

**The California Transparency in
Supply Chains Act:
What It Means to Companies Doing
Business in California**

Jeffrey Rubin

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GENERAL

The California Transparency in Supply Chains Act of 2010 goes into effect on January 1, 2012. The purpose of the Act is to ensure that large retailers and manufacturers provide consumers with information regarding their 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. By doing this, California hopes to improve the lives of victims of slavery and human trafficking. The full text of the Act is available at http://info.sen.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.html. Attached to this memorandum is Section 3 of the Act, which sets forth the disclosure obligations to which companies covered by the Act will be subject.

Because the Act will impose disclosure obligations on many retail sellers and manufacturers doing business in California, including businesses that are based elsewhere, it is important that retail sellers and manufacturers be aware of the Act, determine whether it applies to them, and if it does to implement the measures required to comply with the Act. This memorandum is intended to assist companies with this process. This memorandum is not intended to provide legal advice regarding the measures any particular company should take to comply with the Act. Each company subject to the Act should consider its own compliance obligations.

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TO WHICH COMPANIES DOES THE ACT APPLY?

- The Act applies to every retail seller and manufacturer that:
 - Does business in California; and
 - Has annual worldwide gross receipts in excess of \$100 million.
 - Please note that because the gross receipts test is based on worldwide receipts, retail sellers and manufacturers that do business in California and have worldwide receipts in excess of \$100 million would be subject to the Act, regardless of their gross receipts in California.

- What is a retail seller?
 - A retail seller is defined in the Act as a business entity with retail trade as its principal activity code, as reported on the entity's California tax return.

- What is a manufacturer?
 - A manufacturer is defined in the Act as a business entity with manufacturing as its principal activity code, as reported on the entity's California tax return.

 - What constitutes "doing business" in California?
 - Doing business in California has the same meaning as in Section 23101 of the California Revenue and Taxation Code (the "California Code"). Specific provisions of California Law are available at <http://www.leginfo.ca.gov/calaw.html>. In general, a company is doing business in California if it is organized or commercially domiciled in California, or if it has sales for the tax year in California in excess of the lesser of \$500,000 or 25% of its total sales. The California Code sets forth additional criteria for this determination.

 - How does a company determine gross receipts?
 - Gross receipts are determined in the manner set forth in Section 25120 of the California Code. In general, gross receipts are the 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 U.S. Internal Revenue Code, as applicable. Amounts realized on the sale or exchange of property shall not be reduced by the cost of goods sold or the basis of property sold. Section 25120 sets forth certain exclusions from items considered to be gross receipts.

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IF A COMPANY IS SUBJECT TO THE ACT, WHAT DISCLOSURE IS THE COMPANY REQUIRED TO PROVIDE?

- If a company is subject to the Act, it is required, at a minimum, to disclose to what extent, if any, it does each 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.

WHERE ARE THE DISCLOSURES REQUIRED TO BE MADE?

- A retail seller or manufacturer subject to the Act is required to post the disclosure on its Internet Web site with a conspicuous and easily understood link to the required information (set forth above) placed on the business' homepage. In the event the company does not have an Internet Web site, the company must provide a consumer the written disclosure within 30 days of receiving a written request for the disclosure from a consumer. Companies must be in compliance on January 1, 2012, the effective date of the Act.

TO WHAT PENALTIES WOULD A COMPANY BE SUBJECT IF IT DOES NOT COMPLY WITH THE ACT?

- The Act provides that the exclusive remedy for a violation of the Act is an action brought by the California Attorney General for injunctive relief. Nothing in the Act limits remedies available for a violation of any other state or federal law.

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WHAT ARE OTHER COMPANIES DOING?

- A number of companies have already addressed the Act in their public statements. These include the following:
 - General Electric <http://www.gecitizenship.com/our-commitment-areas/our-suppliers/california-transparency-in-supply-chains-act-disclosure/>
 - Ford Motor Co. http://corporate.ford.com/microsites/sustainability-report-2010-11/issues-supply-materials-brazil#supply_chains_law
 - Hewlett-Packard http://www.hp.com/hpinfo/globalcitizenship/society/california_transparency_in_supply_chains_act_of_2010.html (to access, please cut and paste into a new browser page)
 - Dr. Pepper Snapple <http://www.drpeppersnapplegroup.com/files/california-transparency-in-supply-chains-act.pdf>
- Although the responses of other companies are helpful to review, each company subject to the Act should consider the particular facts and circumstances of its own business and supply chain in determining how proactive it should be in connection with the Act.
- Various organizations have provided guidance on compliance with the Act. For example, the Interfaith Council on Corporate Responsibility, Calvert Investments and Christian Brothers Investment Services, Inc. have recently published “Effective Supply Chain Accountability: Investor Guidance on Implementation of The California Transparency in Supply Chains Act and Beyond”, which is available at <http://www.csrandthelaw.com/uploads/file/Supply%20Chain%20Document%20-%202011%2017%2011.pdf>

WHAT SHOULD COMPANIES SUBJECT TO THE ACT DO?

- First, please recognize that the Act imposes only a disclosure obligation and does not require a company to take any actions related to its procurement or supply chain.
- However, companies should be aware that consumers and other groups may review the company’s disclosures and base their purchasing decisions on the efforts that the company is undertaking to address and eradicate slavery and human trafficking in their supply chains. Each company should therefore review the potential reputational and commercial consequences associated with the required disclosures. Important in this regard will be the disclosure and supply chain efforts being made by competitors and other companies.
- Companies should prepare to post on their Internet homepage, on or prior to January 1, 2012, a “conspicuous and easily understood link to the required information.” They should also prepare the disclosure required by the Act.

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WHAT SHOULD COMPANIES SUBJECT TO THE ACT DO? (CONT'D)

- A company that determines to be more proactive with respect to its supply chain management should consult with its senior supply procurement personnel to develop an action plan. The planning may also include input from representatives of the company's legal and compliance departments. Among the matters the action plan may address are the following:
 - Identifying the countries where the goods a company procured directly originate.
 - Determining whether any of such countries has been identified as a country which is believed to engage in human trafficking or to produce goods by child labor or forced labor in violation of international standards (a "Target Country"). In 2009, the U.S. Department of Labor published a report of goods produced by child labor or forced labor, which is available at <http://www.dol.gov/ilab/programs/ocft/PDF/2009TVPRA.pdf> . This publication lists, by country, goods that are produced by child labor or forced labor. This publication may be supplemented periodically, and in addition there may be additional materials available through NGOs,
 - To the extent that the company does not procure its goods directly, but obtains some or all of its goods through suppliers, a company may determine to:
 - Make inquiry of its suppliers to determine whether any of their products (including products they purchase from other suppliers that are incorporated within their products) originated in a Target Country.
 - Request or require suppliers to provide certifications that the goods they furnish to the company (including their components) have either not been procured from a Target Country or, if they are procured from a Target Country, that the supplier has determined that the production of such goods did not involve slavery or human trafficking. These requirements may also be extended to require suppliers to obtain similar certifications from their subsuppliers.
 - Request or require the suppliers to consent to third-party audit and verification of their supply chain determinations. Suppliers may also be requested or required to obtain similar consents from their subsuppliers.
 - In the event that existing suppliers are unable or unwilling to provide the requested or required information or consents, a company may determine to change suppliers and to contract with entities willing to provide such information and consents. Companies may also want to include in their standard purchase orders or procurement contracts provisions requiring their suppliers to (i) provide information regarding whether they or their subsuppliers source goods from Targeted Countries, (ii) provide corresponding certifications and (iii) consent to third party audits of their supply chain information.

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WHAT SHOULD COMPANIES SUBJECT TO THE ACT DO? (CONT'D)

- Engage in training company procurement and supervisory personnel regarding slavery and human trafficking.
- Engage a third party supply chain auditor to audit and report on the company's and its suppliers' determinations.
- Consult with industry groups and others that may have developed a set of "best practices" with respect to the issue of slavery and human trafficking in the context of supply chains.
- To the extent that a company will be subject to other supply chain review, disclosure or audit obligations, such as under the conflict minerals provisions of the Dodd-Frank Act, it is possible that the inquiry with respect to slavery and human trafficking can be integrated with the company's compliance plan relating to those other obligations.

The foregoing are only general suggestions. Each company should consider whether it would be appropriate to prepare an action plan, as well as the appropriate scope and detail of the plan. Companies are encouraged to speak with their Hogan Lovells relationship partner if they have any questions or seek more specific guidance.

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The California Transparency in Supply Chain Act of 2010 – Section 3

Section 3 of the Act added Section 1714.43 of the California Civil Code. The Section provides as follows:

(a) (1) Every retail seller and manufacturer doing business in this state and having annual worldwide gross receipts that exceed one hundred million dollars (\$100,000,000) shall disclose, as set forth in subdivision (c), its efforts to eradicate slavery and human trafficking from its direct supply chain for tangible goods offered for sale.

(2) For the purposes of this section, the following definitions shall apply:

(A) "Doing business in this state" shall have the same meaning as set forth in Section 23101 of the Revenue and Taxation Code.

(B) "Gross receipts" shall have the same meaning as set forth in Section 25120 of the Revenue and Taxation Code.

(C) "Manufacturer" means a business entity with manufacturing as its principal business activity code, as reported on the entity's tax return filed under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(D) "Retail seller" means a business entity with retail trade as its principal business activity code, as reported on the entity's tax return filed under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code.

(b) The disclosure described in subdivision (a) shall be posted on the retail seller's or manufacturer's Internet Web site with a conspicuous and easily understood link to the required information placed on the business' homepage. In the event the retail seller or manufacturer does not have an Internet Web site, consumers shall be provided the written disclosure within 30 days of receiving a written request for the disclosure from a consumer.

(c) The disclosure described in subdivision (a) shall, at a minimum, disclose to what extent, if any, that the retail seller or manufacturer does each of the following:

(1) 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.

(2) 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.

(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.

(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.

(d) The exclusive remedy for a violation of this section shall be an action brought by the Attorney General for injunctive relief. Nothing in this section shall limit remedies available for a violation of any other state or federal law.

(e) The provisions of this section shall take effect on January 1, 2012.

ABOUT THE AUTHOR



JEFFREY W. RUBIN

Partner, New York

jeffrey.rubin@hoganlovells.com

Phone: +1 212 918 8224

Fax: +1 212 918 3100

www.hoganlovells.com

Jeffrey Rubin's practice focuses on domestic and international securities transactions, corporate finance transactions, and mergers and acquisitions. In addition, Jeffrey is currently Chair of the Federal Regulation of Securities Committee in the Business Law Section of the American Bar Association. This Committee, with over 2,700 members, is the primary liaison between the securities bar and the Securities and Exchange Commission.

In the securities area, Jeffrey has represented issuers and underwriters in public offerings and private placement transactions, with an emphasis on international transactions. Jeffrey has also represented private equity funds in connection with technology and other portfolio investments.

Among the numerous acquisitions in which Jeffrey has been involved are the acquisitions of a movie studio, television network, and publishing house on behalf of an international media and entertainment company. He has assisted clients in the disposition of a wide range of businesses, including technology companies, commercial printing companies, and businesses in the trade show, radio, and publishing industries. Many of the transactions in which he has been involved have required extensive international coordination.