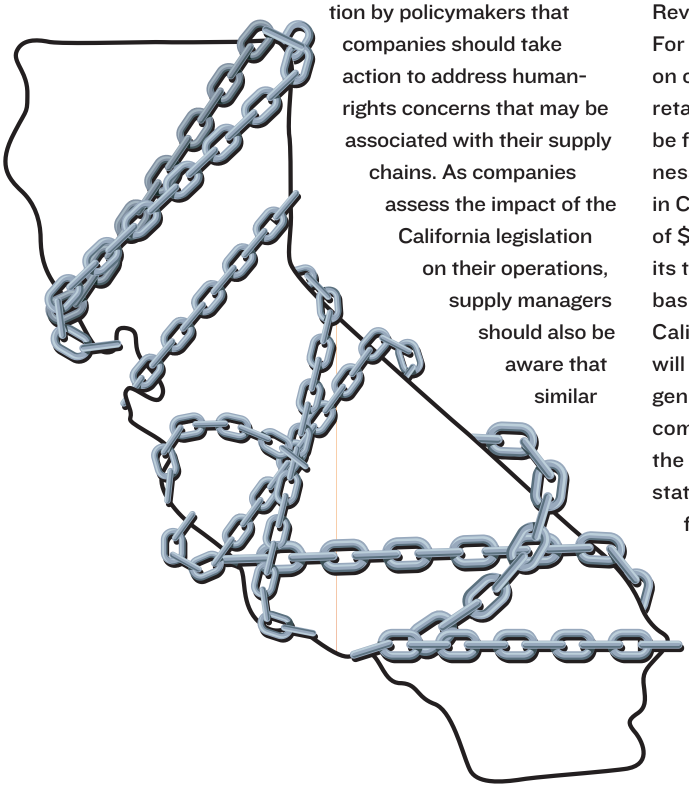
By Sarah A. Altschuller

Trafficking in Supply Chains

The California Transparency in Supply Chains Act presents a new legislative priority for state and federal legislators.

As of January 1, 2012, many retailers and manufacturers doing business in California will be required to disclose the extent of their efforts to evaluate and address the risks of human trafficking and forced labor in their product supply chains. The California Transparency in Supply Chains Act of 2010 reflects the growing expectation by policymakers that companies should take action to address human-rights concerns that may be associated with their supply chains. As companies assess the impact of the California legislation on their operations, supply managers should also be aware that similar federal legislation will likely be introduced later this year.



Passed in September 2010, the California Transparency in Supply Chains Act applies to retailers and manufacturers doing business in California that have annual gross receipts exceeding US$100 million. Companies assessing the impact of the legislation on their operations should be aware of recent changes in California's Revenue and Taxation Codes: For taxable years beginning on or after January 1, 2011, a retailer or manufacturer may be found to be "doing business" in California if its sales in California exceed the lesser of $500,000 or 25 percent of its total sales. On an annual basis, beginning in 2012, the California Franchise Tax Board will provide the state attorney general with a list of known companies required to make the disclosures specified by the statute. The exclusive remedy for failure to comply with the law is an action brought by the attorney general for injunctive relief.

The California legislation requires companies to disclose, on their corporate websites, the efforts they have taken, if any, to:

- Evaluate and address the risks of human trafficking and forced labor in their product supply chains. These disclosures must specify whether or not this verification was conducted by an independent third party.
- Require their direct suppliers to certify that the materials incorporated into company products comply with laws regarding forced labor and human trafficking in the countries in which they are doing business.
- Conduct audits of their suppliers to evaluate compliance with company standards on trafficking and forced labor. These disclosures must state whether the company uses independent, unannounced audits.
- Maintain accountability standards and procedures for employees or contractors who fail to meet corporate standards regarding forced labor and human trafficking.
- Provide employees and managers with direct responsibility for supply chain management with training on the mitigation of human trafficking and forced-labor risks.

The legislation is notable in that it impacts both brand-name retailers that have already faced considerable scrutiny with regard to human-rights issues in their supply chains as well as companies that have not historically received much attention regarding these issues.

The legislation was passed as the result of the work of a coalition of institutional investors, faith-based investors and human-rights advocates. It is reflective of the emerging expectation that all companies should conduct "human-rights due diligence" to assess, and respond to, the adverse human-rights impacts associated with their activities. The expectation is at the core of the *Guiding Principles on Business and Human Rights*, drafted by the U.N. Special Representative for Business and Human Rights Professor John Ruggie, and approved by the U.N. Human Rights Council in June 2011.

Drawing upon Professor Ruggie's work, the Organization for Economic Co-operation and Development (OECD) recently revised the *OECD Guidelines of Multinational Enterprises*, which now state that "respect for human-rights is the global standard of expected conduct for enterprises" and companies should "carry out human-rights due diligence as appropriate to the size, the nature and context of operations and the severity of the risks of adverse human-rights impacts."

Human trafficking has recently received significant attention from state and federal policy leaders. The language of the California statute cites a September 2009 report by the U.S. Department of Labor that identifies 122 goods from 58 countries that the Department of Labor has reason to believe were produced with either forced labor or child labor. As a result of increased attention to this issue, companies should be aware that other states and the federal government are considering legislation similar to the California statute. In Washington, D.C., Rep. Carolyn Maloney (D-NY) is expected to introduce federal legislation with similar disclosure requirements for retailers and manufacturers in the second half of 2011.

All impacted companies will be vulnerable to scrutiny regarding the sufficiency of their efforts, but no company is expected to adopt a specific set of procedures to comply.

Necessary Steps for Supply Management

In advising companies on how to comply with the legislation, the following steps are recommended:

- **Review the risks related to forced labor and human trafficking associated with your company's specific supply chain.** Risk factors may relate to the type of product being sourced, the geographic location of specific suppliers and/or specific practices by suppliers, including the use of labor recruiters.
- **Review the company's policies and standards.** Review, revise or draft policies and standards, as necessary, to set clear expectations for employees and suppliers regarding company prohibitions on forced labor and human trafficking.
- **Review supplier guidelines and contracts.** Review and modify, as necessary, supplier standards, guidelines and/or certification requirements to ensure the company's expectations regarding forced labor and human trafficking are clearly documented. Direct suppliers should be required to certify that all materials were sourced in compliance with relevant laws.
- **Review audit protocols and guidelines.** Review existing audit protocols and guidelines and evaluate whether independent social compliance audits may be required. This determination should consider the nature and scope of the supply chain, the relative degree of risk that human trafficking and forced labor may be linked to suppliers' business practices, and the nature of the company's existing audit practices with regard to social compliance. Companies will be required to disclose whether or not they use independent audits to evaluate supplier compliance with company standards.
- **Review accountability mechanisms.** Ensure that employees and contractors are held accountable to the company's standards on forced labor and human trafficking, as appropriate to the nature of their specific responsibilities.
- **Evaluate sufficiency of existing training programs.** Evaluate current training programs for supply chain managers and employees and, as necessary, identify opportunities to integrate material on forced labor and human trafficking.

The disclosures required by the California legislation are explicitly intended to provide consumers with the information they need to make informed purchasing decisions. The disclosures will also be the subject of considerable advocacy by those who originally advocated for the statute. Many companies will likely face scrutiny as to the sufficiency of their efforts and disclosures. As drafted, the California statute requires disclosure of corporate efforts, "if any"; this allows for companies to take a range of approaches in developing programs and disclosures appropriate to the nature and risk profile of their supply chain. All impacted companies will be vulnerable to scrutiny regarding the sufficiency of their efforts, but no company is expected to adopt a specific set of procedures to comply. Companies should base their efforts on informed evaluations of the risks associated with their particular sourcing activities. ISM

Sarah A. Altschuller is an associate with the corporate social responsibility practice at Foley Hoag LLP in Washington, D.C. For more information, send an e-mail to **author@ism.ws**.