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Compliance deadline looms for new Transparency in Supply Chains Act

By Peter M. Menard

On Jan. 1, 2012, the California Transparency in Supply Chains Act of 2010 (SB 657) will become effective. This legislation will require every large retailer and manufacturer doing business in California to publicly disclose to what extent it: evaluates the risk of slavery and human trafficking in its product supply chain, and whether the evaluation is conducted by a third party; audits its suppliers, and whether the audits are independent and unannounced; requires direct suppliers to certify that materials incorporated into the product comply with applicable laws regarding slavery and human trafficking; holds employees and suppliers accountable; and trains employees on mitigating the risk of slavery and human trafficking in the product supply chain. California Civil Code Section 1714.43(a).

The Act does not require a company to make any effort to eliminate slavery or human trafficking, but only to disclose the extent, if any, to which it has taken the actions listed above. The Act seeks to encourage companies doing business in California to voluntarily take steps to eliminate slavery and human trafficking from their supply chains by providing consumers with the information necessary to patronize those companies that manage their supply chains in a socially responsible manner.

The Act also seeks to level the playing field for socially responsible companies in competing against companies that reduce their cost of goods by purchasing products from suppliers who use forced labor. The impact of the Act ultimately will depend on whether consumers, investors and activists use the required disclosure to pressure companies to eliminate abuses from their supply chains.

The required disclosure must be posted on the company's Web site with a conspicu-



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Former first lady of California, Maria Shriver, speaks about the issue of human trafficking during the 26th Border Governors Conference in Los Angeles in 2008.

ous and easily understood link to the information on the homepage. If the company does not have a Web site, a consumer must be provided the written disclosure within 30 days of a written request.

The Act applies to every "retail seller" and "manufacturer" that is "doing business in the state" of California and has annual worldwide "gross receipts" in excess of \$100 million, as these terms are defined in the Act. An estimated 3,200 companies, or approximately 3.2 percent of the companies doing business in California, which account for over 87 percent of the total sales of goods in California, are subject to the Act.

A company doing business in California and having annual worldwide gross receipts in excess of \$100 million is subject to the Act even if it is organized or domiciled outside of California and its operations in California are relatively small.

A company that is not itself subject to the Act may be affected by its customers' efforts to comply with the Act. The Act likely will increase the number of retailers and manufacturers requiring suppliers to

certify the absence of human rights abuses, adopt human rights policies, perform internal audits, establish employee grievance procedures, and submit to audits by the customer and independent auditors.

The exclusive remedy for a violation of the Act is an action brought by the state attorney general for injunctive relief. The Franchise Tax Board is required to provide annually to the attorney general a list of companies subject to the Act based upon the prior year tax returns.

The Act also provides that it shall not limit remedies for a violation of any other state or federal law. The California Unfair Competition Law and Consumer Legal Remedies Act may allow a consumer, competitor or activist to seek damages, injunctive relief, and attorney fees for the failure to comply with the Act or any misstatement in the disclosure made in response to the Act. In addition, a company that seeks to affect the business practices of its suppliers may be deemed a "joint employer" responsible for the suppliers' treatment of their workers.

A company could comply with the Act by simply disclosing that it has no policy regarding, and does not monitor, labor conditions involved in the production of its products or the materials incorporated in its products. This response, however, may have a negative public relations consequence with a cost far greater than implementing a policy and internal controls to monitor and address the impact of forced labor in the supply chain. Human rights organizations can be expected to develop score cards to evaluate a company's commitment to eliminating forced labor from its supply chain based upon the disclosure made in response to the Act. Socially responsible investors and consumers are likely to be influenced by the attendant publicity in making their investment and purchasing decisions. A company with a detailed knowledge of its supply chain

also will be better positioned to respond to the continuing evolution of legislative, investor and consumer sentiment regarding corporate social responsibility.

With the varying ability of retailers and manufacturers to affect the labor practices of their suppliers, there is no one-size-fits-all response to the Act. Elements that may be considered include:

Assess the likelihood that the supply chain is tainted by slavery and human trafficking in light of the specific circumstances of the company's operations.

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Develop a policy on slavery and human trafficking. A policy condemning forced labor is a necessary, but not sufficient, response to the risks associated with a supply chain tainted by human rights abuses, and should be embodied in processes that identify, prevent and mitigate the impact of forced labor in the supply chain.

Communicate the policy to suppliers, managers, employees, investors and other stakeholders on a regular basis.

Assess the risk of forced labor presented by each direct supplier based on such factors as the supplier's location, the type of product provided, publicly available information on the supplier's human rights record, and reports of human rights organizations.

Implement mechanisms to verify compliance by suppliers, including internal audits and self-reporting by suppliers, audits by the company's own employees or independent auditors, tracking key performance indicators, and monitoring employee grievance procedures.

Integrate the policy into the management of the supply chain. Establish incentives and consequences to ensure accountability. Consider making compliance a condition of supplier agreements and purchase orders and requiring suppliers to certify that they comply with the policy and applicable laws. Provide training to employees and suppliers on a regular basis.

Establish consequences for a supplier's failure to comply with the policy, taking into account the repugnance of forced labor, as well as the importance of the product to the company's operations, the availability of alternative sources, and whether terminating the supplier would itself have

adverse human rights consequences.

Consider methods of enhancing the ability of suppliers to comply with the policy, such as assisting suppliers in developing their internal audit capability and employee grievance procedures.

Consider the content of the company's Web site disclosure, as well as other forms of publicly disclosing the company's efforts to eliminate forced labor from its supply chain.

With the effective date of the Act rapidly approaching, large retailers and manufacturers doing business in California must finalize their response to the disclosure requirements. Whether as a matter of corporate social responsibility or public relations, they also should consider whether they will go beyond the minimum requirements of the Act and seek to address the existence of slavery and human trafficking in their supply chains.

A more in-depth analysis of this topic by the author will appear in the September issue of the *Business Law News*.

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