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California Transparency in Supply Chains Act

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California Transparency in Supply Chains Act (SB 657)

A new California law, the California Transparency in Supply Chains Act of 2010 (SB 657) (the Act), went into effect on January 1, 2012. The Act affects certain retailers and manufacturers "doing business" in California with annual global gross receipts of US$100 million or more. It requires companies to disclose on their website their policies and efforts, if any, to combat the use of slave labor or trafficked humans in their supply chains. Importantly, the obligations under the Act extend to qualifying businesses whether based inside or outside of California.

WHY?

The Act was written to give consumers sufficient information to make informed and "responsible" purchasing decisions and, if necessary, exert their economic power in order to try to effect social change – for instance, by boycotting products manufactured with slave labor or as a result of human trafficking.

WHO?

Under the Act, the state Franchise Tax Board (FTB) will look at an entity's tax returns for relevant information and create a list to submit annually to the California Attorney General, identifying the companies doing business in California that must comply with the Act. Thus, the first hurdle is determining whether your business must comply with the Act's disclosure requirements. Your business must comply if all of the following are met:

- Your company has at least US$100 million in annual worldwide "gross receipts," as defined in Section 25120 of the California Revenue and Taxation Code.
    - A company may not deduct its cost of goods in arriving at its gross receipts.
- In addition to meeting the US$100 million threshold, your company does business in the state of California. This means any of the following:
    - Your company is organized or commercially domiciled in California.
    - Your company's sales in California exceed the lesser of US$500,000 or 25 percent of the company's total sales.
    - Your company's real property or tangible personal property in California exceeds the lesser of US$50,000 or 25 percent of your company's total real property and tangible personal property.
    - Your company pays the lesser of US$50,000 or 25 percent of its total payroll compensation in California.
- Assuming your company meets the US$100 million threshold *and* does business in California, your company must also be either a "manufacturer" or a "retail seller." This means that on its California tax returns, your company lists either manufacturing or retail trade as its principal business activity code.

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WHAT?

If your company is subject to the Act, it must meet the Act's disclosure requirements with respect to five categories of information. This means it must, at a minimum, disclose to what extent, if any, it does any of the following:

- Engages 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.
- Conducts audits of suppliers to evaluate supplier compliance with company standards for trafficking and slavery in supply chains. The disclosure shall specify if the verification was not an independent, unannounced audit.
- Requires 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.
- Maintains internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.
- Provides company employees and management who have direct responsibility for supply chain management training on human trafficking and slavery, particularly with respect to mitigating risks within the supply chains of products.

If your company does *not* engage in any of the foregoing activities, it must affirmatively disclose that fact. For instance, one retail seller has disclosed on its website simply that: "As of 1st January 2012, [Company] does not have a formal program to address these issues."

Remember that the Act does not require companies to take affirmative action with regard to human trafficking or slavery. It merely requires companies subject to the law to disclose their efforts, if any, already in place to eradicate human trafficking and slavery in the supply chain.

WHERE?

A business subject to the Act must post the disclosure on its website. A conspicuous and easily understood link to the required information must be placed on the company's homepage. If your company does not have a website, it must provide its disclosure in writing to any consumer who makes a written request for disclosure, within 30 days of receiving the request.

NONCOMPLIANCE

If a company does not comply with the Act, the exclusive remedy for a violation is an action brought by the California Attorney General for injunctive relief. However, nothing in the Act limits remedies available for a violation of any other state or federal law. Thus, inaccurate or misleading disclosures may subject companies to false advertising, unfair business practices or California Consumer Legal Remedies Act claims.

ACTION ITEMS

Because the law is now in effect, we suggest your company may want to do the following to the extent it has not already done so:

- Prepare and update your website with your disclosure. Consider reviewing your Code of Ethics and/or Supplier Code of Conduct and other policies and procedures to determine whether they provide for the verifications or other actions required by the Act. To the extent your company does not perform the actions described in the Act, determine whether it will do so. Prepare your disclosure describing the actions the company takes, and post a clear and conspicuous link on your homepage to your Supply Chains Act disclosure.

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- While the Act does not require your company to take affirmative action with regard to human trafficking or slavery, it is important to remember the reason for this Act is to give consumers or other groups the ability to review the company's efforts with regard to disclosure and base purchasing decisions; otherwise, your company may receive bad press. Thus, each company should analyze the potential commercial and/or reputational consequences that may be associated with a disclosure that is based on its current policies and practices. For instance, does your company anticipate that disclosing that it "does not have a formal program to address these issues" will create a backlash by reducing consumer demand or driving consumers to competitors' goods? If you determine that, in the long run, it will be more beneficial for your bottom line – both reputational and commercial – for your company to be more proactive with respect to supply chain management, you may decide to now develop and implement an action plan with the help of management and legal counsel. This new action plan can be included in your company's disclosure.
- Finally, companies should be aware that similar, broader federal legislation may be passed in the near future. While the federal legislation that has been introduced tracks California's law in many respects, there will be some differences. For instance, under proposed federal legislation, all publicly traded or private companies that meet the annual gross receipts threshold and are currently required to submit annual reports to the US Securities and Exchange Commission (SEC) – not only retail sellers and manufacturers – would have to make the disclosure. The SEC would compile all disclosures and make them publically available. It is a good idea for all companies to get a start on their action plan and disclosure in anticipation of broader federal legislation.

If you have any questions regarding SB 657, please contact your principal Squire Sanders lawyer or one of the individuals listed below.

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