

## Complying with The California Transparency in Supply Chains Act 2010

By Susanne Gebauer

On September 30, 2010, former Governor Arnold Schwarzenegger signed The California Transparency in Supply Chains Act 2010 (Senate Bill 657) into law. Section 1714.43 in the California Civil Code goes into effect on January 1, 2012. The Act requires retail sellers and manufacturers that do business in California and have worldwide gross receipts exceeding \$100 million (US) to publicly disclose their efforts to eradicate slavery and human trafficking from their direct supply chains for tangible goods offered for sale. According to an estimate by the California Franchise Tax Board, around 3,200 companies will be affected by this Act. Indirectly, the Act will also affect thousands of suppliers and vendors along the supply chains of these large retailers and manufacturers.

### Background on the Act

Senate Bill 657 was put forward by Senate President pro Tem Darrell Steinberg (D-Sacramento) with the Alliance to Stop Slavery and End Trafficking (ASSET) as the source and the Coalition to Abolish Slavery and Trafficking

(CAST) as the co-sponsor. The not-for-profit organizations that sponsored and rallied for the Act argued that it would create an opportunity for California companies to demonstrate leadership in eradicating slavery and human trafficking from their supply chains and empower consumers to reward companies that proactively engage in such efforts.

As opponents of the bill, industry associations such as the California Grocers Association (CGA) and the California Manufacturers and Technology Association (CMTA), argued that the lack of resources—especially on the side of grocers—would prevent them from monitoring supplier employment. Furthermore, the associations noted that the bill provides no details as to what constitutes compliance with the legal requirement. This last point of criticism will become apparent when reviewing the legal requirements.

### Who needs to abide by the Act

Every retail seller and manufacturer who does business in the state of California and has annual



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worldwide gross receipts that exceed \$100 million for taxable years beginning on or after January 1, 2011 needs to abide by The California Transparency in Supply Chains Act. (The 2011 tax returns will be used to identify who needs to comply when the Act goes into effect in 2012.) Definitions of “retail seller,” “manufacturer,” “doing business in California,” and “gross receipts” are referenced and provided for in the California Revenue and Taxation Code. These definitions concern the type of activity, investments, and financial gain in the state of California. Legal counsel should be consulted to evaluate the applicability of this Act.

### How to disclose

If the company has an Internet website, the public disclosure

should be posted with a “conspicuous and easily understood link” on the homepage. In cases where the company does not have a website, the written disclosure shall be provided within 30 days to consumers who make a written request for it.

The legal text does not provide any details on how to present the disclosure. It is unclear to what extent the Act actually needs to be mentioned or how a link can be made “conspicuous.” That is, should the link be named “The California Transparency in Supply Chains Act,” “Eradicating Slavery and Human Trafficking in our Supply Chain,” or can it be a more general title such as “Corporate Social Responsibility?”

Furthermore, once one clicks on the link on the homepage, it is unclear whether to disclose the information on the ensuing page or whether it can be incorporated into a document, such as a corporate social responsibility report. These items and the topics required to be covered in the disclosure (detailed below) are some of the compliance problems that companies have confronted.

## What to disclose

Companies need to disclose to “what extent, if any” they engage in the five following activities:

- **Verification**

Engagement in verification of product supply chains to evaluate and address risks of human trafficking and slavery. The disclosure

shall specify if the verification was not conducted by a third party.

- **Auditing**

Evaluate supplier compliance with company standards by auditing for trafficking and slavery in supply chains. The disclosure shall specify if the verification was not an independent, unannounced audit.

- **Certification**

Requirement of direct suppliers to certify that materials incorporated into the product comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business.

- **Internal accountability**

Maintenance of internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.

- **Training**

Company employees and management who have direct responsibility for supply chain management must receive training on human trafficking and slavery, particularly with respect to mitigating risks within the supply chains of products.

None of the terms used in these requirements have been defined. Important definitions for terms such as “direct supplier,” “slavery” and “human trafficking” are missing from the legal Act. The California Attorney General

has been contemplating holding a multi-stakeholder roundtable later this year to discuss the difficulties companies have been facing with the Act and issuing guidelines for legal compliance with the Act thereafter. If guidelines are issued, they will most likely be presented after the Act comes into effect on January 1, 2012. Thus, currently, as the industry associations pointed out in their criticism of the Act, the details as to what constitutes compliance with the legal requirements are missing. Nevertheless, some recommendations for assessing the scope of a company’s engagement in activities to eradicate slavery and human trafficking can be made.

## Evaluating the extent of your activity

Although the legal text does not provide definitions for verification, auditing, certification, internal accountability, and training, common perceptions exist on what these activities consist of in the realm of supply chain management.

**Verification:** A general risk assessment of the supply chain can be conducted in order to identify the risks of slavery and human trafficking in a specific supply chain and the possible action to address said risks. The product sourced or manufactured, the location of the sourcing activity, and the type of labor involved are

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important factors to consider in such a risk assessment. Best practice is to engage a third party for the assessment.

**Auditing:** Regardless of the risk, audits can be conducted in order to examine compliance with laws in a company's supply chain. Most companies, however, will take the results of the risk assessment and identify high-risk areas to perform due diligence. Audit activity should be based on company standards set for suppliers. This means in order to address slavery and human trafficking in audits, company standards should include these aspects. Best practice is to engage an independent party to conduct the audits and enter the supplier's facility unannounced.

**Certification:** It is important to set up contractual obligations with suppliers to create a framework for compliance with company standards on slavery and human trafficking. Furthermore, suppliers should be performing due diligence with regard to their own suppliers and ensure that the suppliers further down the supply chain are complying with local laws on slavery and human trafficking. This due diligence activity by the supplier can be required by the company through supplier agreements or terms and conditions.

**Internal accountability:** Not only for external stakeholders, but also for internal stakeholders such as employees and contractors, a

company should set standards on slavery and human trafficking and introduce internal procedures to verify compliance with the company's standards.

**Training:** Employees who have direct responsibility for supply chain management, such as buyers, engage with suppliers and make decisions on entering new business relationships on a regular basis. Through training, they should be made aware of the risks of slavery and human trafficking and on ways to mitigate those risks specific to the company's supply chain.

In complying with the Act and writing the disclosure, the aforementioned activities and the extent to which a company engages in such could be taken into account. These are only recommendations to consider for the disclosure, because legal definitions have not been provided yet.

### **Beyond legal compliance**

The activities to be considered in the disclosure statement have been identified as best practice activities with regard to supply chain management. Keep in mind that the supporters of the Act are advocacy groups campaigning against slavery and human trafficking, and these activities are the demands they are placing on the private sector. Legally, a company is not required to engage in any of the above listed activities; however, with public disclosure comes the increasing awareness of the risks of

slavery and human trafficking in supply chains, increased demand for positive action, and thus, pressure on companies to go beyond legal compliance.

Advocacy groups have already been engaging in benchmarking activities to evaluate supply chain management. These evaluations have been shared with the public in support of transparency and consumer empowerment. If a company is contemplating publicly disclosing its inactivity in the eradication of slavery and human trafficking from its supply chain, it should be prepared for "naming and shaming" by civil society actors. The supporters of the Act may well use the public disclosure to raise awareness for their cause. \*

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