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California Supply Chain Transparency Law May Affect Non-California Businesses

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On September 30, 2010, California Senate Bill 657, the California Transparency in Supply Chains Act of 2010 (the "Act"), was signed into law and codified in Section 1714.43 of the California Civil Code and Section 19547.5 of the California Revenue and Taxation Code. The Act requires retail and manufacturing companies to disclose what efforts they have taken to eliminate slavery and human trafficking from their supply chains. As explained in the policy statement in the beginning of the Act, the law aims to "provide consumers with information regarding [companies'] efforts to eradicate slavery and human trafficking from their supply chains" and to "educate consumers on how to purchase goods produced by companies that responsibly manage their supply chains."[2] The Act becomes effective on January 1, 2012.

While the law has garnered significant attention in California, it has been less noticed outside that state. However, the law's expansive jurisdictional provisions will make it applicable to many companies that are based outside California. Companies that fall within the scope of the Act need to be aware of its requirements and consider how and to what extent they can provide the disclosures that it envisions.

Businesses Subject to the Act

The Act will require any company that (1) is a retail seller or manufacturer; (2) does business in California; and (3) has annual worldwide gross receipts that exceed $100,000,000, to disclose its efforts to eradicate slavery and human trafficking from the company's direct supply chain for tangible goods offered for sale.[3] The Act, referencing the California Revenue and Taxation Code, defines the terms used in (1) - (3) as follows:

> *Retail Seller* – means a business entity with retail trade as its principal business activity code, as reported on the entity's tax return.

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2 California Senate Bill 657 Section 2(j).

3 California Civil Code Section 1714.43.

Manufacturer – means a business entity with manufacturing as its principal business activity code, as reported on the entity's tax return.

Doing Business in California[4] – an entity is deemed to be doing business in California if:

1. it is organized or commercially domiciled in California;

2. sales in California for the applicable tax year exceed the lesser of $500,000 or 25 percent of the company's total sales;

3. the real property and the tangible personal property of the company in California exceeds the lesser of $50,000 or 25 percent of the company's total real property and tangible property; or

4. the amount paid in California by the company for compensation exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the company.

Gross Receipts[5] – means gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code, as applicable for purposes of this part.

All retail sellers and manufacturers that do business in California, as set forth in Section 23101 of the California Revenue and Taxation Code, and have annual worldwide gross receipts that exceed $100,000,000 fall within the scope of the Act's disclosure requirements and should respond accordingly.

Many large retail sellers and manufacturers that are organized or domiciled outside of California are likely to be affected by the Act, even if the activities and operations that such retail sellers and manufacturers perform in California are relatively small. The Act was intended to only target the state's largest retailers and manufacturers who, based on information provided by California's tax authority to the Act's author, account for the majority of the income and cost of goods sold in California (over 87%).[6] Despite this intention, the Act does not provide an exemption for large companies with relatively few California contacts.

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4 Section 23101 of the California Revenue and Taxation Code.

5 Section 25120 of the California Revenue and Taxation Code.

6 California State Assembly Committee on Judiciary, Analysis of Senate Bill No. 657, June 29, 2010, p. 10.

Companies that do business in California should note that annual gross receipts are measured globally, under the Act. The requirement that such receipts exceed $100,000,000 is intended to serve as a "small business exemption" for those companies that lack the ability to exert substantial economic influence on their suppliers.[7] This exemption does not, and was not intended to, release larger companies from for the Act's disclosure requirements based on economic activity in California.

Disclosure Requirements of the Act

Each Company that is required to comply with the Act must, at a minimum, disclose whether, and to what extent, the company:

1. engages in verification of product supply chains to evaluate and address risks of human trafficking and slavery, and whether the verification was conducted by a third party;

2. conducts audits of suppliers to evaluate supplier compliance with company standards for trafficking and slavery in supply chains, and whether the audits were independent and unannounced;

3. 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;

4. maintains internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking; and

5. 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.

The required disclosures must be made available on the company's website with a conspicuous link to the disclosure placed on the company's homepage. Companies that do not have websites must provide written copies of the disclosure within 30 days of receiving a written request for the disclosures from a consumer. The California Attorney General is empowered to enforce compliance with the Act. The exclusive remedy available to the California Attorney

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[7] California State Assembly Committee on Judiciary, Analysis of Senate Bill No. 657, June 29, 2010, p. 9.

General for violations of the Act is an action for injunctive relief. The Act does not create a private right of action.[8]

Conclusion

The Act is a disclosure law and does not impose any substantive regulation on supply chain activities. Nor, unlike the "conflict minerals" provisions of the Dodd-Frank regulatory reform law,[9] does it impose any affirmative obligations on companies to perform diligence regarding the existence of slavery or human trafficking in their supply chains. Nonetheless, as a matter of corporate social responsibility as well as public image, companies may wish to consider whether it is appropriate to adopt policies or procedures to mitigate the risk that slavery or human trafficking exist in their supply chains.

[8] California Civil Code Section 1714.43.

[9] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 1502 (2010). This provision requires U.S. public reporting companies to make disclosures regarding whether their products contain certain minerals the production of which is supporting groups engaged in human rights abuses in the Democratic Republic of Congo and surrounding regions.