2. *See* EQUATOR PRINCIPLES, THE "EQUATOR PRINCIPLES": A FINANCIAL INDUSTRY BENCHMARK FOR DETERMINING, ASSESSING, AND MANAGING SOCIAL AND ENVIRONMENTAL RISK IN PROJECT FINANCING (2006), *available at* http://www.equator-principles.com/documents/Equator_Principles.pdf [hereinafter THE EQUATOR PRINCIPLES] (defining project finance as "a method of funding in which the lender looks primarily to the revenues generated by a single project both as the source of repayment and as security for the exposure, plays an important role in financing development throughout the world"). *See generally* SCOTT L. HOFFMAN, THE LAW AND BUSINESS OF INTERNATIONAL PROJECT FINANCE (2008) (explaining project finance).

3. David B. Hunter, *Civil Society Networks and the Development of Environmental Standards at International Financial Institutions*, 8 CHI. J. INT'L L. 437, 437–51 (2008) (listing sources of international project finance capital as multilateral development banks, such as the World Bank and the IFC, export credit agencies ("ECAs"), and private commercial banks).

4. *See* Kirk Herbertson & David Hunter, *Emerging Standards for Sustainable Finance of the Energy Sector*, 7 SUSTAINABLE DEV. L. & POL'Y 4, 5 (2007) (explaining that international financial institutions ("IFIs") were supporting "some of the most environmentally damaging projects taking place in developing countries"); *see also* Robert F. Lawrence & William L. Thomas, *The Equator Principles and Project Finance: Sustainability in Practice?*, NAT. RESOURCES & ENV'T, Fall 2004, at 20 (2006) ("The environmental and social impacts of such projects are sometimes highly controversial . . . .").

5. *See* Herbertson & Hunter, *supra* note 4, at 5 (explaining that IFIs adopted social and environmental policies as a result of pressure from civil society groups); *see also* Hunter, *supra* note 3, at 437–51 (explaining the emergence of social and environmental standards among project finance lending institutions).

6. *See About the Equator Principles*, *supra* note 1 (defining the Principles as "a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing"); *see also* Andrew Hardenbrook, *The Equator Principles: The Private Financial Sector's Attempt at Environmental Responsibility*, 40 VAND. J. TRANSNAT'L L. 197, 200–01 (2007) (describing the purpose of the Principles).

7. *See* Hardenbrook, *supra* note 6, at 207–10 (describing various criticisms of the Principles); *see, e.g.*, Nick Mathiason, *Banks Attacked for Failures to Meet Equator Principles on Environment*, GUARDIAN (London), Jan. 15, 2010, at 38. ("The world's biggest banks are continuing to lend money to some of the most environmentally damaging energy and infrastructure projects despite a supposed groundbreaking protocol . . . .").

affected areas.[8] Unfortunately, for a variety of reasons, the communities affected by these projects often lack access to remedies.[9] In other contexts, such as racial equality,[10] fair housing,[11] and shareholder rights,[12] US courts have allowed nonparties to enforce a contract under a third-party-beneficiary theory in US contract law.[13] Because international project finance contracts are often governed by US law,[14] recognition of a third-

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8. *See, e.g.*, Lawrence & Thomas, *supra* note 4, at 22 (arguing that imposing the Principles is not always in the lender's interest because "[r]equiring such compliance would increase the operating costs of the project, and reduce the project's financial viability"); *see also* Alan Clendenning, *Brazil's Amazon Building Boom Draws Protests*, MSNBC, May 23, 2008, http://www.msnbc.msn.com/id/24794759 (discussing the tension between indigenous communities and the eagerness of project finance investors on the Madeira River).

9. *See* Natalie L. Bridgeman & David B. Hunter, *Narrowing the Accountability Gap: Toward a New Foreign Investor Accountability Mechanism*, 20 GEO. INT'L ENVTL. L. REV. 187, 207 (2008) ("[L]ocally-affected communities have little effective access to justice under international law."); *see also* 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*, ¶ 3, U.N. DOC. A/HRC/8/5 (Apr. 7, 2008) (by John Ruggie) ("[G]overnance gaps provide the permissive environment for wrongful acts by companies of all kinds without adequate sanctioning or reparation.").

10. *See, e.g.*, Bossier Parish Sch. Bd. v. Lemon, 370 F.2d 847, 852 (5th Cir. 1967) (finding African-American school children to be third-party beneficiaries of a contract between the school board and the federal government); Macedonia Church v. Lancaster Hotel Ltd., 2010 WL 3925199, at *6 (D. Conn. Sept. 30, 2010) (finding members of an African-American congregation to be third-party beneficiaries of a contract between their church and a hotel that failed to provide them with adequate accommodations).

11. *See, e.g.*, Zigas v. Superior Ct., 120 Cal. App. 3d 827, 834 (1981) (finding housing tenants to be third-party beneficiaries of a contract between a developer and a federal government agency); Holbrook v. Pitt, 643 F.2d 1261, 1265 (Wis. 1981) (finding housing project tenants to be third-party beneficiaries of a contract between a federal government agency and a housing project owner).

12. *See, e.g.*, *In re* Enron Corp., 292 B.R. 507, 511 (S.D.N.Y. 2002) (finding shareholders in a bankruptcy proceeding to be third-party beneficiaries of a merger agreement); Weinberger v. N.Y. Stock Exch., 335 F. Supp. 139, 145 (S.D.N.Y. 1971) (finding an investor to be a third-party beneficiary of a contract between the New York Stock Exchange and the Securities and Exchange Commission).

13. *See* Prouty v. Gores Tech. Grp., 121 Cal. App. 4th 1225, 1232 (2004) (granting third-party beneficiary status to former employees pursuant to a merger); Chen v. St. Beat Sportswear, Inc., 226 F. Supp. 2d 355, 361 (E.D.N.Y. 2002) (granting third-party beneficiary status in the employment context).

14. *See* Pandora D. Strasler, *Practical Considerations in Negotiating International Credit Facilities*, 25 SUFFOLK TRANSNAT'L L. REV. 335, 338 (2002) ("Many international credit transactions apply New York law to the credit agreement... even if the borrower and lender have little connection to New York."); *see also* Charlotte Ku & Christopher J. Borgen, *American Lawyers and International Competence*, 18 DICK. J. INT'L L. 493, 514

party-beneficiary right may provide a remedy for project-affected communities. Recognition of such a right to enforce compliance with social and environmental standards would change the project finance landscape, as borrowers are challenged to keep their contractual commitments.[15]

The creation of a third-party-beneficiary interest is a method to police the actions of entities doing business abroad.[16] This Note discusses the viability of gleaning from the Principles a third-party-beneficiary right for project-affected communities to ensure compliance with the Industry's social and environmental standards. Part I defines project finance, discusses the emergence of social and environmental standards, such as the Principles, and describes the requirements of each of the ten individual Principles. Part II provides real world examples of the lack of effectiveness of the Principles in practice and explains some of the forces contributing to this practical failure. Part II also provides an overview of third-party-beneficiary rights in US law, describes three relevant cases involving third-party-beneficiary rights, and explains barriers to enforcement of a third-party-beneficiary claim. Finally, Part III analyzes the viability of enforcing compliance with the Principles through third-party-beneficiary rights under US contract law.

(stating that historically New York law is a common choice of law and the Southern District of New York is a common forum for international loan documentation).

15. *See* Roger P. Alford, *Arbitrating Human Rights*, 83 NOTRE DAME L. REV. 505, 540–41 (2008) (suggesting that a third-party-beneficiary right would increase the ability to monitor abuses); *see also* WORLD WILDLIFE FUND, SHAPING THE FUTURE OF SUSTAINABLE FINANCE: MOVING FROM PAPER PROMISES TO PERFORMANCE 79 (2006) ("[A]ffected people should be able to bring third-party complaints regarding the behaviour of either the bank or its clients under the dispute resolution procedures of the financial agreement."); Avnita Lakhani, *The Role of Citizens and the Future of International Law: A Paradigm for a Changing World*, 8 CARDOZO J. CONFLICT RESOL. 159, 174–81 (2006) (espousing the use of the "citizen suit" to increase enforcement).

16. *See, e.g.*, Alford, *supra* note 15, at 541 ("[C]orporations can grant to a narrow category of constituents third-party beneficiary rights to address human rights concerns . . . ."); Wendy N. Duong, *Partnerships with Monarchs—Two Case Studies: Case Two Partnerships with Monarchs in the Development of Energy Resources: Dissecting an Independent Power Project and Re-Evaluating the Role of Multilateral and Project Financing in the International Energy Sector*, 26 U. PA. J. INT'L ECON. L. 69, 136–37 (2005) ("[T]he people of the 'Third World' should be regarded as 'third-party beneficiaries' of [corporations'] partnerships with governments.") (emphasis omitted); Lakhani, *supra* note 15, at 178 (explaining that creation of a third-party-beneficiary interest would improve compliance with environmental laws).

I. *THE PRINCIPLES AS ENVIRONMENTAL AND SOCIAL STANDARDS*

The Principles are a set of guidelines that govern the social and environmental practices of project finance deals that obtain funding from private commercial banks. Before delving into the details of the Principles, Part I provides a brief overview of project finance and explains recent changes in the Industry toward promoting sustainable practices. Section A defines project finance, identifies the major lenders, and discusses the governing law that typically applies to loan documentation. Section B discusses the social and environmental policies in the Industry, including the emergence of the Principles as an Industry framework. Finally, Section C explains each of the ten individual principles in detail.

A. *What is Project Finance?*

Project finance is a method of funding typically used to finance large infrastructure projects built for purposes such as power generation, chemical production, mining, telecommunication, and transportation.[17] The major project finance lenders include multilateral development banks, such as the World Bank and the International Finance Corporation ("IFC"),[18] export credit agencies ("ECAs"),[19] and private

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17. *See* BASEL COMMITTEE ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (2005), *available at* http://www.bis.org/publ/bcbs118.pdf [hereinafter BASEL COMMITTEE] ("Project finance is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure."); *see also* HOFFMAN, *supra* note 2, at 4.

18. The IFC is an affiliate of the World Bank that invests in the private sector. *See* Carol M. Mates, *Project Finance in Emerging Markets—The Role of the International Finance Corporation*, 18 TRANSNAT'L LAW. 165, 165 (2004); *see also* Margaret B. Cole, *Project Financing: An International Finance Corporation Perspective*, *in* INTERNATIONAL RESOURCES LAW II: A BLUEPRINT FOR MINERAL DEVELOPMENT ch. 8C (1995) ("IFC's fundamental role is to promote economic development by encouraging private sector investment activities in developing countries.").

19. ECAs are public agencies that provide loans, insurance, and guarantees to corporations doing business abroad. *See* Hunter, *supra* note 3, at 445–46; *see also* HOFFMAN, *supra* note 2, at 451 (defining ECAs as "credit facilities or guarantee programs made available by a country for the benefit of exporters of goods or services in that country, in an effort to promote exports").

commercial banks.[20] Because these infrastructure projects are capital intensive and often high risk,[21] a project sponsor[22] generally forms a special purpose entity, which serves as both the project company and borrower.[23] The project company is responsible for creating, owning, and maintaining the infrastructure facility, as well as obtaining the capital to finance it.[24] In turn, the lender has recourse primarily against the project company, with repayment dependent on the cash flow, assets, and value of the project itself, rather than on the resources of the project sponsor.[25]

Due to the nature of such projects, large amounts of investment are subject to high risk of loss, particularly in emerging markets.[26] For example, because projects operate under the authority of host governments, a major concern is expropriation risk, in which a government nationalizes or takes ownership of a project without providing just compensation to

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20. *See* Hunter, *supra* note 3, at 437–38; *see also* Herbertson & Hunter, *supra* note 4, at 5 (listing the major IFIs in project finance as the World Bank Group, other multilateral development banks, ECAs, and private commercial banks).

21. *See* HOFFMAN, *supra* note 2, at 7, 27–28. For a discussion of risk specific to emerging markets, *see id.* at 18; *see also* Duong, *supra* note 16, at 69, 81 (explaining that project finance is used in capital-intensive projects with multiple sources of risk).

22. The project sponsor is the entity that initiates the project and owns, at least in part, the project company. *See* HOFFMAN, *supra* note 2, at 452; *see also* ETHICAL INVESTMENT RESEARCH SERVICES, PROJECT FINANCE: A SUSTAINABLE FUTURE? 3 (2006) ("Project sponsors usually contribute the equity and 'own' the project . . . .").

23. *See* BASEL COMMITTEE, *supra* note 17, at 49 ("The borrower is usually an SPE (Special Purpose Entity) that is not permitted to perform any function other than developing, owning, and operating the installation."); *see also* HOFFMAN, *supra* note 2, at 87, 452 (defining "project company" as "a special-purpose entity that develops, owns, and operates a project" and citing the "single-purpose corporate subsidiary" as the most common structure for project financing).

24. *See* sources cited *supra* note 23; *see also* HOFFMAN, *supra* note 2, at 87 (explaining that the project company's sole purpose is to "develop, construct, own, operate, and maintain a particular project").

25. There are two common types of financing: limited recourse and nonrecourse financing. In nonrecourse financing, repayment to the lender is entirely dependent on the value and earnings of the facility, effectively shielding the sponsor from any repayment obligation of the project company. In limited recourse financing, which is more typical, the sponsor has some obligation to repay, which will be determined based on the specific risks associated with the facility. *See* HOFFMAN, *supra* note 2, at 4–5; *see also* Duong, *supra* note 16, at 76–77.

26. *See* Duong, *supra* note 16, at 97–101 (discussing special considerations for project finance in developing countries); *see also* HOFFMAN, *supra* note 2, at 7, 27–28 (discussing the various risks associated with project finance). For a discussion of risk specific to emerging markets, see HOFFMAN, *supra* note 2, at 18.

the project developers.[27] Additional sources of risk include currency devaluation resulting from fluctuations in the market; political turmoil associated with transfers of power in the host state; and civil unrest or war in the region.[28] To insulate lenders from bearing these risks, the law governing project finance loan documentation is often the law of a jurisdiction with an established commercial law and legal system.[29] For this reason, loan documentation is commonly governed by New York state law and designates New York as the forum for handling disputes between the parties to the contract.[30] New York law allows any person to bring a breach of contract action against an out-of-state corporation provided that the contract is governed by New York law and involves an amount of money greater than one million US dollars, and that the corporation submits to the jurisdiction of New York courts.[31] In addition, it is common for lenders to

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27. *See* HOFFMAN, *supra* note 2, at 48–49 (describing expropriation risk as "[n]ationalization by the host country of project assets or rights, or the equity ownership of the project, in an arbitrary, discriminatory way, or without just compensation"); *see also* Duong, *supra* note 16, at 81–82 (discussing measures for avoiding expropriation risk in project financing).

28. *See* HOFFMAN, *supra* note 2, at 44, 51–52 (discussing currency risks, political collapse and succession, and "political force majeure events"); *see also* Harold F. Moore, *Allocating Foreseeable Sovereign Risks in Infrastructure Investment in Indonesia: Force Majeure and Indonesia's Economic Woes*, 822 P.L.I. COM. L. & PRAC. HANDBOOK SERIES, 463, 471 (2001) ("[I]nfrastructure projects in developing countries remain subject to sovereign credit risks, sovereign currency fluctuations, resulting difficulties emerging from fundamental mismatch between project liabilities denominated in hard currency and revenues denominated in local currency, and sovereign political risks.").

29. *See* HOFFMAN, *supra* note 2, at 356 (stating that the laws of a jurisdiction with "a developed commercial law, case law precedents and experienced judges" will govern credit documents); *see also* Strasler, *supra* note 14, at 338 (selection of New York law driven by existence of a "well defined, independent, and sufficiently developed legal system").

30. *See* Strasler, *supra* note 14, at 338 ("Many international credit transactions apply New York law to the credit agreement . . . even if the borrower and lender have little connection to New York."); *see also* Ku & Borgen, *supra* note 14, at 514 ("The laws of the State of New York have historically been a common choice of law for international loan documents and—if the dispute is settled before a court as opposed to through arbitration—the federal courts, especially the Southern District of New York, are often the forum of choice."). California law might also be chosen as governing law. *See* Darryl D. Chiang, *Foreign Lawyer Provisions in Hong Kong and the Republic of China on Taiwan*, 13 UCLA PAC. BASIN L.J. 306, 307 n.3 (1995) (explaining that California law is a common choice for international commercial contracts).

31. *See* N.Y. GEN. OBLIG. LAW § 5-1402(1) (McKinney 2010) ("[A]ny person may maintain an action . . . against a foreign corporation . . . where the action . . . arises out of or relates to any contract . . . for which a choice of New York law has been made in whole or in part . . . and which (a) is a contract . . . relating to any obligation arising out

require borrowers to waive their rights to any jurisdictional objections that could arise in the course of litigation, such as forum non conveniens.[32]

B. *The Rise of the Principles as an Industry Framework*

The Principles emerged as an Industry standard for private commercial banks in 2003, only after other lending institutions in the Industry had established best practices for sustainability.[33] The need for social and environmental standards began in the 1980s when the World Bank faced significant public outcry against its funding of certain controversial projects.[34] As a result, the World Bank created a set of "safeguard policies" aimed at

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of a transaction covering in the aggregate, not less than one million dollars, and (b) which contains a provision . . . whereby such foreign corporation agrees to submit to the jurisdiction of the courts of this state."); *see also* Kimmo Mettälä, *Governing-Law Clauses of Loan Agreements in International Project Financing*, 20 INT'L LAW. 219, 239 (1986) (noting that "it is not entirely clear" how forum non conveniens would apply in New York courts, but discussing New York General Obligations Law section 5-1402(1)); Beatie & Osborn LLP v. Patriot Scientific Corp., 431 F. Supp. 2d 367, 390 n.13 (S.D.N.Y. 2006) (stating that New York General Obligations Law section 5-1402 is "a statutory mandate that a clause designating New York as the forum shall be enforceable . . . regardless of any inconvenience to the parties" (citing Int'l Medical Tech., Inc. v. Lintech, LLC 2000 WL 1449889 (S.D.N.Y. 2000) (quoting Nat'l Union Fire Ins. Co. v. Worley, 690 N.Y.S.2d 57, 59 (1st Dept. 1999))).

32. *See* Carl S. Bjerre, *International Project Finance Transactions: Selected Issues under Revised Article* 9, 73 AM. BANKR. L.J. 261, 268 (1999) ("Not only do the documents most often choose New York or other U.S. law in their governing law clauses; they also require the project company and other non-U.S. parties to submit to the jurisdiction of U.S. state and federal courts, to appoint a U.S. agent for service of process, and to waive jurisdictional objections such as forum non conveniens and sovereign immunity under the U.S. Foreign Sovereign Immunities Act."); *see also* Philip Le B. Douglas, *Resolving Project Disputes*, 734 P.L.I. COM. HANDBOOK SERIES, 47, 79 (1996) (stating that in project financings, "parties may wish to waive the defense of forum non conveniens").

33. *See* Hunter, *supra* note 3, at 437–51 (explaining that public pressure led the World Bank to create social and environmental standards that spurred other IFIs to follow suit); *see also* Hansen, *supra* note 1, at 4 (explaining that the Principles arose from "sustained external and internal pressure").

34. These included the Sardar Sarovar dam in India and the Polonoreste highway in Brazil. *See* Hunter, *supra* note 3, at 438–39 ("Projects such as the Sardar Sarovar dam in India's Narmada Valley and the Polonoroeste highway in the Brazilian Amazon led to worldwide civil society opposition, because they were designed with limited concern for impacts on local communities and the environment."); *see, e.g.*, Komala Ramachandra, *Sardar Sarovar: An Experience Retained?*, 19 HARV. HUM. RTS. J. 275, 276–77 (2006) (explaining that the World Bank was criticized for serious environmental and human rights abuses); Philip Shabecoff, *World Bank Offers Environmental Projects*, N.Y. TIMES, May 6, 1987, at A14 (stating that the World Bank introduced new policies after "a road project in the Amazon that critics said led to the destruction of tropical forests").

ensuring sustainable practices for large, public sector infrastructure projects.[35] These policies require borrower compliance with a number of items before funding is approved,[36] including the performance of a social and environmental assessment and the formulation of a plan to mitigate damage to the local community and environment.[37] Other multilateral development banks, such as the Asian Development Bank, the Inter-American Development Bank, and the African Development Bank, follow the World Bank's policies.[38]

In 1997, a controversy involving the hydroelectric Pangue Dam[39] project caused the IFC, the World Bank's private sector lending institution, to adopt its own set of standards to ensure

35. *See* Hunter, *supra* note 3, at 438 (explaining the purpose and origin of the World Bank's social and environmental policies); *Operation Manual: Table A1—Environmental and Social Safeguard Policies—Policy Objectives and Operational Principles*, WORLD BANK (July 2005), http://siteresources.worldbank.org/OPSMANUAL/Resources/EntireOM_External.pdf [hereinafter The World Bank Social Safeguard Policies] (outlining the safeguard policies).

36. *See* Hunter, *supra* note 3, at 439 (stating that projects must be assessed for their social and environmental impacts before projects will be financed by the World Bank); *Operation Manual: OP 4.0—Environmental Assessment*, WORLD BANK (Jan. 1999), http://siteresources.worldbank.org/OPSMANUAL/Resources/EntireOM_External.pdf ("The Bank requires environmental assessment (EA) of projects proposed for Bank financing to help ensure that they are environmentally sound and sustainable . . . .").

37. *See* Hunter, *supra* note 3, at 440–42 (summarizing the World Bank safeguard policies); The World Bank Social Safeguard Policies, *supra* note 35 (outlining the safeguard policies).

38. *See* Hunter, *supra* note 3, at 442 ("Regional development banks, such as the Asian Development Bank . . . the Inter-American Development Bank . . . and the African Development Bank . . . largely copy the policies of the World Bank."); *see also* Herbertson & Hunter, *supra* note 4, at 5 (stating that multilateral development banks such as the African Development Bank and Inter-American Development Bank all follow the World Bank's standards).

39. The Pangue Dam is a hydroelectric power facility that was constructed over the Bío-Bío river in Chile between 1993 and 1997. Despite mass protests by the local community and both national and international non-governmental organizations ("NGOs"), the IFC continued with its US$150 million financing of the project. The project resulted in, among other things, the forced eviction of members of the indigenous community and a failure to provide adequate resettlement assistance. The IFC eventually withdrew its support of the project, but the host government obtained funding elsewhere. *See* Barbara Rose Johnston & Carmen Garcia-Downing, *Hydroelectric Development on the Bío-Bío River, Chile: Anthropology and Human Rights Advocacy*, *in* IN THE WAY OF DEVELOPMENT: INDIGENOUS PEOPLES, LIFE PROJECTS AND GLOBALIZATION 211–34 (Mario Blaser et al. eds., 2004). *See generally The Bío-Bío River Case, Chile*, AM. UNIV., http://www1.american.edu/ted/ice/chiledam.htm (last visited Jan. 11, 2011) (detailing the case background and social and environmental impacts of the Bío-Bío River project).

the sustainability of IFC-funded projects.[40] The IFC's Policy on Social and Environmental Sustainability identifies the obligations of the IFC in conducting project review, while the IFC Performance Standards consist of eight requirements with which the borrower must comply.[41] This framework would later serve as the basis for the Principles.[42]

ECAs, which provide the largest amount of public funding for investment in developing nations,[43] followed suit after their involvement in projects such as China's Three Gorges Dam, which displaced a reported 1.13 million people.[44] Between 2001 and 2007, member countries of the Organization for Economic Cooperation and Development ("OECD") created the Common Approaches on the Environment and Officially Supported Export Credits ("Common Approaches").[45] The Common Approaches require ECAs to monitor the environmental impacts

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40. *See* Hunter, *supra* note 3, at 443–44 ("[I]n response to controversy around the Pangue Dam in Chile, the IFC was forced to announce publicly that it would henceforth follow the environmental and social policies of its sister organizations at the World Bank Group."); *see also* IFC, LESSONS LEARNED: PANGUE HYDROELECTRIC PROJECT 2 (2008) ("[I]t was the Pangue project that catalyzed the strengthening of IFC's institutional capacity to address environmental and social issues.").

41. *See* Hunter, *supra* note 3, at 444 (explaining the two-tiered approach of the IFC's social and environmental policies). *See generally* IFC, POLICY ON SOCIAL & ENVIRONMENTAL SUSTAINABILITY (2006) (stating the IFC's Policy on Social and Environmental Sustainability and the eight Performance Standards for borrowers).

42. *See* Hunter, *supra* note 3, at 445 (stating that the IFC policies are "largely incorporated" in the Principles); Jose Antonio Urrutia, *The Equator Principles or How the Way to Do Business Has Changed*, 54 ROCKY MTN. MIN. L. INST., § 16.03 (2008) (discussing the IFC as the origin of the movement to create the Principles).

43. ECAs are national government agencies that provide loans, insurance, and guarantees to home country corporations to do business abroad. *See* Hunter, *supra* note 3, at 445–46 (explaining ECAs). In 1998, the United States was the only country with ECAs that had written environmental policies. *See id.*; *see also* U.S. GOV'T ACCOUNTING OFFICE, EXPORT CREDIT AGENCIES: MOVEMENT TOWARD COMMON ENVIRONMENTAL GUIDELINES, BUT NATIONAL DIFFERENCES REMAIN 1 (2003) ("ECAs annually finance around $60 billion in exports each year for medium- and long-term projects . . . .").

44. *See* Hunter, *supra* note 3, at 446 (explaining that ECA funding of controversial projects such as China's Three Gorges Dam lead ECAs to develop a set of social and environmental standards); *see also* U.S. GOV'T ACCOUNTING OFFICE, *supra* note 43, at 8 (explaining that pressure for ECA standards arose "as a result of actual or proposed ECA funding of large potentially environmentally harmful projects as the Three Gorges Dam in China . . . ."); Jim Yardley, *At China's Dams, Problems Rise with Water*, N.Y. TIMES, Nov. 19, 2007, at A1 (citing "the project's official tally of 1.13 million displaced people").

45. *See* Hunter, *supra* note 3, at 447–48 (describing the evolution of the Common Approaches on the Environment and Officially Supported Export Credits ("Common Approaches")); *see also* U.S. GOV'T ACCOUNTING OFFICE, *supra* note 43 (outlining the progression of ECAs' adoption of social and environmental standards).

of ECA-funded projects, albeit to a lesser degree than under the World Bank standards.[46]

Once ECAs began to establish social and environmental standards, the only remaining project finance lenders without such standards were private commercial banks.[47] In 2002, the IFC and nine other banks met to discuss these recent Industry developments.[48] As a result of this meeting, four private commercial banks created a set of global standards, known as the Equator Principles, to be voluntarily adopted by private banks involved in project finance.[49] In 2003, ten private banks publicly announced that they would adhere to the Principles.[50] By 2006, the Principles had been adopted by forty IFIs, comprising eighty percent of all lending for project finance deals.[51] IFIs that subscribe to the Principles, known as the Equator Principles Financial Institutions ("EPFIs"),[52] explicitly state that they will

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46. *See* Hunter, *supra* note 3, at 449 ("Although progress has been substantial, most ECA policies still do not meet the environmental and social standards of the World Bank and other MDBs."); *see also* U.S. GOV'T ACCOUNTING OFFICE, *supra* note 43, at 11–15 (explaining differences in the World Bank standards and those applying to ECAs).

47. *See* Hunter, *supra* note 3, at 450 ("[T]he primary remaining sources of project finance lacking environmental standards were private commercial banks.").

48. *See About the Equator Principles*, *supra* note 1, at 4 (stating that in October 2002 nine international banks met in London with the IFC); *see also* Hansen, *supra* note 1, at 4 ("[A] small number of influential banks gathered . . . and . . . agreed to develop a framework for handling the environmental and social risks . . . .").

49. *See About the Equator Principles*, *supra* note 1, at 4 ("Four of the banks present . . . , acknowledging the general consensus amongst those present, volunteered jointly to develop a banking industry framework for addressing environmental and social risks in project financing that could be applied globally and across all industry sectors."). The four private commercial banks were ABN Amro, Barclays, Citi, and WestLB. *Id.*

50. *See About the Equator Principles*, *supra* note 1, at 4 (naming the ten banks that adopted the Principles); *see also* Hardenbrook, *supra* note 6, at 199 (describing that ten private banks adopted the Principles on June 4, 2003). A revised set of Principles, which took into account issues raised by the public, was promulgated in 2006. *See* Hardenbrook, *supra* note 6, at 199–200 (discussing the 2006 version of the Principles).

51. *See* Hardenbrook, *supra* note 6, at 199 (stating that forty IFIs had adopted the Principles by its third anniversary, amounting to eighty percent of all project lending); *see also* ETHICAL INVESTMENT RESEARCH SERVICES, *supra* note 22, at 2 (explaining that the Principles were adopted by eighty percent of IFIs in project finance by 2006). As of the date of this writing, sixty-eight IFIs have adopted the Principles. *See About the Equator Principles*, *supra* note 1, at 13.

52. *See* Hardenbrook, *supra* note 6, at 199 (referring to private institutions that subscribe to the Principles as Equator Principles Financial Institutions ("EPFIs")); *see also About the Equator Principles*, *supra* note 1, at 1 (same).

not lend to projects in which a borrower cannot, or will not, adhere to the Principles' social and environmental policies.[53]

C. *The Principles in Detail*

According to the preamble, the purpose of the Principles is to ensure that EPFI-funded projects are performed in a way that is socially and environmentally sound[54] and avoids negative impacts on local communities.[55] The preamble states, "We believe that adoption of and adherence to these Principles offers *significant benefits* to ourselves, our borrowers *and local stakeholders* through our borrowers' engagement with locally affected communities."[56] An "affected community" is the local population within the project's "area of influence" that likely will be negatively impacted by the project.[57]

In order for a project to obtain funding from an EPFI, the project must conform to the Principles.[58] Under Principle 1, EPFIs must categorize each project according to IFC standards by the potential impacts and risks on the local environment and community.[59] Category A projects have substantial negative impacts on the local community, while Category B projects have

53. *See* THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1 ("We will not provide loans to projects where the borrower will not or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles."); *see also* Hansen, *supra* note 1, at 5 (citing the Preamble to the Principles).

54. THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1 ("[EPFIs] have . . . adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices."); *see also* Hansen, *supra* note 1, at 5–6 (discussing the pros and cons of this flexible standard).

55. THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1("[N]egative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately.").

56. *Id.* (emphasis added).

57. *Id.* at 4 n.4 (defining "affected community" as "communities of the local population within the project's area of influence who are likely to be adversely affected by the project").

58. *See id.* at 2–3 ("EPFIs will only provide loans to projects that conform to Principles 1–9"; Principle 10 concerns the responsibilities of the EPFI).

59. *See id.* princ. 1, at 2 ("When a project is proposed for financing, the EPFI will, as part of its internal social and environmental review and due diligence, categorise such project based on the magnitude of its potential impacts and risks in accordance with the environmental and social screening criteria of the [IFC]."); *see also* Hansen, *supra* note 1, at 9–10 (discussing categorization of projects by EPFIs under Principle 1).

more limited social or environmental consequences.[60] Projects in Category C have little or no social or environmental effects.[61] High-impact projects, those in Category A or B, must conduct and submit an assessment of these impacts and risks ("Assessment"), including labor, health, and safety concerns.[62] The Assessment should also propose methods to alleviate and control these impacts and risks.[63] In addition, projects must create an action plan ("Action Plan") and management system, which prioritize the steps required to mitigate, monitor, and rectify the impacts and risks in accordance with host country laws and the IFC Performance Standards.[64]

60. The categorization of projects is detailed in Exhibit I of the Principles. THE EQUATOR PRINCIPLES, *supra* note 2, Exhibit I, at 6. EPFIs categorize each project based on the project's estimated impacts on the local community. *Id.* (defining a Category A project as having "significant adverse social or environmental impacts that are diverse, irreversible or unprecedented" and a Category B project as having limited effects that are "few in number, generally site-specific, largely reversible and readily addressed through mitigation measures"); *see also* Hansen, *supra* note 1, at 9 (discussing categorization of projects by EPFIs under Principle 1); Lawrence & Thomas, *supra* note 4, at 20 (stating that most major, new projects would fall under Category A).

61. *See* THE EQUATOR PRINCIPLES, *supra* note 2, Exhibit I, at 6 (defining a Category C project as having little or no social or environmental effects); *see also* Hansen, *supra* note 1, at 9 (discussing the categorization of projects).

62. *See* THE EQUATOR PRINCIPLES, *supra* note 2, at 2 n.2 (defining the Social and Environmental Assessment ("Assessment") as a "process that determines the social and environmental impacts and risks (including labour, health, and safety) of a proposed project in its area of influence"). Examples of the items that should be included in the Assessment are provided in Exhibit II to the Principles. *Id.* at 7, Exhibit II; *see also* Hansen, *supra* note 1, at 11–12 (discussing the Assessment).

63. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 2, at 2 ("For each project assessed as being either Category A or Category B, the borrower has conducted a Social and Environmental Assessment . . . to address, as appropriate and to the EPFI's satisfaction, the relevant social and environmental impacts and risks of the proposed project. . . . The Assessment should also propose mitigation and management measures relevant and appropriate to the nature and scale of the proposed project.").

64. *See id.* princ. 4, at 3 ("The [Action Plan] will describe and prioritise the actions needed to implement mitigation measures, corrective actions and monitoring measures necessary to manage the impacts and risks identified in the Assessment. Borrowers will build on, maintain or establish a Social and Environmental Management System that addresses the management of these impacts, risks, and corrective actions required to comply with applicable host country social and environmental laws and regulations, and requirements of the applicable [IFC] Performance Standards and [Industry-Specific Environmental, Health and Safety (EHS)] Guidelines . . . ."); *see also* Hansen, *supra* note 1, at 13 (discussing the Action Plan). The IFC Performance Standards are included as Exhibit III to the Principles. *See* THE EQUATOR PRINCIPLES, *supra* note 2, Exhibit III, at 8.

Principles 5 and 6 address communication with affected communities.[65] A project that is expected to have significant negative impacts must demonstrate, to the satisfaction of the EPFI, that it has sufficiently taken into account the concerns of the community.[66] To do so, the project must establish "free, prior and informed"[67] consultation and involvement with the community.[68] Throughout the construction and operation of the project, a grievance mechanism must be accessible to project-affected communities as a forum in which to raise their concerns.[69] The mechanism must be able to resolve issues

65. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princs. 5, 6, at 3–4 (establishing the requirements for "[c]onsulation and [d]isclosure" with the project-affected community and the creation of a "[g]rievance [m]echanism"); *see also* Hansen, *supra* note 1, at 13–14 (discussing consultation and grievance mechanisms).

66. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 5, at 3 ("[T]he government, borrower or third party expert has consulted with project affected communities in a structured and culturally appropriate manner."); *see also* Hansen, *supra* note 1, at 13 (discussing Principle 5).

67. THE EQUATOR PRINCIPLES, *supra* note 2, princ. 5, at 3 (defining "free, prior and informed" as follows: "free" means "free of external manipulation, interference or coercion, and intimidation"; "prior" means the disclosure of information about the project must be timely; "informed" means the consultation and participation is "relevant, understandable and [provides] accessible information"); *see also* Hansen, *supra* note 1, at 13–14 (discussing adequate consultation). The Principles specify that these parameters apply not only to the initial aspects of the project but also to the entire project, from start to finish. *See* THE EQUATOR PRINCIPLES, *supra* note 2, at 3 n.5, (establishing that the consultation requirement should "apply to the entire project process and not to the early stages of the project alone"). In addition, projects affecting the rights of indigenous peoples must meet a more rigorous set of requirements. *Id.* ("Consultation with Indigenous Peoples must conform to specific and detailed requirements as found in [IFC] Performance Standard 7. Furthermore, the special rights of Indigenous Peoples as recognised by host-country legislation will need to be addressed.").

68. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 5, at 3 ("For projects with significant adverse impacts on affected communities, the process will ensure their free, prior and informed consultation and facilitate their informed participation as a means to establish, to the satisfaction of the EPFI, whether a project has adequately incorporated affected communities' concerns."); *see also* Hansen, *supra* note 1, at 13–14 (discussing Principle 5).

69. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 6, at 4 ("[T]o ensure that consultation, disclosure and community engagement continues throughout construction and operation of the project, the borrower will, scaled to the risks and adverse impacts of the project, establish a grievance mechanism as part of the management system. This will allow the borrower to receive and facilitate resolution of concerns and grievances about the project's social and environmental performance raised by individuals or groups from among project-affected communities. The borrower will inform the affected communities about the mechanism in the course of its community engagement process and ensure that the mechanism addresses concerns

expeditiously, transparently, and in accordance with the local culture.[70]

Independent experts must be appointed to monitor compliance under Principles 7 and 9.[71] EPFIs will require independent monitoring and reporting of the borrower's compliance for the life of the loan.[72] Thus, borrowers must either appoint independent experts or retain appropriate external experts to monitor their projects.[73]

In Principle 8, the Principles create formal contractual obligations, rather than solely voluntary guidelines.[74] Principle 8 requires Category A borrowers and Category B borrowers to covenant to the following items in their financing documents.[75] Borrowers must promise to comply with all relevant host country laws, as well as their Action Plans for the duration of the project's construction and operation.[76] Borrowers must also promise to

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promptly and transparently, in a culturally appropriate manner, and is readily accessible to all segments of the affected communities.").

70. *See id.* (discussing the grievance mechanism); *see also* Hansen, *supra* note 1, at 14 (same).

71. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princs. 7, 9, at 4–5 (requiring independent review and monitoring); *see also* Hansen, *supra* note 1, at 14 (explaining that the purpose of Principles 7, 8, and 9 is "to secure objectivity and accountability throughout the life of the project").

72. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 9, at 5 (requiring the "appointment of an independent environmental and/or social expert, or requir[ing] that the borrower retain qualified and experienced external experts to verify its monitoring information which would be shared with EPFIs."); *see also* Hansen, *supra* note 1, at 14–15 (discussing the independent review required by Principles 7 and 9).

73. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 9, at 5; *see also* Hansen, *supra* note 1, at 14–15 (stating that EPFI's "sign off" on the borrower's compliance leading to potential liability on the part of EPFIs).

74. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (requiring borrowers to make covenants in loan documentation); *see also* Hansen, *supra* note 1, at 16–17 ("Principle 8 is perhaps the most important of all the Principles; it maximizes EPFI influence over a project by requiring borrowers to comply with the Principles or face possible default and EPFIs' enforcement of remedial rights under the loan agreement.").

75. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (requiring borrowers to covenant to four items in loan documentation); *see also* Hansen, *supra* note 1, at 16–17 (discussing Principle 8).

76. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (stating that borrowers must covenant to "comply with all relevant host country social and environmental laws, regulations and permits in all material respects" and "comply with the [Action Plan] (where applicable) during the construction and operation of the project in all material respects"); *see also* Hansen, *supra* note 1, at 16–17 (restating and discussing Principle 8).

provide documentation of their compliance.[77] Finally, borrowers must promise to decommission facilities in accordance with an agreed plan.[78]

EPFIs also have responsibilities under the Principles,[79] which has led some authors to consider whether banks may be liable for failing to abide by them.[80] Under Principle 8, should a borrower fail to uphold the above covenants, the EPFI will assist the borrower to achieve compliance for an agreed grace period.[81] If, after this period, the borrower still fails to comply, the EPFI may exercise remedies against the borrower.[82] In addition, EPFIs must release reports of their projects to the public at least once a year

77. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (stating that borrowers must covenant to "provide periodic reports . . . that i) document compliance with the [Action Plan] (where applicable), and ii) provide representation of compliance with relevant local, state and host country social and environmental laws, regulations and permits); *see also* Hansen, *supra* note 1, at 16 (discussing Principle 8).

78. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (stating that borrowers must covenant to "decommission the facilities, where applicable and appropriate, in accordance with an agreed decommissioning plan"); *see also* Lawrence & Thomas, *supra* note 4, at 25 (discussing the decommissioning of facilities and noting that this requirement is not typical of most loan agreements).

79. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princs. 8–10, at 4–5 (defining the responsibilities of EPFIs); *see also* Hansen, *supra* note 1, at 19–20 ("By adopting . . . the Principles, EPFIs agree to shoulder responsibility for assessing and monitoring a borrower's social and environmental activities.").

80. *See, e.g.*, Hansen, *supra* note 1, at 1 ("By adopting more responsible lending practices . . . lenders increase their control over project activities, potentially exposing themselves to greater liability risks."); Lawrence & Thomas, *supra* note 4, at 25–26 (discussing the Principles' ambiguity regarding the EPFIs' roles and the expectation that NGOs will seek new ways to hold EPFIs to their commitments); Paul Q. Watchman, *Banking on Responsibility*, SL098 ALI-ABA 385, 392 (2006) (stating that EPFIs "should review the potential legal liability of the bank and its officers where failure to take enforcement action as provided for in the loan documentation for known pollution or the likelihood of pollution occurring, results in pollution occurring or continuing"). *But see* Urrutia, *supra* note 42, § 16.07 (stating that one criticism of the Principles is that they "do not create any type of legal obligation for banks").

81. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 ("Where a borrower is not in compliance with its social and environmental covenants, EPFIs will work with the borrower to bring it back into compliance to the extent feasible, and if the borrower fails to re-establish compliance within an agreed grace period, EPFIs reserve the right to exercise remedies, as they consider appropriate."); *see also* Hansen, *supra* note 1, at 16 ("EPFIs will grant the borrower a grace period and attempt to work with them to reestablish compliance."); Lawrence & Thomas, *supra* note 4, at 25 (interpreting Principle 8 as "when a loan covenant is breached by a borrower, and it would constitute a default by the borrower, then the lenders must 'engage' the borrower").

82. *See* THE EQUATOR PRINCIPLES, *supra* note 2, princ. 8, at 4 (establishing the EPFI's right to exercise remedies against the borrower); *see also* Hansen, *supra* note 1, at 16–17 (discussing Principle 8).

under Principle 10, taking into account the relevant confidentiality issues.[83] Finally, EPFIs are responsible for establishing whether borrowers have complied with the Principles.[84] As a result of these requirements, EPFIs have educated their staff and hired external consultants to achieve the Principles' standards, which sometimes requires the EPFI to act in the borrower's stead.[85] Finally, a new set of governance rules released in July 2010 ("Governance Rules")[86] requires EPFIs to make a commitment to comply with the Principles in a formal contract ("Adoption Agreement").[87]

The Principles, however, also contain two elements that tend to release an EPFI from responsibility. First, the preamble states that the Principles serve as "a common baseline and framework" for implementation in each project.[88] Second, a disclaimer that appears in the Principles and in the Governance Rules states that no rights or liabilities are created by the

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83. THE EQUATOR PRINCIPLES, *supra* note 2, princ. 10, at 5 ("Each EPFI adopting the Equator Principles commits to report publicly at least annually about its Equator Principles implementation processes and experience, taking into account appropriate confidentiality considerations."); *see also* Hansen, *supra* note 1, at 6–8 (discussing Principle 10).

84. *See* Hardenbrook, *supra* note 6, at 203 ("The EPFIs are responsible for determining whether the borrower is in compliance with the Equator Principles."). *See generally* THE EQUATOR PRINCIPLES, *supra* note 2 (requiring in many instances that borrowers meet "the satisfaction of the EPFI").

85. *See* Hansen, *supra* note 1, at 10 (stating that EPFIs have "recruited outside specialists, trained and redeployed staff internally, or employed a mixture of both strategies"). Hansen also describes numerous instances in which the EPFI acts on behalf of the borrower to accomplish the goals of the Principles. For example, communities and host governments may be more amenable to negotiating with an EPFI, rather than a borrower. *Id.* at 14. In addition, an independent expert assigned to monitor the impacts of a project may have a duty of care to the EPFI, rather than the borrower. *Id.* at 15.

86. *See* Press Release, The Equator Principles, New Governance Rules Introduced for the Equator Principles (July 1, 2010), http://www.equator-principles.com/documents/EPGovernanceRulesAnnounce1July2010.pdf (discussing the release of the new set of governance rules ("Governance Rules")).

87. *See* EQUATOR PRINCIPLES, THE EQUATOR PRINCIPLES ASSOCIATION GOVERNANCE RULES 5 (2010), http://www.equator-principles.com/documents/EP_Governance_Rules_April_2010.pdf [hereinafter GOVERNANCE RULES] (requiring EPFIs to "make a contractual commitment to comply with these Rules"); *see also Equator Principles Association Adoption Agreement*, EQUATOR PRINCIPLES (June 2010), http://www.equator-principles.com/documents/Adoption_Agreement_Aug2010.doc [hereinafter *Adoption Agreement*] (requiring EPFIs to contractually agree to "put in place internal policies and procedures for environmental and social risk management consistent with the Equator Principles dated 6 July 2006").

88. THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1.

Principles.[89] Thus, although EPFIs have responsibilities pursuant to the Principles, EPFI liability under the Principles appears to be disclaimed.

The Principles are a set of social and environmental policies that have reshaped the Industry approach to project finance. While the Principles define the responsibilities of borrowers and lenders on paper, in reality those obligations often are not fully implemented.

II. *THE PROBLEM OF PRINCIPLES COMPLIANCE AND AN OUTLINE OF THIRD-PARTY-BENEFICIARY RIGHTS*

Although the Principles aspire to create sustainable practices in project finance, both borrowers and EPFIs often fail to implement the Principles in practice.[90] This failure results in serious environmental and social impacts that leave project-affected communities devastated and often without a legal remedy.[91] This Part discusses how the implementation of the

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89. *See id.* at 5 ("The adopting EPFIs view these Principles as a financial industry benchmark for developing individual, internal social and environmental policies, procedures and practices. As with all internal policies, these Principles do not create any rights in, or liability to, any person, public or private. Institutions are adopting and implementing these Principles voluntarily and independently, without reliance on or recourse to IFC or the World Bank."); *see also* Hansen, *supra* note 1, at 4 ("[L]ike all internal policies, the Principles do not purport to create rights in, or liability to, third parties."). Not all courts, however, have upheld disclaimers. *See, e.g.*, McIlravy v. Kerr-McGee Corp., 74 F.3d 1017 (10th Cir. 1996), *withdrawn*, 98 F.3d 1255 (10th Cir. 1996), *reinstated in part on other grounds on reh'g*, 119 F.3d 876 (10th Cir. 1997) (applying Wyoming law); Mecier v. Branon, 930 F. Supp. 165 (D. Vt. 1996) (applying Vermont law).

90. *See* WORLD WILDLIFE FUND, *supra* note 15, at 76 ("[E]ven banks with relatively strong policies are still supporting high profile projects that have unacceptable environmental or social impacts."); *see also* Mathiason, *supra* note 7, at 38 (describing civil society criticism of banks' failure to implement the Principles in practice). *See generally* PLATFORM, PRINCIPAL OBJECTIONS: ANALYSIS OF THE SAKHALIN II OIL AND GAS PROJECT'S COMPLIANCE WITH THE EQUATOR PRINCIPLES (2005) (describing deficiencies in compliance with the Principles in the Sakhalin project).

91. *See* Bridgeman & Hunter, *supra* note 9, at 207 ("[L]ocally-affected communities have little effective access to justice under international law."); *see also* Ruggie, *supra* note 9, at 3 ("[G]overnance gaps provide the permissive environment for wrongful acts by companies of all kinds without adequate sanctioning or reparation."); Justice Ian Binnie, *Legal Redress for Corporate Participation in International Human Rights Abuses* BRIEF, Summer 2009, at 44, 45 (explaining that "transnational companies have power and influence . . . but without the public law responsibilities of statehood," which results in a lack of remedies for human rights abuses committed by corporations). Despite the recognition that corporations have committed human rights abuses, there is an inability

Principles may fail in practice and the effect of such failure. In addition, this Part explains the third-party-beneficiary right under US contract law, which allows non-signatories to a contract to enforce their rights against the contracting parties.

A. *The Principles in Practice*

Although a borrower must covenant to comply with the Principles in order to obtain funding from an EPFI, borrowers are able to circumvent the Principles in myriad ways.[92] For example, borrowers may avoid being categorized as high risk through a process of segmentation during the assessment period.[93] Because borrowers typically divide a project into phases, the Assessments often are based on isolated segments of the project's lifespan.[94] Thus, the Assessment may represent an incomplete picture of the project's total impact on the local community or ecosystem.[95]

Also, because many of the Principles require only that a borrower meet "the satisfaction of the EPFI," no well-articulated test exists to determine whether borrowers are in compliance.[96] Thus, EPFIs and non-governmental organizations ("NGOs")

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to police them—the International Criminal Court has no jurisdiction over corporations and there are practical problems in obtaining home country jurisdiction for entities with activities abroad. *Id.* at 49.

92. *See* Hardenbrook, *supra* note 6, at 207–10 (detailing various loopholes of the Principles); *see also* Watchman, *supra* note 80, at 390 (noting that a survey conducted in 2004 found that "[t]he Equator Principles can be easily circumvented and there is evidence which suggests that some sponsors and some banks discuss attempts to bypass the Equator Principles in certain circumstances").

93. *See* Hardenbrook, *supra* note 6, at 208 ("Segmentation, or piecemealing, occurs when a party separates a number of related actions into individual actions."); *see also* DANIEL R. MANDELKER, NEPA LAW AND LITIGATION § 9:11 (2010) (describing the segmentation problem).

94. *See* Hardenbrook, *supra* note 6, at 208 ("Generally, a private company will segment a project into phases or into individual but simultaneously implemented actions.").

95. *See id.* ("By piecemealing the project in this fashion, a party can misrepresent the overall environmental impact of the project. For example, a party that prepares individual [Assessments] masks the project's overall environmental impact and avoids considering the cumulative environmental impacts of the related actions."); *see also* MANDELKER, *supra* note 93, § 9:11 (describing the segmentation problem).

96. *See* Hansen, *supra* note 1, at 5 ("[E]ach EPFI retains the discretion to fashion policies and procedures tailored to their organization and the particular project under review."); *see also* Hardenbrook, *supra* note 6, at 210 (stating that the Principles fail to "articulate a clear standard"); Lawrence & Thomas, *supra* note 4, at 21 ("The Principles include several ambiguities concerning their scope and requirements.").

often disagree as to whether a project satisfies Principles standards.[97] In addition, prior to the newly implemented Governance Rules, the Principles did not address how to deal with EPFIs that adopt the Principles in name but fail to implement them in practice.[98] Thus, noncompliant EPFIs gained good publicity from their association with the Principles, while affected communities suffered from a lack of implementation.[99] The Governance Rules begin to resolve this issue with procedures for de-listing noncompliant EPFIs; the liberal criteria, however, have met criticism.[100]

Finally, because the current regime recognizes legal redress only by EPFIs, proper policing and enforcement by EPFIs remains a primary concern.[101] Monitoring of borrower compliance is performed by the EPFIs themselves, thus the level of oversight will depend on staff and resource allocation by each EPFI.[102] This leads to inconsistent levels of monitoring among EPFIs and a way for borrowers to avoid carrying out their

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97. *See* Hardenbrook, *supra* note 6, at 210 ("NGOs and EPFIs frequently disagree on whether the requirements of the Equator Principles have been met prior to funding."); PLATFORM, *supra* note 90 (noting deficiencies in compliance with the Principles in the Sakhalin project). *See generally* Vivian Lee, *Enforcing the Equator Principles: An NGO's Principled Effort to Stop the Financing of a Paper Pulp Mill in Uruguay*, 6 NW. U. J. INT'L HUM. RTS. 354 (2008) (discussing the disagreement between NGOs and EPFIs).

98. *See* Hardenbrook, *supra* note 6, at 210 (explaining that there is no recourse against a bank that adopts the Principles in name only); *see also* Urrutia, *supra* note 42, § 16.07 (explaining that the voluntary nature of the Principles means compliance by banks is also voluntary).

99. *See* Hardenbrook, *supra* note 6, at 210 (describing the inadequate treatment of noncompliant EPFIs); *see also* Watchman, *supra* note 80, at 394 ("[S]ome Equator banks do not take their commitments as seriously as others.").

100. *See* GOVERNANCE RULES, *supra* note 87, at 6 (describing the criteria for de-listing an EPFI); *New Rules for Equator Principles, but No New Commitments from Banks*, BANKTRACK, July 1, 2010, *available at* http://www.banktrack.org/show/news/new_rules_for_equator_principles_but_no_new_commitments_from_banks ("It is disappointing that the [Principles] Association has decided to choose 'meeting extremely limited reporting requirements' and 'dutifully paying the membership fee' as the only two criteria for such a decision.").

101. *See* WORLD WILDLIFE FUND, *supra* note 15, at 77–78 (discussing the need for a monitoring and compliance mechanism independent of EPFIs); *see also* Urrutia, *supra* note 42, § 16.07 ("There is no mechanism to confirm compliance with the Principles.").

102. *See* Urrutia, *supra* note 42, § 16.07 ("[I]mplementing the Principles requires having enough trained staff knowledgeable in social and environmental issues."); *see also* Hunter, *supra* note 3, at 460 (explaining the inconsistent application of Principles due to EPFI staffing problems).

promises.[103] As noted by Professor David B. Hunter, who has written extensively about climate-change law in the international context:

> Because of well-recognized internal incentives to lend money, [financial institution] project staff frequently view environmental and social concerns as impediments to their development role. The net result is somewhat frequent examples of [financial institution] project staff downplaying or ignoring significant environmental and social concerns during project preparation . . . .[104]

Furthermore, the former general counsel to the World Bank, Ibrahim Shihata, commented that, although covenants are included in loan documentation, the covenants do not guarantee actual compliance with social and environmental standards.[105] In addition, after completion of a project, once the full amount of a loan has been disbursed, the EPFI's ability to enforce compliance is limited.[106] While the EPFI could declare that the borrower has defaulted on its loan obligations, this is a severe path that IFIs most likely would not be inclined to follow.[107] Although the Principles create contractual obligations for both borrowers and EPFIs, in practice there are many ways to avoid compliance. Such noncompliance has serious implications for local communities.

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103. *See* Hardenbrook, *supra* note 6, at 227 ("[Q]uality and comprehensiveness of these systems vary greatly depending on the financial institution"); *see also* Hansen, *supra* note 1, at 10 ("[V]ast disparities in expertise threaten to hamper the Principles' credibility . . . .").

104. Hunter, *supra* note 3, at 460; *see* Lawrence & Thomas, *supra* note 4, at 25 ("[E]ven the arguably better-staffed IFIs occasionally find it difficult to effectively monitor and enforce environmental and social standards.").

105. Ibrahim Shihata, *The World Bank and the Environment: Legal Instruments for Achieving Environmental Objectives*, *in* THE WORLD BANK IN A CHANGING WORLD 207–08 (1995) ("Appropriate covenants in the legal documents do not of course ensure by themselves that the required action will be taken.").

106. *See* Hansen, *supra* note 1, at 16 (explaining that enforcement of loan covenants may be used to enforce compliance after loans are disbursed); *id.* at 15 (stating that EPFIs maintain control by withholding funds if social and environmental standards are not upheld).

107. *See* Shihata, *supra* note 105, at 208 (explaining that the exercise of EPFI remedies is "a serious path which has been avoided in practice"); *see also* HOFFMAN, *supra* note 2, at 335 (suggesting that banks typically will not stop funding a project once the initial loan is paid, despite a default).

B. *The Real Consequences of Lack of Accountability under the Principles*

While insufficient monitoring by harried EPFI staff may seem trivial, this lack of oversight has real-life consequences for project-affected communities. One recent example is the Theun-Hinboun Expansion Project in Laos, a dam and water diversion project funded by three EPFIs that began construction in 2008.[108] In addition to the detrimental environmental impacts, including riverbank erosion and destruction of local fisheries, the project will "displace 4,186 mostly indigenous people . . . and displace or negatively affect another 51,441 people living downstream, on project construction lands, and in resettlement host villages."[109] The borrower also failed to adhere to requirements under the Principles and under national law.[110] A May 2009 study found five separate violations of the Principles and three violations of the borrower's resettlement Action Plan.[111] The violations of the Principles included failure to create a monitoring mechanism for certain environmental impacts, failure to report on good-faith negotiations with project-affected communities, and failure to provide displaced persons with options for resettlement.[112]

The project also violated a Laotian law that requires, among other things, compensation for loss of assets and land for land compensation for displaced persons.[113] Because the project will displace primarily indigenous and farming villages, this

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108. *See* IKUKO MATSUMOTO, BANKTRACK ET AL., EXPANDING FAILURE: AN ASSESSMENT OF THE THEUN-HINBOUN HYDROPOWER EXPANSION PROJECT'S COMPLIANCE WITH EQUATOR PRINCIPLES AND LAO LAW 4 (2009)] (describing the Theun-Hinboun project). The three EPFIs involved in the project are ANZ Banking Group, BNP Paribas, and KBC. *Id.* The Expansion Project builds upon a previously existing water diversion project that commenced operations in 1998 and has already caused severe detrimental impacts on the environment and local communities. *Id.* at 7–8.

109. *Id.* at 4; *see* E. Souk, *Laos Struggles with Dam Dilemma*, NEWSMEKONG, Oct. 20, 2008, http://ipsnews.net/news.asp?idnews=44346 (reporting "greater frequency and intensity of project-induced flooding" and disappearance of fish).

110. MATSUMOTO, *supra* note 108, at 5 (outlining the violations of the Principles and Laotian law).

111. *Id.* at 5–6.

112. *Id.* at 6, 16 (describing the violations of the Principles).

113. *See id.* at 18 (explaining the violations of the *Decree on the Compensation and Resettlement of the Development Project in Lao PDR*); *see also* AVIVA IMHOF, INTERNATIONAL RIVERS, REVIEW OF DRAFT FINAL RESETTLEMENT ACTION PLAN FOR THEUN-HINBOUN EXPANSION PROJECT, LAO PDR 1 (2008) (discussing inadequate resettlement provisions, such as "no commitment to provide land-for-land" compensation).

compensation is crucial to ensuring that the project-affected communities maintain their livelihoods.[114] The borrower deemed the "resettlement" of local villagers to be "relocation," which one NGO understood as a way for the borrower to avoid its obligations under the Principles and national law.[115] Despite these shortcomings, the April 2009 edition of *Project Finance* magazine named the project "Asia-Pacific Multi-source Deal of the Year 2008," indicating not only that the project has been financed successfully, but also that failure to comply with the Principles is not an affront to Industry standards.[116]

Environmental organizations challenged another EPFI, Spain's Banco Santander, for its financing of hydroelectric dams currently in construction on the Madeira River in Brazil, a major tributary to the Amazon River.[117] The project company failed to obtain the free, prior, and informed consent of the indigenous communities in project-affected areas.[118] The environmental repercussions of the project included the killing of more than eleven tons of fish, deforestation, and disease epidemics.[119]

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114. *See* MATSUMOTO, *supra* note 108, at 18–19 (noting the words of one village headman: "[W]e depend on natural resources in the village and there are many resources here. In our village, we are self-sufficient."); *see also* IMHOF, *supra* note 113, at 4–7 (describing the insufficient provision of replacement livelihood options).

115. MATSUMOTO, *supra* note 108, at 13–14; *see also* IMHOF, *supra* note 113, at 10 (discussing the project's classification of the displacement of persons as "relocation" rather than "resettlement").

116. *See generally Theun Hinboun: Hydro against the Current*, PROJECT FINANCE, Apr. 9, 2009, *available at* 2009 WLNR 26671893.

117. *See* Press Release, Amazon Watch, Spain's Banco Santander Criticized for Hypocrisy Funding Destructive Dam in the Amazon while Adopting Green Principles (May 14, 2009), *available at* http://www.amazonwatch.org/newsroom/view_news.php?id=1797 (describing the controversial dam project and the EPFI's failure to comply with the Principles); *see also Deals & Developments: Furnas and Odebrecht Win Rio Madeira Hydro*, PROJECT FINANCE, Dec. 1, 2007, *available at* 2007 WLNR 28152746 (noting that opponents to the project estimate the number of people to be displaced at 10,000).

118. *See* Spain's Banco Santander Criticized, *supra* note 117 ("[T]he lack of the free, prior, and informed consent of the impacted indigenous communities breaches Convention 169 of the International Labor Organization, which was ratified by Brazil, as well as the United Nations Declaration on the Rights of Indigenous Peoples."); *see also Amazon Indians Condemn Destructive Madeira River Dams*, SURVIVAL INT'L, Sept. 24, 2010, *available at* http://www.survivalinternational.org/news/6518 [hereinafter *Amazon Indians Condemn Dam*] (stating that the affected indigenous communities were not adequately consulted and did not grant their consent).

119. *See* Spain's Banco Santander Criticized, *supra* note 117 ("[D]am construction has already caused an environmental disaster, including the killing of over 11 tons of fish, which has led to fines of over . . . US$4.26 million."); *see also Amazon Indians*

Among the social changes caused by the construction are higher rates of immigration, prostitution, and violence in the area,[120] most likely caused by the influx of money and workers from outside the local community.[121]

Another controversial project is the development of the Kashagan oil field in Kazakhstan, funded by BNP Paribas, an EPFI. By the bank's own report, the project will result in the emission of toxic "sour gas," such that the "significant climate consequences . . . undermines the positive outcomes of any financing in the renewable energy sector."[122] Although the project began in 2002, in October 2008 the environmental and social impact Assessment had not yet been published nor made

Condemn Dam, *supra* note 118 (stating that the Madeira river construction brings "deforestation, the death of fish, dengue epidemics").

120. *See* Spain's Banco Santander Criticized, *supra* note 117 (noting that there are "drastic environmental and social threats the projects pose to the region's complex and fragile ecosystems as well as to the indigenous and traditional communities that rely on the waterway for their survival"); *see also Amazon Indians Condemn Dam*, *supra* note 118 (stating that the Madeira river construction brings "large-scale immigration to the area . . . and increased rates of prostitution and violence").

121. *See, e.g.*, Tarek F. Maassarani et al., *Extracting Corporate Responsibility: Towards a Human Rights Impact Assessment*, 40 CORNELL INT'L L.J. 135, 140 (2007) (describing the effects on a local community due to "sudden, drastic changes in the local economy—commonly referred to as boomtown effects or 'Dutch Disease'—as the project gets underway. The costs of domestic goods and services rise sharply, HIV/AIDS follows on the tails of flourishing drug markets and prostitution, and labor is drawn away from traditional public and private sectors such as education and subsistence agriculture"); Naomi Cahn, *Corporate Governance Divergence and Sub-Saharan Africa: Lessons From Out Here in the Fields*, 33 STETSON L. REV. 893, 911–12 (2004) (stating that the Chad-Cameroon Pipeline Project resulted in "outside workers [causing] an increase in local prostitution, HIV/AIDS, and substance abuse").

122. *Banks Set to Finance Disastrous Kashagan Oil Project*, CEE BANKWATCH NETWORK, Oct. 8, 2008, *available at* http://bankwatch.ecn.cz/project.shtml?apc=147580–g–1&x=2131442&d=r; *see Work on Kashagan May Be Halted According to the Minister of Environmental Protection*, KAZAKHSTAN TODAY, Aug. 21, 2007, *available at* http://www.crudeaccountability.org/en/index.php?mact=News,cntnt01,detail,0&cntnt01articleid=3&cntnt01detailtemplate=press&cntnt01returnid=71 [hereinafter KAZAKHSTAN TODAY] ("[A]mong the fundamental violations are the following: . . . placing an excess of industrial and consumption wastes into the environment over the course of a number of years; . . . unsanctioned flaring of waste in the sea; . . . no detailed report on the harmful impact of oil operations on the Caspian Sea's fish reserves, as should have been prepared as a condition of the contract; and . . . consistent violations . . . of the Republic of Kazakhstan's environmental protection legislation." (citing a public statement by the Ministry of Environmental Protection of Kazakhstan)).

available to project-affected communities, in violation of the Principles.[123]

Projects like the Theun-Hinboun Expansion Project, the Madeira River dams, and the Kashagan oil fields led a consortium of NGOs to challenge EPFIs for espousing the Principles while simultaneously lending to some of the world's most environmentally and socially destructive projects.[124] As a result, EPFIs and NGOs convened in Zurich in February 2010 to discuss methods for improving compliance with the Principles. A summary published by one NGO in attendance noted, "The meeting, while conducted in good spirit, did not result in any of the concrete proposals . . . being accepted by banks as a way forward with the Equator Principles."[125]

C. *Third-Party-Beneficiary Status under US Contract Law*

The third-party-beneficiary rule provides for a right to promised performance enforceable by a non-signatory to a contract.[126] The basic requirement for third-party-beneficiary status is establishing the intent of the contracting parties to benefit a non-signatory, such that the non-signatory is classified as an intended beneficiary of the contract.[127]

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123. *See* CEE BANKWATCH NETWORK, *supra* note 122 (stating in 2008 that the Assessment had not yet been disclosed despite the project having been in development since 2002).

124. *See* Mathiason, *supra* note 7 (describing the criticisms of EPFIs made by NGOs).

125. BANKTRACK, GOING 'ROUND IN CIRCLES: AN OVERVIEW OF THE BANKTRACK-EPFI ENGAGEMENT ON THE EQUATOR PRINCIPLES 2003–2010 8 (2010).

126. *See* RESTATEMENT (SECOND) OF CONTRACTS § 304 (2009) [hereinafter RESTATEMENT (SECOND)] (discussing the creation of a duty to a beneficiary); *see also* Anthony Jon Waters, *The Property in the Promise: A Study of the Third Party Beneficiary Rule*, 98 HARV. L. REV. 1109, 1111 (1985) (explaining that *Fox* "defied the prevailing rules of contractual liability by holding that a third party . . . could . . . enforce [a contract]"). As much as the third-party-beneficiary rule may challenge the textualist theory of contract interpretation, it aligns with the intentionalist view that dominates the Restatement (Second) of Contracts ("Second Restatement"), which deems the written language of a contract to be evidence of the parties' intent, but is not determinative. *See* Sital Kalantry, *The Intent-to-Benefit: Individually Enforceable Rights under International Treaties*, 44 STAN. J. INT'L L. 63, 78–79 (2008) (stating that the intentionalist theory adopted by the Second Restatement treats the written language of a contract as "probative, but not conclusive").

127. RESTATEMENT (SECOND), *supra* note 126, § 302.

1. Intent to Benefit a Third Party

The seminal third-party-beneficiary case in the United States, *Lawrence v. Fox*, provides a basic illustration of the common-law right. The case arose when Holly, who owed US$300 to Lawrence, lent US$300 to Fox in exchange for Fox's promise to return the money to Lawrence the following day. When Fox (promisor) failed to do so, Lawrence (third-party beneficiary), and not Holly (promisee), sued Fox for the money and prevailed. The New York Court of Appeals memorialized the third-party-beneficiary rule as a "principle of law" requiring that "[when] a promise [is] made to one for the benefit of another, he for whose benefit it is made may bring an action for its breach."[128] Courts have since elaborated on the *Fox* rule, leading to both the qualification and expansion of its use to contexts beyond the lender-debtor scenario.[129]

The Restatement (Second) of Contracts ("Second Restatement")[130] codifies the third-party-beneficiary rule as "[a] promise in a contract [that] creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty."[131] Thus, it is essential that the parties intend for their contract to benefit a third party.[132] More importantly, the intention concerns whether a beneficiary has a right to performance of the promise, not whether the parties intend for the beneficiary to be able to enforce the promise.[133] The Second Restatement also notes that to determine the intent

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128. Lawrence v. Fox, 20 N.Y. 268, 275 (1859) (finding third-party-beneficiary status in a non-signatory to the contract).

129. *See* Kalantry, *supra* note 126, at 76 ("The Second Restatement broadened the scope of third parties that have enforceable rights."). *See generally* Waters, *supra* note 126 (discussing the expansive use of the third-party-beneficiary rule).

130. The *Fox* rule is codified in both the Restatement (First) of Contracts ("First Restatement") and the Second Restatement. The First and Second Restatements differ in many ways, which Waters attributes to the influence of Williston in the First Restatement and Corbin in the Second. *See* Kalantry, *supra* note 126, at 78–80 (discussing differences in the First and Second Restatements); Waters, *supra* note 126, at 1111 (discussing the Williston-Corbin discrepancy in the First and Second Restatements). The most striking differences are in the classification of parties and the method of contract interpretation. *See* Kalantry, *supra* note 126, at 78–80 (discussing major differences between the First and Second Restatements).

131. RESTATEMENT (SECOND), *supra* note 126, § 304.

132. *See id.* (discussing the creation of third-party-beneficiary status).

133. *See id.* § 302 (noting that an intended beneficiary "acquires a right by virtue of a promise").

of the parties, courts should consider not only the language of the contract, but also the circumstances of the transaction.[134]

2. Classifications of Beneficiaries

The Second Restatement further clarifies the *Fox* rule with a test for intended and incidental beneficiaries, where the rights to be afforded are defined by the type of beneficiary.[135] Unless otherwise agreed by the parties to the contract, a third party is an intended beneficiary of a contract if two conditions are satisfied.[136] First, acknowledging the third party's right to performance properly carries out the intent of the contracting parties.[137] Second, either performance of a promise releases the promisee from a debt or the circumstances demonstrate that "the promisee intends to give the beneficiary the benefit of the promised performance."[138] Finally, any third party that is not an

134. *See id.* § 302, Reporter's Note, cmt. a ("A court in determining the parties' intention should consider the circumstances surrounding the transaction as well as the actual language of the contract.").

135. *See id.* § 302 ("(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance. (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.").

136. *See id.* (discussing the requirements for intended beneficiary status).

137. *See id.* ("[A] beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties.").

138. *See id.* ("[E]ither (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance."). Subsections (1)(a) and (b) describe classifications that appeared in the First Restatement as either a creditor or a donee beneficiary. *See id.* cmts. b, c. Both creditor and donee beneficiaries are third-party beneficiaries to a contract and therefore have a right to the promised performance. *See id.* A creditor beneficiary is in the position of Lawrence in *Fox*—the promisor's debt to the promisee is satisfied through fulfillment of a promise which, rather than benefiting the promisee, benefits a third party. *See id.* A donee beneficiary receives the fulfillment of a promise without having provided any consideration—otherwise known as a "gift promise." *See id.* cmt. c. In the gift promise context, the beneficiary does not pay for the performance and has no obligation that must be discharged. *See id.* ("[T]he promised performance is not paid for by the recipient, discharges no right that he has against anyone, and is apparently designed to benefit him . . . ."). While these distinctions still are evident in court opinions and in the Second Restatement, the terminology is no longer used. *See id.* Reporter's Note.

intended beneficiary is classified as an incidental beneficiary, which has no third-party-beneficiary rights under a contract.[139]

In sum, the right of a non-signatory to enforce a contract is determined by whether the non-signatory is an intended or an incidental beneficiary.[140] Whereas an intended beneficiary has a right to enforce a promise in a contract, an incidental beneficiary has no such right.[141] The Second Restatement provides the following illustration of intended beneficiaries:

> A, the operator of a chicken processing and fertilizer plant, contracts with B, a municipality, to use B's sewage system. With the purpose of preventing harm to landowners downstream from its system, B obtains from A a promise to remove specified types of waste from its deposits into the system. C, a downstream landowner, is an intended beneficiary . . . .[142]

In this example, the two parties to the contract have some overall purpose that is mutually beneficial to both.[143] There is, however, an additional interest in a third party and a clear intent to benefit that party through performance of the contract.[144] This is not the case with respect to incidental beneficiaries, who obtain a secondary benefit from the parties' performance:

> B contracts with A to erect an expensive building on A's land. C's adjoining land would be enhanced in value by the

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139. *See id.* ("An incidental beneficiary is a beneficiary who is not an intended beneficiary.").

140. *See id.*

141. *See id.* cmt. a ("This Section distinguishes an 'intended' beneficiary, who acquires a right by virtue of a promise, from an 'incidental' beneficiary, who does not."); *see also* Alicea v. City of New York, 145 A.D.2d 315, 317 (1988) ("The law is settled that an intended beneficiary may maintain an action to enforce an agreement to which it is not actually a party, but an incidental beneficiary may not." (citations omitted)).

142. RESTATEMENT (SECOND), *supra* note 126, § 302. According to the Second Restatement, Illustration 10 is based on *Ratzlaff v. Franz Foods*, 468 S.W.2d 239 (Ark. 1971). *Id.* § 302, cmt. d, illus. 10.

143. *See* RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. d, illus. 10.

144. *See* Calamari v. Grace, 469 N.Y.S.2d 942, 945 (1983) ("It is a generally accepted tenet of New York law that a duty directly assumed for the benefit of a particular person or entity does not extend to third parties who were not intended beneficiaries of the subject undertaking."); Pac. Carlton Dev. Corp. v. 752 Pac., LLC, 2007 WL 2781874 at *5 (N.Y. Sup. Ct. 2007) ("[A] person who is not a party to an agreement is without standing to enforce it, unless the parties to the agreement intended to confer third-party beneficiary status upon them." (citations omitted)).

performance of the contract. C is an incidental beneficiary.[145]

In this example, the benefit to the third party is tangential to the performance of the contract.[146] While courts have debated the application of the intended/incidental distinction,[147] intended beneficiary status requires that the contracting parties intend to confer a benefit that is more than merely coincidental to the performance of their contract.[148]

3. Implications of "Other Intended Beneficiaries"

The Second Restatement describes a third situation that would include a class of "other intended beneficiaries."[149] A third party is an intended beneficiary based on a reliance argument, i.e., where the third party would be reasonable to rely on a promise that demonstrates the parties' intent to grant him a right to performance.[150] Reliance is reasonable where, for example, a promisor promises to carry out a duty of the promise and that duty is for the third party's benefit.[151] Reasonable reliance may

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145. RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. e.

146. *See, e.g.*, 4th Ocean Putnam Corp. v. Interstate Wrecking Co., 66 N.Y.2d 38, 45 (1985) (explaining that a property owner was only an incidental beneficiary where the demolition work on the property was performed not to benefit the owner but to protect the public); Bd. of Managers of Arches at Cobble Hill Condo. v. Hicks & Warren, LLC, 2007 WL 556897, at *2 (N.Y. Sup. Ct. 2007) ("[T]he ordinary construction contract—i.e., one which does not expressly state that the intention of the contracting parties is to benefit a third party—does not give third parties who contract with the promisee the right to enforce the latter's contract with another.... Such third parties are generally considered mere incidental beneficiaries." (citations omitted)).

147. *See 4th Ocean Putnam Corp.*, 66 N.Y.2d at 43 ("The intent to benefit test has, however, been difficult to apply... and a 'prolific source of judicial and academic discussion'" (citations omitted)); Port Chester Elec. Constr. Co. v. Atlas, 40 N.Y.2d 652, 653, 656 (1976) (disagreeing with the lower courts' theories and noting "the interpretational difficulties prevalent in third-party beneficiary contracts").

148. *See, e.g.*, Airco Alloys Div. v. Niagara Mohawk Power Corp., 430 N.Y.S.2d 179, 185–86 (4th Dep't 1980) ("An incidental beneficiary is a third party who may derive [a] benefit from the performance of a contract though he is neither the promisee nor the one to whom performance is to be rendered." (citing 2 WILLISTON, CONTRACTS § 402 (3d ed.)); *4th Ocean Putnam Corp.*, 66 N.Y.2d at 45 (explaining that a property owner is only an incidental beneficiary where the demolition work on property was performed not to benefit the owner but to protect the public).

149. RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. d.

150. *See id.* ("[I]f the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary.").

151. *See id.* ("[A] promise to pay the promisee's debt... or a gift promise involves a manifestation of intention by the promisee and promisor sufficient, in a contractual

also be found in factors outside of the parties' manifest intent.[152] For example, if "an overriding policy" demands it, a court may find third-party-beneficiary status regardless of the intention of the signatories.[153] Thus, a court may look beyond the contract to find a third-party-beneficiary right for policy reasons or due to the third party's reasonable reliance on the contract.[154]

4. Further Rules Pertaining to Intended Beneficiaries

The Second Restatement notes other considerations with respect to intended beneficiaries. First, an intended beneficiary need not be mentioned by name;[155] it is sufficient that the beneficiary is part of an identifiable class of people.[156] Second, communication with the beneficiary is not required to create third-party-beneficiary status.[157] Third, the promised performance need not be provided directly to the beneficiary.[158] For example, in the promise to pay a debt on behalf of a debtor, the promise benefits the third party debtor in that it is rendered

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setting, to make reliance by the beneficiary both reasonable and probable. Other cases may be quite similar in this respect. Examples are a promise to perform a supposed or asserted duty of the promisee . . . .").

152. *See id.* ("Where there is doubt whether such reliance would be reasonable, considerations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question . . . .").

153. *See id.* ("In some cases an overriding policy, which may be embodied in a statute, requires recognition of such a right without regard to the intention of the parties.").

154. *See id.* (discussing the ability to find third-party-beneficiary status due to policy reasons or reasonable reliance); Montana v. United States, 124 F.3d 1269, 1273 (Fed. Cir. 1997) ("One way to ascertain such intent is to ask whether the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him." (citing RESTATEMENT (SECOND), *supra* note 126, § 302(1)(b), cmt. d)).

155. RESTATEMENT (SECOND), *supra* note 126, § 308 ("It is not essential to the creation of a right in an intended beneficiary that he be identified when a contract containing the promise is made.").

156. County of Santa Clara v. Astra USA, Inc., 588 F.3d 1237, 1244 (9th Cir. 2010); *Montana*, 124 F.3d at 1273 ("The intended beneficiary need not be specifically or individually identified in the contract, but must fall within a class clearly intended to be benefited thereby."); *see also* MODERN LAW OF CONTRACTS § 20:15 (2010) (noting that courts recognize third-party-beneficiary status where a contract "was entered into to secure an advantage for . . . a distinct class of people other than simply to protect the public from harm").

157. RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. c (stating that no contact or communication with the beneficiary is necessary).

158. *See id.* § 302, cmts. a, c (stating that the beneficiary need not be "the person to whom performance is to be rendered, the person who will receive the economic benefit, or the person who furnished the consideration").

debt-free, but the actual benefit of payment goes to the third party's creditor.[159] Finally, for a third party to enforce contractual rights, there must be a valid contract between the two signatories.[160]

D. *Variations on the Third-Party-Beneficiary Rule*

The elements of a third-party-beneficiary claim are fundamentally similar in all US jurisdictions, though courts and states differ in important ways.[161] New York courts apply a three-pronged test for third-party-beneficiary status, in which a nonparty must show:

> (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for his benefit, and (3) that the benefit to him is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties to compensate him if the benefit is lost.[162]

In addition, the crucial question of intent in the second prong will be determined by the existence of one of two factors: "(1) no one other than the third party can recover if the promisor breaches the contract or (2) the language of the contract otherwise evidences an intent to permit enforcement by third parties."[163] Some New York courts look to the surrounding

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159. *See id.* § 302, cmt. c ("The contract need not provide that performance is to be rendered directly to the beneficiary: a gift may be made to the beneficiary, for example, by payment of his debt.").

160. *See id.* § 304, cmt. b ("The requirements for formation of a contract must of course be met. . . ."); *see, e.g.*, Burns Jackson Miller Summit & Spitzer v. Lindner, 59 N.Y.2d 314, 336 (1983) (explaining that a party may recover "only by establishing . . . the existence of a valid and binding contract between other parties").

161. Waters, *supra* note 126, at 1111 ("In the United States, since the New York Court of Appeals decided *Lawrence v. Fox* in 1859, it has become generally accepted that a third party (one not party to the contract) may enforce a contractual obligation made for his or her benefit." (citations omitted)).

162. Chen v. St. Beat Sportswear, Inc., 226 F. Supp. 2d 355, 355 (E.D.N.Y. 2002) (citing Cabrera v. DeGuerin, 1999 WL 438473, at *4 (E.D.N.Y. May 18, 1999)); *see also* State of Cal. Pub. Employees' Ret. Sys. v. Shearman & Sterling, 95 N.Y.2d 427, 435–36 (2000) (stating the three-pronged test).

163. MBL Contracting Corp. v. King World Prods., Inc., 98 F. Supp. 2d 492, 496 (S.D.N.Y. 2000) (citing Piccoli A/S v. Calvin Klein Jeanswear Co., 19 F. Supp. 2d 157, 162 (S.D.N.Y. 1998)); *see* Premium Mortg. Corp. v. Equifax, Inc., 583 F.3d 103, 108 (2009) ("A non-party to a contract . . . lacks standing to enforce the agreement in the absence of terms that 'clearly evidence . . . an intent to permit enforcement by the third

circumstances to determine intent.[164] In contrast, the most-cited California case on this issue states that intent is sufficiently present if the promisor has understood the promisee's intent to benefit a third party.[165]

With respect to the classification of intended or incidental beneficiaries, one New York court stated that absent intent to benefit a third party, the third party is an incidental beneficiary with no right to enforce the contract.[166] Another court applying New York law, however, stated that, where performance of the contract is made directly to the third party, that party is an intended beneficiary.[167] Finally, the Ninth Circuit asserted that a third-party beneficiary's right to sue need not be stated expressly in the contract.[168] Rather, the right to enforce a promise inheres in one's status as an intended beneficiary—there is no requirement for an additional provision to grant the right to

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party.'" (quoting 4th Ocean Putnam Corp. v. Interstate Wrecking Co., 66 N.Y.2d 38, 45 (1985))).

164. *See, e.g.*, Westport Marina, Inc. v. Boulay, 2010 WL 1223238 at *5 (E.D.N.Y. Mar. 24, 2010) (examining the "timing, language, and financial obligations" of the parties (citing Septembertide Pub., B.V. v. Stein and Day, Inc., 884 F.2d 675, 679 (2d Cir. 1989))); Trans-Orient Marine Corp. v. Star Trading & Marine, Inc., 925 F.2d 566, 573 (2d Cir. 1991) (stating that the court may look to surrounding circumstances).

165. Lucas v. Hamm, 56 Cal. 2d 583, 591 (1961) ("Insofar as intent to benefit a third person is important in determining his right to bring an action under a contract, it is sufficient that the promisor must have understood that the promisee had such intent. No specific manifestation by the promisor of an intent to benefit the third person is required."). Other jurisdictions have different ways to determine whether the intent to benefit exists. *See, e.g.*, Union Pac. R.R. Co. v. Novus Int'l, Inc., 113 S.W.3d 418, 422 (Tex. App. 2003) (illustrating that Texas courts state that the intent to benefit "must be clearly and fully spelled out in the four corners of the contract; otherwise, enforcement of the contract by a third party must be denied"); CF Indus., Inc. v. Transcon. Gas Pipe Line Corp., 448 F. Supp. 475, 480 (W.D.N.C. 1978) (explaining that the determination of a third-party-beneficiary relationship must be found by looking "not only to the contract terms but more generally to surrounding facts").

166. Port Chester Elec. Constr. Co. v. Atlas, 40 N.Y.2d 652, 653, 656 (1976) ("[A contract] which does not expressly state that the intention of the contracting parties is to benefit a third party . . . does not give third parties who contract with the promisee the right to enforce the latter's contract with another. Such third parties are generally considered mere incidental beneficiaries.").

167. Cauble v. Mabon Nugent & Co., 594 F. Supp. 985, 991 (S.D.N.Y. 1984) ("Where performance is to be rendered directly to a third party under the terms of an agreement, that party must be considered an intended beneficiary.").

168. County of Santa Clara v. Astra USA, Inc., 588 F.3d 1237, 1244 (9th Cir. 2010) ("[W]e reject the suggestion that the availability of a third party contract claim is conditioned on the contract's inclusion of a provision expressly granting the third party the right to sue. Any intended beneficiary has the right to enforce the obligor's duty of performance; the right to sue inheres in one's status as an intended beneficiary.").

sue.[169] Decisions by courts have not been uniform. The unsettled nature of these rules may work in favor of a plaintiff seeking redress under a third-party-beneficiary theory, particularly where an overriding public policy exists.[170]

E. *Notable Third Party Beneficiary Cases*

Despite its various interpretations, courts have narrowly applied the third-party-beneficiary rule. The following three cases provide examples of courts' reasoning with respect to the third-party-beneficiary rule. The New York case, *Chen v. Street Beat Sportswear, Inc.*, is an example of plaintiffs who successfully proved third-party-beneficiary status. *Jane Doe v. Wal-Mart Stores, Inc.* illustrates how the third-party-beneficiary rule has been used by non-US plaintiffs. Finally, *Prouty v. Gores Technology Group* demonstrates how plaintiffs may overcome barriers to the third-party-beneficiary claim.

1. *Chen v. Street Beat Sportswear, Inc.*

Chen v. Street Beat Sportswear, Inc. provides a useful illustration of the third-party-beneficiary rule. *Chen* involved a suit against a domestic clothing manufacturer, Street Beat Sportswear, Inc., by its workers who alleged that they were third–party-beneficiaries of a contract between the defendant and the Department of Labor ("DOL").[171] Through this contract, the defendant had entered into an Augmented Compliance Program Agreement ("ACPA"), which required the defendant to review, monitor, and report on its contractors' compliance with the Fair Labor Standards Act.[172]

Applying the three-pronged test under New York law, the court agreed with the plaintiffs' contract claim.[173] The court reasoned that the parties' intent to benefit the plaintiffs was clear from the ACPA because every provision to evaluate and monitor factories was for the sole purpose of protecting the factory

169. *See id.* at 1245 (discussing the right to sue).

170. *See* RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. d (stating that an overriding policy may allow a finding of third-party-beneficiary status).

171. Chen v. St. Beat Sportswear, Inc., 226 F. Supp. 2d 355, 355 (E.D.N.Y. 2002).

172. *Id.* at 358.

173. *Id.* at 365–66.

workers.[174] Thus, the court rejected the argument that the ACPA was only evidence of intent to benefit the contractors, rather than the workers.[175] In addition, the court disagreed with the argument that the plaintiffs were merely incidental beneficiaries, noting that intent may be established either by demonstrating that only the third party would recover or by the express language of the contract.[176] Although the language of the ACPA provided for a recovery only by the DOL, the court rejected the assertion that the parties never intended to permit enforcement by outside parties.[177] Though the ACPA was silent on the issue of enforcement by third parties, the intent to benefit the plaintiffs could be interpreted from the contract as a whole.[178] The court also found that the third requirement of a "sufficiently immediate" benefit had been satisfied.[179] Because the ACPA required the defendant to evaluate and report on violations and to compensate workers within a specified period, the court found the scheme to be sufficiently immediate.[180]

Ultimately, the court held that the plaintiffs were the intended beneficiaries of the ACPA, the parties had specific intent to benefit the plaintiffs and, as a result, the plaintiffs had standing to sue for breach of the contract.[181]

2. *Jane Doe v. Wal-Mart Stores, Inc.*

In *Wal-Mart Stores*, the company's published code of conduct and alleged failure to comply with the code led non-US plaintiffs to file an action against Wal-Mart in California.[182] The plaintiffs

174. *Id.* at 363.

175. *Id.* at 364. The court focused on a phrase in the Augmented Compliance Program Agreement ("ACPA") that explicitly required the defendant to pay wages to the employees of contractors who violated the Fair Labor Standards Act. *Id.* The court found that this was a sufficient basis to recognize "a right to performance in the beneficiary." *Id.* (quoting RESTATEMENT (SECOND), *supra* note 126, § 302(1)).

176. *Id.* at 362 n.7. By the language of the ACPA, the court found it obvious that the purpose of the ACPA was to ensure that workers were paid appropriately. *Id.* at 363.

177. *Id.* at 365.

178. *Id.* (citing Owens v. Haas, 601 F.2d 1242, 1250 (2d Cir. 1979)).

179. *Id.* (stating that the third element inquires into "whether the benefit to the factory workers would be sufficiently immediate to indicate the assumption by the contracting parties of an obligation to compensate them if the benefit is lost").

180. *Id.* at 365–66.

181. *Id.* at 366.

182. *See generally* Jane Doe v. Wal-Mart Stores, Inc., 572 F.3d 677 (9th Cir. 2009). For commentary, see Debra Cohen Maryanov, *Sweatshop Liability: Corporate Codes of*

were employees at factories in Bangladesh, China, Indonesia, Nicaragua, and Swaziland that supplied products directly to Wal-Mart.[183] Wal-Mart's code of conduct, which was expressly part of the contract between Wal-Mart and its supplier factories, required that all suppliers comply with local labor laws and allow Wal-Mart to audit the factories to ensure compliance with the code.[184] The plaintiffs argued that because the code was for the benefit of the workers, Wal-Mart's contract with their employer provided them with third-party-beneficiary status and standing to sue Wal-Mart for failing to enforce the standards.[185]

Both the United States District Court for the Central District of California and the Ninth Circuit Court of Appeals disagreed with the third-party-beneficiary claim for two reasons.[186] First, Wal-Mart's reservation of rights to inspect the suppliers' factories did not amount to a promise by Wal-Mart to uphold its code of conduct.[187] Second, the court noted that a promise creates a duty of performance in the promisor, not the promisee.[188] Because the Wal-Mart contracts required a promise by the supplier to comply with local labor laws, Wal-Mart was in fact not the promisor—rather, the suppliers were the promisors.[189] Thus, the plaintiffs sought performance from the incorrect party to the contract.[190] Because the plaintiffs did not allege sufficient facts to show third-party-beneficiary status, the court dismissed the plaintiffs' contract claim.[191]

3. *Prouty v. Gores Technology Group*

In *Prouty*, the California Court of Appeals recognized a third-party-beneficiary right in plaintiffs who had been denied severance benefits, despite the existence of a "no third party

Conduct and the Governance of Labor Standards in the International Supply Chain, 14 LEWIS & CLARK L. REV. 397, 431–36 (2010).

183. *Wal-Mart Stores*, 572 F.3d at 680.

184. *Id.*

185. *Id.* at 681.

186. *Id.* at 681–82.

187. *Id.*

188. *Id.* at 682.

189. *Id.* (noting that Wal-Mart was the promisee).

190. *See* RESTATEMENT (SECOND), *supra* note 126, § 304 ("A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise . . . .").

191. *Wal-Mart Stores*, 572 F.3d at 682.

beneficiaries" clause (also known as a negation clause) in the underlying contracts.[192] Gores Technology Group ("GTG") agreed to purchase all of the capital stock of VeriFone, Inc. from Hewlett Packard ("HP").[193] The stock purchase agreement included a clause in which GTG agreed to offer benefits to VeriFone employees, with the exception of severance benefits.[194] HP introduced an amendment in section 6 that specifically provided for severance benefits, which GTG signed.[195] Although the agreement included a "no third party beneficiaries" clause in section 10.5,[196] the amendment indemnified HP against liabilities "recovered by a third party."[197] Within one week of the closing, GTG breached the section 6 amendment by terminating VeriFone employees without providing severance packages.[198] The employees brought suit against GTG, asserting their rights as third-party beneficiaries under section 6 of the agreement.[199]

To determine whether the plaintiffs had standing to sue as third-party beneficiaries, the court interpreted the language of the contract as a whole as well as the circumstances of the transaction.[200] The court found that the amendment in section 6 was "a classic third party provision," with the sole purpose of benefiting the employees.[201] The court rejected the argument that GTG had no intent to benefit the plaintiffs through the inclusion of section 6 because GTG itself gained nothing from the clause.[202] The court found that the language of the contract and the negotiations were sufficient to show that the parties expressly intended the employees to be third-party beneficiaries.[203]

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192. Prouty v. Gores Tech. Grp., 121 Cal. App. 4th 1225, 1225 (2004).
193. *Id.* at 1227.
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 1228.
198. *Id.* at 1229.
199. *Id.* at 1232.
200. *Id.* at 1233 (interpreting "the contract as a whole . . . in light of the uncontradicted evidence of the circumstances and negotiations of the parties in making the contract").
201. *Id.*
202. *Id.* ("It is difficult for GTG to argue section 6 did not intend to benefit plaintiffs when GTG gained nothing from agreeing to its terms.").
203. *Id.* at 1234.

The court rejected the defendants' argument that the negation clause in section 10.5 was controlling.[204] The court reasoned that if the parties had not intended to benefit the plaintiffs, they would not have agreed to the amendment.[205] In addition, the court found that sections 6 and 10.5 were in direct contradiction—one expressly denying rights to third parties, the other expressly granting them.[206] Under the rules of contract interpretation, "when a general and a particular provision are inconsistent, the particular and specific provision is paramount to the general provision."[207] Thus, the court found that section 6 was an exception to section 10.5, enabling the plaintiffs to enforce it.[208] The court cited the Second Restatement: "In choosing among the reasonable meanings of a promise or agreement or a term thereof, a meaning that serves the public interest is generally preferred."[209]

F. *Barriers for Plaintiffs Asserting a Third-Party-Beneficiary Claim in US Courts*

Several roadblocks, both legal and practical, exist for plaintiffs pursuing claims under the third-party-beneficiary theory.

1. Express Negation Clauses

In New York, an express clause negating the creation of a third-party-beneficiary right is controlling.[210] The US Court of Appeals for the Fifth Circuit, however, recently determined in *Halliburton Company Benefits Committee v. Graves* that a negation clause in a merger agreement did not preclude enforcement of a

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204. *Id.* at 1236. Defendants raised the argument that under *East Bay Municipal Utility District v. Richmond Redevelopment Agency*, 93 Cal. App. 3d 346 (1979), the negation clause should control. *Prouty*, 121 Cal. App. 4th at 1236. The court distinguished *East Bay* on the ground that the contracts in that case did not contain a provision similar to Section 6. *Id.* (citing *E. Bay Mun.*, 93 Cal. App. 3d at 357).

205. *Id.* at 1234.

206. *Id.* at 1235.

207. *Id.* (citations omitted).

208. *Id.*

209. *Id.* (quoting RESTATEMENT (SECOND), *supra* note 126, § 207).

210. *See, e.g.*, Morse/Diesel, Inc. v. Trinity Indus. Inc., 859 F.2d 242, 249 (2d Cir. 1988) ("[W]here a provision in a contract expressly negates enforcement by third-parties, that provision is controlling."); Nepco Forged Prods., Inc. v. Consol. Edison Co. of N.Y., Inc., 470 N.Y.S.2d 680, 681 (N.Y. App. Div. 1984) (stating same).

contract by a third-party beneficiary.[211] In addition, not every contract will contain such a clause.

The rules of contract interpretation may also provide assistance to plaintiffs fighting a negation clause. First, there is a presumption in favor of negotiated terms, rather than standard or boilerplate terms.[212] Second, a contract will be interpreted such that none of its terms are superfluous.[213] These rules may provide some leeway for plaintiffs to circumvent a negation clause.

2. Jurisdictional Issues for International Plaintiffs

International plaintiffs bringing suit in US court for wrongs committed abroad often encounter jurisdictional issues.[214] Defendants would surely raise jurisdictional defenses such as forum non conveniens, and other issues, such as concerns about international comity, which have been well documented elsewhere.[215] On the other hand, most contracts contain choice-

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211. Halliburton Co. Benefits Comm. v. Graves, 463 F.3d 360, 375–76 (5th Cir. 2006). The suit was by employees seeking to enforce an amendment to their medical plan. *See id.* The court reasoned that although a negation clause existed in the merger agreement, this did not preclude plaintiffs from seeking a remedy under ERISA. *Id.* at 375–76; *see also* Union Carbide Corp. v. Siemens Westinghouse Power Corp., 2001 WL 91714 (S.D.N.Y. Feb. 2, 2001) at *1 (finding third-party-beneficiary status under the purchase order despite a negation clause in the asset purchase agreement that incorporated the purchase order by reference); *Prouty*, 121 Cal. App. 4th at 1237 (finding third-party-beneficiary status despite a negation clause).

212. RESTATEMENT (SECOND), *supra* note 126, § 203.

213. *Id.*; *see also* Laba v. Carey, 29 N.Y.2d 302, 308 (1971) ("[A] court should not 'adopt an interpretation' which will operate to leave a 'provision of a contract . . . without force and effect.'" (citations omitted)).

214. *See* Binnie, *supra* note 91, at 49 (discussing the lack of jurisdiction of courts over entities doing business internationally). *See generally* Alexandra Reeve, *Within Reach: A New Strategy for Regulating American Corporations that Commit Human Rights Abuses Abroad*, 2008 COLUM. BUS. L. REV. 387 (discussing jurisdictional barriers in the context of the Alien Tort Claims Act and other torts involving international plaintiffs).

215. *See, e.g.*, Reeve, *supra* note 214, at 388; Jonathan Turley, *"When in Rome": Multinational Misconduct and the Presumption against Extraterritoriality*, 84 NW. U. L. REV. 598, 608–09 (1990) (discussing the presumption against extraterritoriality in US courts). The *Wal-Mart* court never addressed the jurisdiction question. Jane Doe v. Wal-Mart Stores, Inc., 572 F.3d 677, 685 n.6 (stating that because plaintiff's claims had failed, the court "need not address Wal-Mart's additional contentions that United States domestic law does not apply and that foreign affairs preemption bars application of state law").

of-law clauses, and all of the fifty states in the United States recognize a third-party-beneficiary right in some form.[216]

3. Practical Issues for International Plaintiffs

Non-US plaintiffs may also be barred from bringing a lawsuit in US court for practical reasons. Plaintiffs may lack resources as well as knowledge about laws, court systems, or other mechanisms.[217] In addition, confidentiality issues may bar plaintiffs from discovering the terms of a contract in order to assert their third party right.[218]

Under the third-party-beneficiary rule, a non-signatory to a contract may enforce a promise in a contract if it can be shown that the parties intended to benefit the non-signatory. Non-US plaintiffs, particularly, must overcome multiple barriers to prove third-party-beneficiary status. In the context of international project finance, where project-affected communities often have no recourse against a project with negative impacts, third-party-beneficiary status may provide a remedy.

III. *THE PRINCIPLES AS A WINDOW TO THIRD-PARTY-BENEFICIARY STATUS FOR PROJECT-AFFECTED COMMUNITIES*

As a set of global, social, and environmental standards, the Principles are a step toward sustainable practices for project finance. The failure of many projects to implement the Principles, despite promising to abide by them in financing documentation, presents a serious threat to the livelihoods of project-affected communities. The lack of monitoring and

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216. Waters, *supra* note 126, at 1111 (noting that third-party-beneficiary status is "generally accepted" in the United States).

217. *See* Ruggie, *supra* note 9, at 6 ("[C]onsiderable numbers of individuals whose human rights are impacted by corporations, lack access to any functioning mechanism that could provide [a] remedy."); Bridgeman & Hunter, *supra* note 9, at 218 (stating that "[l]ocally-affected communities and their international allies frequently have evidence of significant environmental and social damage" with no mechanism for accountability).

218. *See* Hansen, *supra* note 1, at 7 (discussing the justification for confidentiality in the context of international project finance); Urrutia, *supra* note 42, § 16.07 (stating that the inability of the local community to access the confidential terms of a loan agreement creates a "conflict between the principle of access to information and the principle of confidentiality of negotiations").

enforcement by EPFIs only compounds the problem. In light of this, a new method to hold borrowers accountable for failing to adhere to the Principles is necessary.[219]

As indicated by the Principles' requirement of public consultation,[220] the entities most appropriate to monitor the effects of a project, and with the highest stake in the event of noncompliance, are the affected communities themselves.[221] One potential way to ensure that borrowers and EPFIs uphold their promises under the Principles is to recognize a third-party-beneficiary right for those project-affected communities. Under US contract law, affected communities would have standing to sue through the Principles.[222] Unfortunately, no such lawsuit has been reported, thus no guiding precedent exists.[223]

This Part argues that the Principles successfully create third–party-beneficiary status for project-affected communities. In addition, this Part discusses the implications of *Chen*, *Wal-Mart*, and *Prouty* for the Industry and the potential liability of EPFIs themselves. Finally, this Part addresses barriers to bringing and winning a lawsuit under the third-party-beneficiary theory in the international project finance context.

A. *The Principles Lead to the Creation of Third-Party-Beneficiary Status*

The Principles show that EPFIs and borrowers intend to benefit project-affected communities directly.[224] Because borrowers covenant to comply with the Principles, which exist for

219. *See supra* notes 90–125 and accompanying text (discussing the weaknesses of the Principles, the real consequences of failing to comply with the Principles, and the EPFIs' inability to monitor compliance).

220. *See supra* notes 65–70 and accompanying text (discussing Principles 5 and 6, which require borrowers to communicate adequately with affected communities).

221. *See* Bridgeman & Hunter, *supra* note 9, at 190 (explaining that social and environmental standards are meant to benefit local communities, but no mechanisms exist to provide the communities with ways to hold companies accountable for their acts); Hunter, *supra* note 3, at 461 (noting the critical monitoring and implementation role that civil society organizations play).

222. *See supra* notes 54–78 and accompanying text (discussing the details of the Principles); notes 126–60 and accompanying text (discussing the requirements of third-party-beneficiary status).

223. *See* Hardenbrook, *supra* note 6, at 199, 218. Additionally, this author's search did not find any reported lawsuits.

224. *See supra* notes 54–87 and accompanying text (discussing the Principles in detail).

the purpose of protecting project-affected communities, the inclusion of the Principles in loan documentation effectively creates third-party-beneficiary status for project-affected communities.[225] Thus, borrowers as promisors owe duties of performance to project-affected communities that, if breached, are enforceable by the communities. In turn, project-affected communities should be able to assert their third-party-beneficiary rights through breach of contract actions in US courts.

1. The Principles as Proof of Intent to Benefit a Third Party

The Principles show a clear intent to benefit project-affected communities. The preamble to the Principles states: "We believe that adoption of and adherence to these Principles offers significant benefits to . . . local stakeholders."[226] In addition, the EPFIs' reason for creating the Principles was to curb negative environmental and social impacts on local communities.[227] While there may be reputational benefits for EPFIs, implementing the Principles has placed increased burdens on both lenders and borrowers.[228] A project inevitably incurs financial burdens and timing setbacks that deter compliance.[229] Significant resources must be diverted to create and manage Action Plans.[230] There appear to be greater losses than gains for projects that abide by the Principles. This suggests that there is little incentive to adopt the Principles other than to provide a benefit to affected communities.

2. The Benefit Conferred is More than Merely Tangential

As noted above, the creation of intended beneficiary status that confers on a third party the right to promised performance

225. *See supra* notes 54–78 and accompanying text (discussing the details of the Principles); notes 126–60 and accompanying text (discussing the requirements of third-party-beneficiary status).

226. THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1.

227. *See supra* notes 54–55 and accompanying text (citing the Preamble to the Principles).

228. *See* Lawrence & Thomas, *supra* note 4, at 22 (noting that imposing standards is not necessarily in the best interest of the lender).

229. *Id.* ("Requiring . . . compliance would increase the operating costs of the project, and reduce the project's financial viability.").

230. *See* Hansen, *supra* note 1, at 12 ("Undertaking an [Assessment] for a major project is itself an expensive commitment . . . .").

turns on the existence of intent to benefit a third party.[231] In project financing contracts, the Principles are for the benefit of project-affected communities and adequately manifest the intent necessary to establish intended beneficiary status.[232] The Principles create a situation analogous to the example in the Second Restatement.[233] In the factory operator example,[234] the municipality requires that the operator promise not to harm downstream residents, effectively creating intended beneficiary status in the downstream residents.[235] To envision the Principles in this example, the EPFI would be the municipality, and the borrower would be the factory operator, thus conferring intended beneficiary status on the project-affected community.

Finally, based on the reliance argument discussed in Part II.C.3, a court could find that a project-affected community is in the class of "other intended beneficiaries."[236] The Second Restatement states that "if the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary."[237] Based on this theory, the argument would be as follows. Borrowers covenant to abide by the Principles, which are expressly for the purpose of mitigating negative impacts on project-affected communities.[238] Thus, based on the Principles, communities would be reasonable in believing that EPFIs and borrowers intend to implement the Principles for their benefit. This reasonable reliance on the promises creates third-party-beneficiary rights in the affected communities. Should a court doubt this proposition, the overriding policy to compensate injured parties could serve as an additional basis for finding intended beneficiary status. In sum, because project-affected communities are the intended

231. *See supra* notes 126–60 and accompanying text (discussing the third-party-beneficiary rule).

232. *See supra* notes 54–87 and accompanying text (discussing the Principles in detail).

233. *See supra* notes 142–44 and accompanying text (discussing the factory operator example in the Second Restatement).

234. RESTATEMENT (SECOND), *supra* note 126, § 302.

235. *Id.*

236. *See supra* notes 149–54 and accompanying text (discussing "other intended beneficiaries" as a class of intended beneficiary).

237. RESTATEMENT (SECOND), *supra* note 126, § 302, cmt. d.

238. *See supra* notes 74–78 and accompanying text (discussing Principle 8, which requires borrowers to covenant to abide by the Principles in loan documentation).

beneficiaries of the Principles, they have a right to proper implementation of the Principles.[239]

3. Other Requirements to Establish Third-Party-Beneficiary Status Are Met

The other requirements to establish third-party-beneficiary status for project-affected communities are likely met in a project finance deal.[240] First, a project-affected community is an identifiable class of people.[241] The Principles assume this to be true—if it were not, the requirement of consultation and participation by a "free, prior and informed" group of local stakeholders[242] would be fatal to all EPFI-funded projects. In addition, the benefits that may flow from Assessments and Action Plans would directly benefit individuals.[243] Projects that have only environmental impacts would still qualify under this theory because changes in the environment directly impact individuals, particularly in agrarian communities. Finally, given the magnitude of a typical project finance deal, a valid contract will usually exist.[244]

B. *Case Law Supports the Recognition of Third-Party-Beneficiary Status*

In light of these considerations, the Principles effectively confer third-party-beneficiary status upon project-affected communities. The analysis below of *Chen*, *Wal-Mart Stores*, and *Prouty* will show how a claim under the Principles would be successful.

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239. *See supra* notes 135–41 and accompanying text (discussing the right to performance as contingent on classification as an intended beneficiary).

240. *See supra* notes 155–60 and accompanying text (discussing further rules that must be satisfied in order to establish status as an intended beneficiary).

241. *See supra* note 156 and accompanying text (intended beneficiaries must be part of an identifiable class of persons).

242. THE EQUATOR PRINCIPLES, *supra* note 2, at 5; *see supra* note 67 and accompanying text (discussing the "free, prior and informed" community requirement).

243. *See supra* notes 62–64 and accompanying text (discussing the Action Plans and Assessments required by the Principles).

244. *See supra* notes 17–32 and accompanying text (discussing project finance).

1. Implications of *Chen*: A Viable Claim Pursuant to the Principles

Several features of *Chen* suggest that a third-party-beneficiary breach-of-contract claim pursuant to the Principles would be viable under New York law. As noted in Section II.C, *Chen* involved the suit against Street Beat Sportswear, Inc. by its employees for failing to uphold the DOL standards embodied in the ACPA in its employment practices.[245] Like the ACPA, the Principles are a set of standards that are for the benefit of third persons.[246] As in *Chen*, a borrower's argument that the Principles are for their own benefit would be rejected in light of the Principles' clear, overriding purpose.[247] Also, similar to the employer in *Chen*, an EPFI borrower is a private actor that is contractually obligated to adhere to a set of standards for evaluation, monitoring, and reporting for the benefit of an identifiable class of persons.[248]

In *Chen*, the court found a right to performance in the beneficiary based on the explicit requirement that the defendants pay wages to the employees.[249] As for the Principles, the requirements to follow an Action Plan and affirmatively manage a project's impacts and risks[250] provides a right to performance in affected communities, which are the direct recipients of those impacts and risks. At the very least, the requirements to hold consultations and create grievance mechanisms[251] are actions that benefit the community, giving rise to a right to performance in the community. In addition, although the Principles do not expressly provide for recovery by communities, a court could "glean[] from the contract as a whole"[252] the parties' intent to benefit the project-affected

245. *See supra* notes 171–81 and accompanying text (discussing *Chen*).

246. *See supra* notes 54–87 and accompanying text (discussing the Principles).

247. *See supra* notes 54–57, 171–81 and accompanying text (discussing the purpose of the Principles and the court's reasoning in *Chen*).

248. *See supra* notes 54–87, 156, 171–81 and accompanying text (discussing the borrower's obligations under the Principles, requirement of an identifiable class of people, and the court's reasoning in *Chen*).

249. *See supra* notes 179–81 and accompanying text (discussing the *Chen* court's approach to the "sufficiently immediate" requirement).

250. *See supra* notes 62–64 and accompanying text (discussing the Action Plan required by the Principles).

251. *See supra* notes 65–70 and accompanying text (discussing Principles 5 and 6).

252. Chen v. St. Beat Sportswear, Inc., 226 F. Supp. 2d 355, 362 (E.D.N.Y. 2002).

communities. Finally, as to the third element of "sufficiently immediate" benefit,[253] the Principles require compliance within an agreed grace period.[254] For high-risk projects, the Principles also require free, *prior*, and informed consultation.[255] Thus, sufficient immediacy is established by the Principles.

Taking these considerations as a whole, it is likely that a plaintiff's third-party-beneficiary contract claim based on the Principles would be successful in a US court. To put this in the context of enforcing international standards for human rights, *Wal-Mart Stores* is instructive.

2. Implications of *Wal-Mart Stores*: A Stronger Case under the Principles

In *Wal-Mart Stores*, employees of Wal-Mart's international suppliers sued Wal-Mart for failing to abide by the employment practices required by its contracts with suppliers.[256] *Wal-Mart Stores* is significant because a claim under the Principles would have none of the deficiencies that the Court deemed fatal to plaintiffs' claim. First, for projects in Categories A or B, a borrower expressly must promise to abide by the relevant host country's laws and the EPFI-approved Action Plan.[257] Had Wal-Mart promised to monitor and enforce the employment standards, it would have breached the contract by failing to do so.[258] The Principles require that borrowers promise to monitor and enforce standards via the Action Plan.[259] Thus, the lack of a discernible promise that caused the plaintiffs to lose in *Wal-Mart Stores* would not figure into an analysis under the Principles. Second, unlike the EPFI, the borrower is expressly required to covenant to abide by the Principles in loan documentation, placing the borrower in the position of promisor.[260] Thus, the

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253. *See supra* notes 179–81 and accompanying text (discussing "sufficiently immediate").

254. *See supra* notes 81 and accompanying text (discussing the specified grace period).

255. *See supra* note 67 and accompanying text (discussing the requirement for "free, prior and informed" consultation).

256. *See supra* notes 182–91 and accompanying text (discussing *Wal-Mart Stores*).

257. *See supra* notes 74–78 and accompanying text (discussing Principle 8).

258. *See* Maryanov, *supra* note 182, at 434 ("[I]f Wal-Mart had promised to monitor and enforce the Standards, then failure to do so would have constituted a breach.").

259. *See supra* notes 62–64 and accompanying text (discussing the Action Plan).

260. *See supra* notes 74–78 and accompanying text (discussing Principle 8).

result in *Wal-Mart Stores* would be avoided because a third-party beneficiary would sue the party that promised performance, i.e., the borrower.

3. Implications of *Prouty*: Potential Loopholes for the Weary Plaintiff

Although the case took place in a different context, the situation in *Prouty* is analogous to that which would exist under the Principles where an EPFI requires the borrower to promise to provide specific benefits to third parties. *Prouty* involved a severance payment clause that the court of appeals found created a "classic" third-party-beneficiary right in the defendant's former employees.[261] Because of the Principles' clear intent to benefit project-affected communities, a court would likely find the Principles to be another classic third-party provision. In addition, although most financing documentation does contain a negation clause, *Prouty* demonstrates that overcoming such a clause is possible.[262] The court's reasoning indicates that where negation clauses are considered to be controlling, such as under New York law, the Principles' clear intent to benefit project-affected communities could persuade a court to find an exception to the rule.[263] Finally, given the detrimental impacts of unregulated projects discussed in Part II.B and the often skewed bargaining positions of borrowers vis-à-vis affected communities, a court should find a third-party-beneficiary right.

C. *Potential Liability of the EPFIs*

The proposition that EPFIs could be held liable for damage caused by EPFI-funded projects is unsettled, even for members of the Industry.[264] As noted in Part I, EPFIs are charged with determining whether borrowers are in compliance with the Principles. In addition, pursuant to Principles 8 and 10, an EPFI will assist the borrower to remain in compliance and commits to

261. *See supra* notes 192–209 and accompanying text (discussing *Prouty*).

262. *See supra* notes 204–09 and accompanying text (discussing the *Prouty* court's decision).

263. *See supra* notes 204–09 and accompanying text (discussing the *Prouty* court's treatment of the negation clause).

264. *See supra* note 80 and accompanying text (discussing lender liability).

publishing reports of its projects annually.[265] It is unclear, however, whether the potential for liability would increase as EPFIs engage in more affirmative actions to monitor and ensure compliance by their borrowers.[266]

The Principles, however, do not require EPFIs to covenant to these responsibilities in loan documentation. The Second Restatement is clear that a promise creates a duty in the promisor, not the promisee.[267] As in *Wal-Mart Stores*, because EPFIs are the promisees with respect to the Principles, it is unlikely that they would be held liable for the borrower's (promisor's) breach.[268] If, however, an EPFI signs a contract with, for example, an outside expert to monitor and report on the social and environmental impacts of a project, that contract could potentially form the basis of a third-party-beneficiary claim against the EPFI.

The new Governance Rules, which require EPFIs to contractually commit to the Principles through the Adoption Agreement, provides just such a situation. In the Adoption Agreement, an EPFI makes a contractual commitment to abide by the Governance Rules and to implement processes to remain in compliance with the Principles.[269] Thus, with respect to the Adoption Agreement, each individual EPFI is a promisor. Like the Principles, the Governance Rules were adopted to ensure greater compliance by EPFIs for the benefit of project-affected communities. Similar to the liability of borrowers that covenant to adhere to the Principles, the Adoption Agreement could subject an EPFI to liability from third-party beneficiaries if the EPFI fails to uphold its promises under the Governance Rules.

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265. *See supra* notes 81–85 and accompanying text (discussing responsibilities of EPFIs pursuant to the Principles).

266. *See, e.g.*, Hansen, *supra* note 1, at 30 ("[T]he EPFI's intensive monitoring activities and remedial powers make liability for knowingly permitting, participating in, or failing to prevent pollution a serious threat.").

267. *See supra* notes 130–31 and accompanying text (discussing the third-party-beneficiary rule); RESTATEMENT (SECOND), *supra* note 126, § 304 (stating the third-party-beneficiary rule as "[a] promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty."); *see also* Jane Doe v. Wal-Mart Stores, Inc., 572 F.3d 677, 682 (9th Cir. 2009) (finding no liability on the part of the promisee).

268. *See supra* notes 188–91 and accompanying text (discussing the court's reasoning in *Wal-Mart Stores* with respect to the liability of promisees).

269. *See supra* notes 86–87 and accompanying text (discussing the Governance Rules).

The Principles contain two elements that weigh against EPFI liability. First, the lenders themselves consider the Principles to be merely a set of voluntary guidelines.[270] Second, the disclaimer stating that the Principles do not "create any rights in, or liability to, any person, public or private," appears in both the Principles and the Governance Rules.[271] This disclaimer could establish that an EPFI is not liable to any third parties. In addition, because the disclaimer in the Principles specifies "as with all internal policies,"[272] this disclaimer could negate the liability of an EPFI. Once the Principles are included in a contract with a borrower, however, this disclaimer may no longer apply because the contract terms themselves create liabilities between the parties. In addition, several courts have found disclaimers to be ineffective.[273]

There are some public policy reasons for not shifting the burden of liability from the borrowers to the EPFIs. First, the borrower is in the best position to ensure compliance with the Principles, not the EPFI.[274] Second, imposing liability on an EPFI for a borrower's failure might discourage banks from adhering to the Principles at all, and such discouragement would be counter-productive to the stated goal of ensuring greater socially and environmentally responsible development.[275]

D. *Barriers to the Project-Affected Plaintiff's Claim in US Courts*

1. Principles and the Right to Sue

One potential problem for project-affected communities seeking to sue on this theory may be the argument that the Principles do not purport to create an enforcement right. As noted in Part I.D, the preamble to the Principles states that they are guidelines for implementation in each project.[276] In addition,

270. *About the Equator Principles*, *supra* note 1, at 3 (stating that the Principles are "a voluntary set of standards").

271. *See supra* note 89 and accompanying text (discussing the disclaimer).

272. THE EQUATOR PRINCIPLES, *supra* note 2, at 5.

273. *See supra* note 89 (discussing the effectiveness of disclaimers generally).

274. *See supra* notes 62–78 and accompanying text (discussing the responsibilities of the borrower pursuant to the Principles).

275. THE EQUATOR PRINCIPLES, *supra* note 2, pmbl., at 1 (stating that the Principles are "a common baseline and framework").

276. *Id.*

the disclaimer states that no rights or liabilities are created by the Principles.[277] These facts could pose a problem for a plaintiff bringing an action in New York court.

As noted in Part II.D, there are variations in the application of the third-party-beneficiary rule. One fundamental difference lies in the recognition of a third party's right to enforce a contract.[278] For example, the New York rule states that intent, the second prong of the three-prong test, can be gleaned from whether "the language of the contract otherwise evidences an intent to permit enforcement by third parties."[279] This is a fundamentally different inquiry than whether the parties intended to *benefit* a third party. Rather, the New York rule asks whether the parties intended for the party to be able to sue. This approach, however, was specifically rejected by the Ninth Circuit in *Astra USA*, where the court noted that the right to sue "inhere's in one's status as an intended beneficiary."[280]

The Ninth Circuit's reading of the rule is more consistent with the Second Restatement than the New York rule. The Second Restatement defines third-party-beneficiary status by the intent to benefit, not the intent to create a right to sue.[281] By hinging third-party-beneficiary status on an enforcement right, the New York rule circumvents the very purpose of the rule—to glean an enforcement right from the parties' intent to benefit the non-signatory. As stated in *Fox*, when a promise is made with the intent to benefit a third party, the third party may sue upon breach of the promise.[282] To additionally require that parties expressly allow the third party to bring an action for breach would be duplicative—the right arises from the third party's status as an intended beneficiary.[283] To first ask whether a party

277. *See supra* note 89 and accompanying text (discussing the disclaimer).

278. *See supra* notes 161–70 and accompanying text (discussing variations on the third-party-beneficiary rule).

279. *See supra* note 163 and accompanying text (discussing the intent prong of the third-party-beneficiary rule in New York law).

280. County of Santa Clara v. Astra USA, Inc., 588 F.3d 1237, 1244 (9th Cir. 2010).

281. RESTATEMENT (SECOND), *supra* note 126, § 304 ("A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.").

282. Lawrence v. Fox, 20 N.Y. 268, 274 (1859) (citations omitted).

283. *Astra USA*, 588 F.3d at 1245 ("To require additionally of intended beneficiaries that the contract by its terms provide for third party enforcement would

can sue and *then* find intent, or the lack thereof, is a backward inquiry.

With respect to the Principles, although no enforcement right is expressly given to third parties under the Principles, the New York rule should not defeat the claim. The intent to benefit project-affected communities is clearly stated in the Principles,[284] such that the right to sue will inhere in a community's status as intended beneficiary.

2. Express Negation Clauses

As noted in Part II, several roadblocks exist for plaintiffs pursuing claims under the third-party-beneficiary theory.[285] The New York rule is that an express negation clause controls,[286] and the majority of project finance loan documents most likely will include one. *Halliburton* indicates that a future court may find alternative ways of dealing with a negation clause.[287] For example, a court may focus on the Principles' overwhelming intent to benefit project-affected communities to bypass the negation clause.[288]

The rules of contract interpretation described in Part II may also provide assistance to project-affected plaintiffs.[289] The presumption in favor of negotiated terms, rather than standard or boilerplate terms is helpful.[290] Although every contract might contain a negation clause, the inclusion of the Principles in loan documentation is often heavily negotiated. Indeed, the EPFIs' explicit statement that they will not lend to borrowers that do not adhere to the Principles suggests that the intent to benefit third parties prevails over a negation clause. Second, the prohibition

read the distinction between incidental and intended beneficiaries out of the federal common law of contracts.").

284. *See generally* THE EQUATOR PRINCIPLES, *supra* note 2.

285. *See supra* notes 210–18 and accompanying text (discussing barriers for plaintiffs bringing an action under the third-party-beneficiary theory).

286. *See supra* note 210 and accompanying text (discussing the New York rule regarding express negation clauses).

287. *See supra* note 211 and accompanying text (discussing the treatment of the express negation clause in *Halliburton*).

288. *See supra* notes 204–09 and accompanying text (discussing the treatment of the express negation clause in *Prouty*).

289. *See supra* notes 204–09 and accompanying text.

290. *See supra* notes 212–13 and accompanying text (discussing rules of contract interpretation).

on finding superfluous terms in a contract[291] could allow a court to find in favor of plaintiffs. To read a negation clause as controlling would defeat the purpose of the Principles to benefit project-affected communities, rendering the Principles superfluous. Thus, a court could find that the Principles supersede the negation clause.

3. Jurisdictional Issues

Because many projects governed by the Principles will take place outside of the United States, plaintiffs may face jurisdictional barriers. Fortunately, many project finance contracts are governed by New York law, or the laws of another US state.[292] Thus a breach-of-contract claim would place the lawsuit squarely in US court.

4. Practical Issues

For a project-affected community in a developing nation, to bring a lawsuit in US court would be no small feat. Risk-taking lawyers willing to represent communities against borrowers may be able to address this difficulty. Another barrier is the lack of disclosure and transparency about EPFIs and the projects they fund.[293] Due to confidentiality issues on the part of EPFIs, it may be difficult for the local community to discover the actual terms of a loan agreement.[294] Therefore, seeking enforcement of those terms would be challenging.

CONCLUSION

The Principles' express purpose is to create sustainable practices in project finance. Because of the lack of an adequate enforcement mechanism, however, the Principles often seem to exist only on paper. Given the potential for large-scale social and environmental destruction, greater accountability is required. Absent greater accountability, borrowers and EPFIs obtain a dual

291. *See supra* note 213 and accompanying text (discussing the rules of contract interpretation as to superfluous terms).

292. *See supra* notes 29–32 and accompanying text (discussing the governing law that applies in most project finance contracts).

293. *See supra* note 218 and accompanying text (discussing access to information).

294. *See supra* note 218 and accompanying text (discussing access to information).

windfall: by touting the Principles, they gain a reputation for sustainable practices while remaining noncompliant, and they obtain significant financial benefits from projects that may harm the local community and ecosystem. This outcome is antithetical to the Principles—borrowers should not be able to benefit from the exploitation of project-affected communities.

Under a third-party-beneficiary theory in US contract law, project-affected communities would be able to hold EPFIs and borrowers accountable for failing to perform their promises under the Principles. Project-affected communities have the greatest stake in a project's compliance because they have the most to lose—their own social and environmental well-being. Recognition of a third-party-beneficiary right in project-affected communities would place enforcement power in the hands of the parties most interested in compliance. Thus, in the interest of efficiency, and of justice, courts should recognize project-affected communities as third-party-beneficiaries of contracts that include the Principles.