

The California Transparency in Supply Chains Act: Overview

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A Practice Note discussing the application and requirements of the California Transparency in Supply Chains Act (Supply Chains Act). This Note details the Supply Chains Act factors that determine whether a business is subject to the act's requirements, describes what is required of a covered business and the potential consequences of noncompliance, and identifies best practices for covered businesses.

The California Transparency in Supply Chains Act (Supply Chains Act) became effective in January of 2012, joining other California corporate social responsibility laws (see Practice Note, *Developing a CSR Supply Chain Compliance Program: Key CSR Laws and Regulations* ([2-565-0547](#))).

For more information about corporate social responsibility in the supply chain generally, see:

- Practice Note, *Developing a CSR Supply Chain Compliance Program* ([2-565-0547](#)).
- Practice Note, *Corporate Social Responsibility and the Supply Chain* ([2-520-6599](#)).
- Standard Clauses, *General Contract Clauses: Corporate Social Responsibility Representations and Warranties* ([6-525-8652](#)).

CALIFORNIA TRANSPARENCY IN SUPPLY CHAINS ACT

The California legislature passed the Supply Chains Act with the goal of informing consumers and businesses about companies' efforts to address slavery and human trafficking in the supply chain, so that customers can consider this information when making their purchasing decisions. Companies realizing that efforts to address slavery and human trafficking can influence purchasing decisions may be motivated to increase these efforts for their supply chains. (See generally California Department of Justice: Office of the

Attorney General: *The California Transparency in Supply Chains Act: Introduction*.)

Human trafficking as defined under the California Penal Code, for example, is:

- The deprivation or violation of the personal liberty of another.
- With the intent to obtain forced labor or services.

(Cal. Penal Code § 236.1(a).)

Section 236.1 specifies that this definition is equivalent to the federal definition of a severe form of trafficking found in Section 7102(9) of Title 22 of the United States Code (Cal. Penal Code § 236.1(g)).

For brevity, this Note sometimes uses the term "human trafficking" to include slavery.

The Supply Chains Act is a "reporting statute" that requires covered businesses to disclose their efforts to eliminate slavery and human trafficking:

- From their direct supply chain.
- For tangible goods offered for sale.

(Cal. Civ. Code § 1714.43(a)(1) and see *Covered Businesses and Disclosure Requirements*.)

The Supply Chains Act does not require that companies actually make any effort to eliminate slavery and human trafficking (see *Barber v. Nestle USA, Inc.*, 154 F. Supp. 3d 954, 959 (C.D. Cal. 2015)). Covered businesses need only state what efforts, if any, are being made. A company that discloses it has made no effort in any of the required reporting areas is still in compliance with the Supply Chains Act. Companies concerned that their disclosures may affect customers' decisions to buy from them, however, may be additionally concerned to demonstrate their efforts to combat slavery and human trafficking.

COVERED BUSINESSES

Companies should analyze whether Supply Chains Act requirements apply to them. Unlike some other anti-trafficking laws (for example, the UK Modern Slavery Act 2015 (UK Modern Slavery Act)), this law is

narrower than may appear at first. The Supply Chains Act compliance requirements apply only to businesses that:

- Are retail manufacturers or sellers (see Manufacturers or Retail Sellers).
- Are doing business in California (see Doing Business in California).
- Have annual worldwide gross receipts more than \$100 million (see Gross Receipts).

(Cal. Civ. Code § 1714.43(a)(1) and for more information about the UK Modern Slavery Act, see Other Disclosure Laws for Corporate Social Responsibility in Supply Chains.)

Whether a company meets these three criteria is determined by reference to:

- Its tax reporting information.
- The location and amount of its property and business activities.
- The amount of its business income.

Companies should make a thorough internal review of their tax and other records and obtain outside information and advice as needed to confirm whether the Supply Chains Act compliance requirements apply to them. Businesses initially believing that they are subject to the requirements may discover, with investigation, that they do not meet one or more of the three criteria for a covered business.

The California Franchise Tax Board (FTB) is the state agency responsible for administering California's corporate tax program and arrives at an annual determination which companies must make the required Supply Chains Act disclosures. By November 30 of each year, the FTB sends a list of companies that are covered by the Supply Chains Act to the California Attorney General (Cal. Rev. & Tax Code § 19547.5).

MANUFACTURERS OR RETAIL SELLERS

Under the Supply Chains Act, the definitions of manufacturer and retail seller are based on what the company reports as its principal business activity on its tax return filed under Part 10.2 of Division 2 of California's Revenue and Taxation Code (the Code) (Cal. Rev. & Tax. Code § 18601).

Counsel can, for example, locate a corporation's principal business activity code under Question F in Schedule Q Questions of the company's California Corporation Franchise or Income Tax Return (see, for example, 2017 Form 100).

A business entity is:

- A manufacturer if it reports manufacturing as its principal business activity on its return.
- A retail seller if it reports retail trade as its principal business activity on its return.

(Cal. Civ. Code § 1714.43(a)(2)(C), (D).)

Many companies do not file stand-alone California tax returns. Even if a company does engage in manufacturing or retail sales, therefore, it may find that the Supply Chains Act compliance requirements do not apply to it after all if either:

- The company's reported principal business activity is not:
 - manufacturing; or
 - retail trade.

- The company's information is included in a consolidated tax return filed by its parent.

DOING BUSINESS IN CALIFORNIA

The definition of doing business in California is based on the provisions of Section 23101 of the Code (Cal. Rev. & Tax. Code § 23101).

Under Section 23101, doing business means actively engaging in any transaction for financial or pecuniary gain or profit (Cal. Rev. & Tax. Code § 23101(a)). An entity is doing business in California for a taxable year if it meets any of the following criteria:

- It is organized or commercially domiciled in California.
- Its sales (including sales by an agent or independent contractor) in California for the taxable year are greater than the **lesser** of:
 - \$500,000; or
 - twenty-five percent of the entity's total sales.
- The value of its real and tangible personal property in California is greater than the **lesser** of:
 - \$50,000; or
 - twenty-five percent of the entity's total real and tangible personal property.
- The amount that the entity pays in California for compensation is greater than the **lesser** of:
 - \$50,000; or
 - twenty-five percent of the total amount that the entity pays for compensation.

(Cal. Rev. & Tax. Code § 23101(b)(1) to (4).)

GROSS RECEIPTS

The definition of gross receipts is based on the provisions of Section 25120 of the Code (Cal. Rev. & Tax. Code § 25120).

Under Section 25120, gross receipts means the gross amounts, whether a sum of money or the fair market value of other property or services received, gained in a transaction that produces business income from either:

- The sale or exchange of property.
- The performance of services.
- The use of property or capital.

The transaction must be one in which in which income, gain, or loss is recognized, or would be if the transaction were in the US, under the Internal Revenue Code (Title 26 of the US Code). (Cal. Rev. & Tax. Code § 25120(f)(2).)

Section 25120 lists specific items that are **not** gross receipts even if they are business income, including:

- Repayment, maturity, or redemption of the principal of:
 - a loan;
 - a bond;
 - a mutual fund;
 - a certificate of deposit; or
 - a similar marketable instrument.

- Proceeds from:
 - the issuance of a company's own stock; or
 - the sale of treasury stock.
 - Amounts received as the result of litigation, including damages.
 - Property acquired by an agent on behalf of another party.
 - Tax refunds and other tax benefit recoveries.
 - Certain contributions to capital.
 - Income from discharge of indebtedness.
 - Amounts realized from exchanges of inventory that are not recognized under the Internal Revenue Code.
- (Cal. Rev. & Tax. Code § 25120(f)(2)(A) to (L).)

DISCLOSURE REQUIREMENTS

Disclosure requirements under the Supply Chains Act include both:

- Location requirements (see Required Location of Disclosure).
- Content requirements (see Required Content of Disclosure).

REQUIRED LOCATION OF DISCLOSURE

A business's disclosure of its efforts to eliminate human trafficking from its supply chains **must**:

- Be posted on its website unless it does not have a website.
- Have a link to the required information on its homepage and the link must be:
 - conspicuous; and
 - easily understood.

(Cal. Civ. Code § 1714.43(b).)

A website homepage is generally considered the first page a visitor sees. A company's marketing department may guard its homepage content to ensure that the homepage promotes its business with consistent messaging and branding. To comply strictly with the Supply Chains Act, however, a company should have a link to the required disclosures placed on its homepage.

Best practice is to entitle the link, "California Transparency in Supply Chains Act." The link must take the site visitor directly to the disclosure statement, because a link that requires site visitors to click through additional website pages does not amount to the required link on the homepage to the disclosures.

To comply with the requirement of conspicuousness, the homepage link should appear in **both** a conspicuous:

- Location.
- Manner.

Common practice is to place the link in the header or footer sections of the website homepage, alongside other links to company information, policies, and legal statements. Site visitors are accustomed to look for company policies in these locations, and a company's marketing department may be equally accustomed to allocating these areas for regulatory purposes.

Even when the link appears in a conspicuous location, it should also be presented in a conspicuous manner to stand out to a site visitor. "Conspicuous" has been defined under other California laws as:

- Clearly calling attention to the language (Cal. Bus. & Prof. Code § 17601(c)).
- Appearing in such a way that a reasonable person should notice it (Cal. Com. Code § 1201(b)(10) and see, for example, *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 482 n.5 (Cal. Ct. App. 1982) (a disclaimer of warranty in boldface type twice as large as the other terms of an agreement is conspicuous)).

Similarly, the Supply Chains Act homepage link should:

- Be set apart and not buried or otherwise hidden among other text.
- Have letters that are:
 - clear;
 - large enough to be easily legible;
 - in a color that does not blend into the background; and
 - in a larger font size than nearby text or a contrasting type.

The link can also have a border that sets it apart from other text.

Companies without a website must still provide a compliant, written disclosure to any consumer within 30 days of receiving a written request for the disclosure from the consumer (Cal. Civ. Code § 1714.43(b)).

REQUIRED CONTENT OF DISCLOSURE

The **minimum** required content for a Supply Chains Act disclosure is to what extent, if any, the business:

- Verifies its product supply chain:
 - to evaluate and address risks of human trafficking and slavery; and
 - including if the verification is **not** conducted by a third party.
- (See Product Supply Chain Verification.)
- Evaluates compliance with company standards relating to human trafficking and slavery in supply chains:
 - by doing audits of its suppliers; and
 - including if audits are **not** independent and unannounced.
- (See Supplier Auditing.)
- Requires **direct** suppliers to certify that materials incorporated in the product comply with applicable laws relating to slavery and human trafficking (see Direct Supplier Certification).
- Maintains internal accountability standards and procedures for employees or contractors not meeting company standards relating to slavery and trafficking (see Internal Accountability Standards).
- Trains its management and employees with direct supply chain responsibility on human trafficking and slavery, especially on how to mitigate these risks in the supply chain of products (see Internal Training).

(Cal. Civ. Code § 1714.43(c).)

Product Supply Chain Verification

As issues of corporate social responsibility have gained greater attention and visibility, companies have become more concerned with ensuring that their supply chains are free of human trafficking.

Therefore, while the verification requirement may be satisfied with a statement such as, "We do not engage in any verification of our product supply chains to evaluate and address risks of human

trafficking and slavery,” many companies covered by the Supply Chains Act have begun examining their supply chains to:

- Assess the potential for human trafficking.
- Identify the extent of this risk.

Best practice for this disclosure requirement includes indicating:

- How often the business performs its analysis.
- The extent of the verification, for example:
 - all product supply chains; or
 - only supply chains for certain products or geographical areas.
- Whether the verification is performed by:
 - the company; or
 - an independent third party.

Supplier Auditing

A fundamental consideration for the auditing disclosure is whether a company in fact has anti-trafficking standards for suppliers to meet. Companies may choose to reference either:

- Their supplier codes of conduct.
- Their adherence to recognized anti-trafficking principles and guidelines.

Independent auditors and unannounced audits may be more likely to discover human rights violations and create an accurate report of a supplier, and the Supply Chains Act demonstrates a recognition of this point. For example, an in-house auditor may be reluctant not to issue a clean report card even when there are violations of anti-trafficking codes of conduct. Suppliers who are given advance notice of an audit may also be able to make temporary changes in their practices.

A significant portion of the audit disclosure requirement is therefore written in the negative: companies must “specify if the verification was not an independent, unannounced audit” (Cal. Civ. Code § 1714.43(c)(2)).

Larger companies with complex global supply chains and many suppliers may find the cost of auditing every supplier prohibitive. Best practice for this disclosure requirement includes indicating:

- The number or approximate number of total suppliers and the percentage of suppliers audited.
- If not all suppliers are audited, how suppliers are selected for audit.
- How often audits are performed.
- The extent of the auditing, for example:
 - all product supply chains; or
 - only supply chains for certain products or geographical areas.
- Whether audits are performed by:
 - the company; or
 - independent third parties.

Direct Supplier Certification

A contractual provision in the company’s supply agreements is the most common vehicle for obtaining certification from suppliers that materials incorporated in their products comply with applicable

laws relating to slavery and human trafficking. If a company’s supply agreements contain this type of provision, that method of certification should be disclosed.

Companies should also disclose the use of questionnaires or any other method of obtaining direct supplier certification of compliance with applicable slavery and human trafficking laws.

Many businesses simply state that they do in fact require direct supplier certification. Others also explicitly reference the requirements that suppliers must comply with, including laws, regulations, and international standards as well as the company’s codes of conduct.

Internal Accountability Standards

The internal accountability disclosure requirement provides an opportunity for a company to describe its anti-trafficking policies for operating its own business, as opposed to the standards applicable to its suppliers. Some companies take this opportunity to describe the company’s culture and corporate social responsibility priorities.

The information disclosed under this requirement depends on:

- Whether the company has created a compliance program incorporating anti-trafficking policies.
- What procedures exist to ensure that employees and contractors are following those policies.

As with the supplier auditing requirement (see Supplier Auditing), references to the applicable codes of conduct or recognized anti-trafficking principles and guidelines can provide the necessary context for this disclosure.

Best practice for this disclosure requirement also includes indicating:

- The consequences for an employee or contractor found to have violated anti-trafficking policies. These consequences are often stated as “discipline up to and including termination.”
- Any:
 - reporting procedures, such as toll-free hotlines;
 - no-retaliation policies; and
 - multi-language instructions.

Internal Training

There can be significant flexibility in addressing the internal training disclosure requirement. The Supply Chains Act does not require any particular training materials or methods.

Best practice for this disclosure requirement includes indicating:

- The categories of managers and employees receiving training.
- Whether the training is done by:
 - in-house trainers;
 - outside consultants; or
 - web-based educational institutions.
- The parameters of the training courses, in particular their:
 - substance;
 - class time; and
 - frequency.

CONSEQUENCES OF NONCOMPLIANCE

The consequences of noncompliance with Supply Chains Act requirements may include actions under:

- The Supply Chains Act (see Supply Chains Act Exclusive Remedy).
- Other laws (see Remedies Under Other Laws).

SUPPLY CHAINS ACT EXCLUSIVE REMEDY

The Supply Chains Act itself provides an exclusive remedy for a violation of it, which is an action brought by the California Attorney General for injunctive relief (Cal. Civ. Code § 1714.43(d)).

When the Attorney General's Office has identified companies subject to the Supply Chains Act (see Covered Businesses) who have not properly disclosed their efforts to eliminate slavery and human trafficking from their direct supply chains, the California Department of Justice has sent notices to the companies both:

- Informing them of the Supply Chains Act disclosure requirements.
- Requesting compliance with the law.

REMEDIES UNDER OTHER LAWS

The Supply Chains Act expressly provides that it does not limit any remedies that may be available for a violation of any other state or federal law (Cal. Civ. Code § 1714.43(d)).

Consumers have brought actions pointing to Supply Chain Act disclosure statements as a basis for alleged liability under California consumer protection statutes:

- The Unfair Competition Law (UCL) (Cal. Bus. & Prof. Code §§ 17200 to 17210).
- The False Advertising Law (FAL) (Cal. Bus. & Prof. Code §§ 17500 to 17509).
- The Consumers Legal Remedies Act (CLRA) (Cal. Civ. Code §§ 1750 to 1784).

(See, for example, *Barber*, 154 F. Supp. 3d at 962.)

While the *Barber* plaintiffs were unsuccessful, the UCL, FAL, and CLRA may yet be sources of litigation and potential liability based on Supply Chain Act disclosure statements.

BEST PRACTICES

A business subject to compliance requirements under the Supply Chains Act should consider how best to comply, given:

- The facts of its own supply chain.
- Its resources.
- Its business priorities.

The company should draw on internal and, potentially, external knowledge and experience for information and advice from risk management, product development, marketing, human resources, and legal representatives.

Best practices may include developing and implementing company policies that cover:

- Company standards relating to human trafficking.
- Company procedures for evaluating and auditing suppliers, including:
 - using third-party service providers; and
 - unannounced audits.
- Including in supplier agreements a certification of compliance with applicable laws relating to human trafficking.
- Addressing those employees and contractors who violate the company's anti-trafficking standards.
- Training for management and employees with direct supply chain responsibility on human trafficking and the mitigation of these risks in supply chains.

Based on internal and supplier information, businesses can identify particular areas of risk and may consider whether the company's interests (and any broader interests that the company aims to promote) are best served by either:

- Working with certain suppliers to correct any deficiencies.
- Terminating certain suppliers.

A policy of automatic termination for suppliers found to have engaged in code of conduct violations may, for example, incentivize suppliers to conceal any misconduct. Assisting suppliers to address violations may avoid this dynamic (and help to preserve jobs in the supplier's organization).

The company should:

- Identify the parties responsible for developing its disclosure statement in compliance with the Supply Chains Act.
- Create ongoing processes to:
 - confirm that the company's disclosure statement accurately reflects the company's policies and activities; and
 - ensure that changes in policies and procedures, business operations, organizational structure, or supply chains trigger an analysis of whether the disclosure statement must be revised.
- Schedule, at least annually, a review of the disclosure statement so that internal or external events result in a revision to the statement as needed.

Those responsible for drafting and revising the disclosure statement should carefully:

- Prepare the disclosure statement to avoid factual overstatements and absolute statements that may not be warranted (for example, "our supply chains are free of human trafficking" or "none of our products are touched by forced labor"). As appropriate, the company's objectives may be stated as aspirational (for example, "we desire that our supply chains should be free of human trafficking").
- Verify that there are no inconsistencies between the disclosure statement and:
 - actual practices; or
 - other disclosure statements that may be mandated by additional laws or regulations applicable to the company.

VOLUNTARY STATEMENTS

A business that is not required to comply with the Supply Chains Act may still consider whether its corporate culture, its marketing strategy, or other factors support making voluntary statements on its website or elsewhere about:

- Its evaluation and any audits of its suppliers for human trafficking and slavery risks and violations.
- Its policies regarding certification by its suppliers of compliance with applicable laws relating to human trafficking.
- Its standards, training, and procedures for contractors, employees, and management in connection with:
 - human trafficking risks; and
 - any internal violations of related company policy.

OTHER DISCLOSURE LAWS FOR CORPORATE SOCIAL RESPONSIBILITY IN SUPPLY CHAINS

Various disclosure laws have recently been enacted. For example, the UK Modern Slavery Act requires a covered company to publish a statement on its website that describes the steps it has taken during the year to ensure that slavery and human trafficking are not taking place in its supply chains or its own business. Although there are no required supply chain topics (as opposed to the five required topics of the Supply Chains Act), suggested information to be provided includes:

- A business's slavery and human trafficking policies.
- Due diligence processes regarding slavery and human trafficking.
- Steps to assess and manage risk of slavery and human trafficking.
- Training given to the business's staff.

As with the Supply Chains Act, companies may say they have taken no steps at all. (For more information about the UK Modern Slavery Act, see Expert Q&A on the UK Modern Slavery Act 2015 ([W-001-1387](#))).

MULTIPLE DISCLOSURE REQUIREMENTS: BEST PRACTICES

Companies that are subject to multiple corporate social responsibility disclosure requirements under domestic or foreign law should give strategic consideration to whether the statements should be consolidated or appear separately. Factors to consider include whether:

- The company wants to present its statements in a format that provides topic headings followed by a description. This format allows consumers (and the California Attorney General's Office) to readily identify how the company is addressing each topic.
- The company's website style is more:
 - formal and information-focused, and so more consistent with multiple statements.
 - casual or conversational, so that it may be more appropriate to have a narrative covering the various topics in one inclusive statement.
- The company's anti-trafficking activities align, so that one inclusive statement minimizes redundancies.
- The company wants to present multiple disclosure statements, to dedicate more of its website to anti-trafficking policies and activities.
- Multiple statements have the potential to produce inconsistencies.
- Changes to a statement required under another disclosure scheme would also impact the Supply Chains Act disclosures. Having only one statement to revise may be more straightforward.

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