

## ARNOLD &amp; PORTER LLP

ADVISORY

January 2011

## New California Law Requires Disclosure Regarding Human Trafficking/Slavery in Supply Chains

On September 30, 2010, Governor Arnold Schwarzenegger signed into law California Senate Bill 657, the California Transparency in Supply Chains Act of 2010 (S.B. 657). The new law will require many companies doing business in California to disclose what efforts, if any, they have taken to eliminate human trafficking and slavery from their supply chains. Thousands of companies are likely to be affected: The law applies to retail sellers and manufacturers with annual worldwide gross receipts exceeding \$100 million that have even relatively small contacts with California, such as \$500,000 in sales in that state, personal property in that state valued at \$50,000, or payment of \$50,000 in compensation in that state.

The broad new disclosure requirements, which take effect on January 1, 2012, will affect sellers and manufacturers of everything from electronics to groceries to clothing and textiles. While California already has some requirements relating to sweatshop labor in the production of apparel under state contracts, the new disclosure requirements mandated by S.B. 657 are the first of this kind nationwide and apply across the board to covered companies doing business in the state regardless of whether they have government contracts.

Consumer groups and human rights organizations—many of which lobbied strongly for the bill—will likely focus on companies' responses to these new disclosure requirements. The upcoming disclosures and surrounding publicity could influence consumer decision-making and have significant public affairs consequences. Businesses, at a minimum, should better understand and evaluate human trafficking and slavery risks in their supply chains. Some will want to go further, for example, by auditing their suppliers or developing policies on human trafficking and slavery and communicating these to their suppliers on a regular basis.

As the California law garners increased national attention, some legislators in other jurisdictions may seek similar laws. Affected companies should consider increasing their understanding of labor conditions in their supply chains now so that they are well positioned to comply with S.B. 657 beginning in 2012. Arnold & Porter LLP is prepared to help companies determine the most appropriate individualized options to address the requirements of this new law.

### Contacts



**John B. Bellinger III**  
+1 202.942.6599



**Trenton H. Norris**  
+1 415.356.3040



**James F. Speyer**  
+1 213.243.4141



**Samuel M. Witten**  
+1 202.942.6115



**J. Matthew Owens**  
+1 202.942.6618

## Disclosure Requirements of S.B. 657

Effective January 1, 2012, the new California law requires each retail seller and manufacturer doing business in California that has annual worldwide gross receipts exceeding \$100 million to conspicuously disclose on its website to what extent, if any, it does each of the following:

- Reviews its product supply chains to evaluate and address human trafficking and slavery risks. The company must disclose if this review is not performed by a third party.
- Conducts supplier audits to evaluate whether suppliers comply with company standards on human trafficking and slavery. The company must disclose if the audits are not independent, unannounced audits.
- Requires direct suppliers to certify that materials incorporated into the company's products comply with the laws addressing human trafficking and slavery of the country or countries where the suppliers do business.
- Maintains accountability standards and procedures for company employees or contractors that do not meet company standards concerning human trafficking and slavery.
- Provides training on slavery and human trafficking, including training on mitigating related risks in supply chains, to employees and management with direct responsibility for supply chain management.<sup>1</sup>

## Companies that Must Comply with S.B. 657

For purposes of S.B. 657, every "retail seller and manufacturer" having annual worldwide gross receipts in excess of \$100 million and "doing business in the state" of California under the terms of California's Revenue and Tax Code would be covered under the statute.<sup>2</sup> As of January 1, 2011, a taxpayer is considered to be "doing business in California" under the Revenue and Tax Code if **any** of the following four conditions are met:

- The company is organized or domiciled in California;
- Sales in California for the applicable tax year of the company exceed the lesser of \$500,000 or 25 percent

of the company's total sales. Sales of tangible personal property are deemed "in California" if (1) the property is delivered to a purchaser (other than the US government) in California, or (2) the property is shipped from an office, store, warehouse, or other storage facility in California and the purchaser is the US government or the company is not taxed in the state of the purchaser. Sales, other than sales of tangible personal property, are deemed "in California" if all, or a greater proportion of, the income-producing activity is performed in California;

- The value of the real and tangible personal property of the company in California exceeds the lesser of \$50,000 or 25 percent of the company's total real and tangible personal property; or
- The amount paid by the company in California for compensation exceeds the lesser of \$50,000 or 25 percent of the total compensation paid by the company.<sup>3</sup>

It is important to note that no matter where a company is domiciled, if it has annual global gross receipts over \$100 million and fulfills any of the above criteria, the law applies.

Whether a company is a "manufacturer" or "retail seller" depends on whether the company has "manufacturing" or "retail trade" as its principal business activity code on its California tax return.<sup>4</sup> S.B. 657 requires the California Franchise Tax Board to provide the California Attorney General with a list of all retail sellers and manufacturers that are subject to S.B. 657, based on tax returns for taxable years beginning on or after January 1, 2011.<sup>5</sup> According to materials developed by the California Franchise Tax Board and presented by the bill's author, Representative Darryl Steinberg, during debate, companies that would today be subject to the disclosure requirements of S.B. 657 would constitute approximately 3.2 percent of the companies doing business in California, or roughly 3,000 companies, and their business would account for over 87 percent of the total receipts for income and costs of goods sold in California.<sup>6</sup>

<sup>3</sup> California Revenue & Tax Code §§ 23101, 25135 & 25136 (West 2010), available at <http://www.leginfo.ca.gov/cgi-bin/calawquery?codesecton=rtc&codebody=&hits=20>.

<sup>4</sup> S.B. 657, § 3(a)(2)(C&D).

<sup>5</sup> *Id.*, § 4(a)(1).

<sup>6</sup> California State Assembly Committee on Judiciary, Analysis of Senate

<sup>1</sup> S.B. 657, § 3(c)(1)-(5), available at [http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb\\_0651-0700/sb\\_657\\_bill\\_20100930\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.pdf).

<sup>2</sup> S.B. 657, § 3(a)(1).

## Looking Ahead to Implementation of the Law

The problem of trafficking in persons is substantial and California's new law therefore has far-reaching reporting implications. The US Department of State has estimated that human trafficking is a \$32 billion global business, with over 12 million people worldwide held in servitude of one form or another, and up to 17,500 of these people held in servitude in the United States.<sup>7</sup> In addition, a Department of Labor report listed 122 goods from 58 countries that are believed to be tainted by forced labor or child labor.<sup>8</sup> The California legislature and the various advocacy groups that actively supported the passage of S.B. 657 hope the new law will enable California consumers, with their significant purchasing power, to reward companies that proactively work to eradicate slave labor and human trafficking from their supply chains.

Although the sole remedy for a violation of S.B. 657 identified in the new law is an action brought by the California Attorney General for injunctive relief,<sup>9</sup> S.B. 657 makes clear that it does not limit or prohibit any remedies that may be available for breaches of other state or federal laws.

With a year to prepare for the required disclosures mandated by S.B. 657, companies should take steps now to prepare for the legislatively mandated reports. While companies could comply with the law by simply disclosing that they have no policies and do not inquire about the labor conditions involved in the production of their goods and materials, such a course of action could have negative business or public affairs consequences. The more prudent approach under the law would be to, at a minimum, review their supply chains for human trafficking and slavery risks. Many companies will want to develop policies on human trafficking and slavery and communicate these standards to their suppliers regularly. That

said, even some companies with well-developed standards on human rights issues may find it challenging to implement some of the other actions for which reporting is required under S.B. 657, such as audits of their supply chains. However, other companies already have robust compliance programs in place and have found ways to successfully audit their supply chains for a host of reasons, including labor concerns such as those mentioned in S.B. 657.

Ultimately, each company covered under the statute will have to make its own determination of what policies to implement in anticipation of the mandated disclosures, taking into account the advantages and disadvantages of seeking to influence the activities of suppliers. By deferring the effective date until 2012, the California legislature has given companies a helpful one-year period to decide how it will approach the law. While there may not be a single formula that all companies will adopt, options would include:

- Reviewing or developing company standards on human trafficking and slavery
- Communicating company standards on human trafficking and slavery to suppliers on a regular basis
- Evaluating suppliers' compliance with company standards on human trafficking and slavery
- Developing an understanding of the laws addressing human trafficking and slavery of the country or countries where the companies' suppliers do business, so that companies can confirm whether suppliers comply with such laws
- Reviewing or developing accountability standards and procedures for company employees or contractors that do not meet company standards concerning human trafficking and slavery
- Developing training programs on slavery and human trafficking
- Evaluating and considering contracting with independent, third-party auditors/monitors to review supply chains and conduct supplier audits

Bill No. 657, June 29, 2010, pp. 9-10.

7 US Department of State, **2010 Trafficking in Persons Report**, June 14, 2010, available at <http://www.state.gov/documents/organization/142979.pdf>.

8 US Department of Labor, Bureau of International Labor Affairs, **The Department of Labor's List of Goods Produced by Child Labor or Forced Labor**, Sept. 10, 2009, available at US Department of Labor, Bureau of International Labor Affairs, **The Department of Labor's List of Goods Produced by Child Labor or Forced Labor**, Sept. 10, 2009.

9 S.B. 657, § 3(d).

## Conclusion

With the enactment of S.B. 657, socially responsible consumers, investors, and advocacy groups can be expected to become even more vocal as they continue to pressure companies to conduct more due diligence and become proactive with respect to labor and human rights issues in their supply chains. Similar legislation is possible elsewhere. Companies that have strong knowledge of human trafficking and labor conditions in their supply chains will find themselves better positioned to respond to S.B. 657 and other laws that may follow.

*We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:*

**John B. Bellinger III**

+1 202.942.6599  
John.Bellinger@aporter.com

**Trenton H. Norris**

+1 415.356.3040  
Trenton.Norris@aporter.com

**James F. Speyer**

+1 213.243.4141  
James.Speyer@aporter.com

**Samuel M. Witten**

+1 202.942.6115  
James.Speyer@aporter.com

**J. Matthew Owens**

+1 202.942.6618  
Matthew.Owens@aporter.com

**Dawn Y. Yamane Hewett**

+1 202.942.6278  
Dawn.Yamane.Hewett@aporter.com

---

*© 2010 Arnold & Porter LLP. This advisory is intended to be a general summary of the law and does not constitute legal advice. You should consult with counsel to determine applicable legal requirements in a specific fact situation.*