



# CAPTURING THE GAINS



*economic and social upgrading  
in global production networks*

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## The California Transparency in Supply Chains Act

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## Abbreviations

ASSET	Alliance to Stop Slavery and End Trafficking
BSR	Business for Social Responsibility
CAST	Coalition to Abolish Slavery and Trafficking
CEPAA	Council on Economic Priorities Accreditation Agency
CFTB	California Franchise Tax Board
CPRC	Chronic Poverty Research Centre
CTSCA	California Transparency in Supply Chains Act
DDD	Due Diligence Dashboard
DFID	Department for International Development
DRC	Democratic Republic of Congo
ESRC	Economic and Social Research Council
ETI	Ethical Trading Initiative
EU	European Union
FLA	Fair Labor Association
FLEGT	Forest Law Enforcement, Governance and Trade
FTB	Franchise Tax Board
GSCP	Global Social Compliance Program
HP	Hewlett Packard
SCI	Sustainable Consumption Institute
SER	Social and Environmental Responsibility
UK	United Kingdom
UN	United Nations
UNODC	UN Office on Drugs and Crime
US	United States
WRAP	Worldwide Responsible Apparel Production

## **Abstract**

After a decade or more during which private codes to monitor supply chain and workplace standards have proliferated, recent years have seen the re-emergence of state-based initiatives to create more oversight and accountability across global value chains. In January 2012, the California Transparency in Supply Chains Act (Senate Bill 657) (CTSCA) was enacted. The CTSCA requires that retailers and manufacturers doing business in California, with annual worldwide gross receipts of \$100 million or more, must explicitly disclose their efforts to eradicate slavery and human trafficking, and protect basic human rights, along their entire supply chain. Companies have moved quickly to update their auditing mechanisms to ensure all supplier factories meet the requirements of the Act. The overall goal of the regulation is to ensure companies operate with a much greater level of caution when selecting suppliers and making sourcing decisions. This Working Paper outlines the dimensions of the Act, its implications for global sourcing and some early responses to it by companies that do business in California.

## **Keywords:**

Public governance, standards, codes, human rights, supply chain

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## Public governance dynamics

Global social compliance emerged rapidly in the decade of the 2000s as the consequences of the globalization of production resulted in weaker regulations and deteriorating conditions of work, leading to what Gereffi and Mayer (2004) called a global governance deficit. The geographical competition to reduce costs drove down wages and led to widespread workplace abuse and increasing reputational risk for major brands and retailers. Mayer and Pickles (2010) and Gereffi and Mayer (2010) have subsequently argued that the worker and consumer struggles that resulted from the failure of global value chains to regulate working conditions in turn stimulated the proliferation of new kinds of private and public governance initiatives. This focused largely on the need for buyers to implement private codes of conduct to protect the basic rights of workers, and to ensure minimum compliance with workplace standards in their supply chains, the result was a culture of factory monitoring to regulate and sanction non-compliance and manage brand reputation.

These private governance initiatives have however multiplied code systems and compounded compliance problems, particularly in newly emerging supplier regions. In response, international organizations such as the Fair Labor Association (FLA), Worldwide Responsible Apparel Production (WRAP), the Council on Economic Priorities Accreditation Agency (CEPAA), the Ethical Trading Initiative (ETI), Business for Social Responsibility (BSR) and the Global Social Compliance Program (GSCP) in conjunction with their member companies have recently been implementing new common standards to regulate offshore sourcing operations. The resulting codes of conduct are now widely embraced by global buyers, retailers and lead firms, particularly around nine key areas: child labour; forced labour; health and safety; compensation; working hours; discrimination; discipline; free association and collective bargaining; and management systems.

In parallel with these private initiatives, new public and public–private governance mechanisms have begun to emerge. In China, the 2007 Contract Labour Law has attempted to create a more stable and higher base level of rights and working conditions for workers (Lan and Pickles 2011). In the European Union (EU), the 2010 Forest Law Enforcement, Governance and Trade (FLEGT) Law prohibits marketing of illegally logged timber on European markets and requires companies to exercise due diligence to minimize the risk of illegal products reaching the market. The due diligence obligation requires companies to seek information about the origin of the timber, harvest conditions, suppliers involved and compliance with national laws, to conduct a risk assessment and to put in place mitigation measures. The law applies to virtually all paper-based products, except recycled and printed products such as books and magazines. In the US, under the 2010 Dodd-Frank Act, companies must not only disclose whether conflict minerals (defined as gold, tin, tungsten and tantalum) used in their products originate from the Democratic Republic of Congo (DRC), but also report on the due diligence exercised when they do.<sup>1</sup> The 2011 UK Bribery Act requires companies not only to disclose whether conflict minerals (defined as gold, tin, tungsten and tantalum) in their products originate from the Democratic Republic of Congo (DRC), but also to report on the due diligence exercised when they do. While these two

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<sup>1</sup> For a broader discussion of the conflict mineral coltan, see Nathan and Sarkar (2011).

regulations apply only to companies listed in the US and the UK, it is widely expected that the EU will adopt similar and possibly more far-reaching regulation in the near future. To these public governance initiatives has now been added the 2010 California Transparency in Supply Chains Act (CTSCA) (Barraco 2012).

## **The California Transparency in Supply Chains Act 2010**

On 30 September 2010, former Governor Arnold Schwarzenegger signed the CTSCA (Senate Bill 657) into law, and it came into effect on 1 January 2012 (Gonzalez Marcos 2011). The CTSCA requires retail sellers and manufacturers that do business in California, and have annual worldwide gross receipts of \$100 million or more, to disclose their efforts to eradicate slavery and human trafficking from their direct supply chains for tangible goods offered for sale.<sup>2</sup> Despite decades of non-governmental organization (NGO) pressure and private codes and audits, child labour remains a serious concern in goods production in the supply chain intended for US markets (US Department of Labor 2012). According to an estimate by the California Franchise Tax Board (CFTB), around 3,200 companies will be affected by the CTSCA (Gebauer 2011a). Indirectly, the CTSCA will also have impacts on thousands of suppliers and vendors along the supply chains of these 3,200 retailers and manufacturers.

### **Requirements of the CTSCA**

Companies doing business in the state of California with more than \$100 million in worldwide gross receipts that have listed either manufacturing or retail trade as their principal business activity code<sup>3</sup> on their California tax return must comply with the requirements of the CTSCA. The CTSCA requires these companies to disclose their efforts to ensure slavery-free products and to describe the extent to which they engage in the following (Gebauer 2011b):

- **Verification:** Verify product supply chains to evaluate and address the risk of human trafficking and slavery (the disclosure shall specify if the verification was conducted by a third party or not);
- **Auditing:** Perform supplier audits to evaluate compliance with company standards (the disclosure shall specify if the verification was an independent, unannounced audit or not);
- **Certification:** Require certification by direct suppliers that materials used in products comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business;
- **Internal accountability:** Maintain internal accountability standards and procedures for employees or contractors that fail to meet company standards on slavery and trafficking;

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<sup>2</sup> The UN Office on Drugs and Crime (UNODC) estimates human trafficking to be the third largest international crime industry (after illegal drugs and arms trafficking), with an estimated value of \$32 billion (\$15.5 billion of which is made in industrialized countries) (CNN 2011). Between 14,500 and 17,500 people are trafficked into the US each year, and 600,000 to 800,000 people are trafficked across international borders. Additionally, a Department of Labor report listed 122 goods from 58 countries that are believed to be tainted by force or child labour (US Department of Labor 2009).

<sup>3</sup> A list of 2010 California Principal Business Activity Codes can be found at [https://www.ftb.ca.gov/forms/2010/10\\_100bk.pdf](https://www.ftb.ca.gov/forms/2010/10_100bk.pdf)

- **Training:** Train relevant company employees and management on human trafficking and slavery, particularly concerning the mitigation of risk within supply chains.

CTSCA disclosure must be posted on the websites of retailers and manufacturers bound by its laws with a link to the required information in a conspicuous and easily understood manner (see, for example, General Electric and Hanesbrands Inc.) (General Electric Company 2011). Where retail sellers or manufacturers subject to the CTSCA do not have a website, written disclosure must be provided to consumers making a written request, within 30 days. Initially, there was some confusion about how companies were to present their disclosure. It was unclear to what extent the CTSCA needed to be mentioned or how a link was to be made 'conspicuous and easily understood' (Gebauer 2011a). That is, should the link name 'The California Transparency in Supply Chains Act', 'Eradicating Slavery and Human Trafficking in Our Supply Chain', or could it be a more general title such as 'Corporate Social Responsibility'?

The CTSCA recognizes that slavery and human trafficking exist everywhere, including in the US. It refers to the US Department of Labor report required by the Trafficking Victims Protection Reauthorization Acts of 2005 and 2008 (US Department of Labor 2009). The CTSCA also recognizes that state and federal laws, as well as international treaties, are in place to curtail slavery and human trafficking. It aims to tackle the problems of slavery and human trafficking through market incentives; by giving consumers the ability to know what companies are doing to ensure that their products, and supply chains, are slavery-free, it encourages conscientious consumers to purchase products from compliant companies. However, none of the key terms used, such as 'direct supplier', 'slavery' and 'human trafficking', have been explicitly defined. In 2011, the California Attorney-General held a multi-stakeholder roundtable to discuss the difficulties companies are confronting with the CTSCA and to provide them with guidelines for legal compliance (Gebauer 2011b). As a result, as industry associations pointed out in their criticism of the CTSCA, what constitutes compliance within the legal framework of the Act is far from clear (see Supporting organizations, below), although some assessment of the scope of a company's engagement in activities to eradicate slavery and human trafficking can be made.

## **Enforcement**

The CTSCA is enforced by the CFTB and the California Attorney-General's Office. At the end of the tax year, the Tax Board compiles a list of businesses that are engaged primarily in manufacturing or retail trade, and have gross receipts of \$100 million or more. This list is sent to the Attorney-General's Office, which reviews each company's website and determines whether it is in compliance with the CTSCA. The exclusive sanction available to the Attorney-General to use in response to violations of the CTSCA is an action for injunctive relief. The CTSCA does not create a private right of action (Luxton 2011).

The CTSCA does not impose a direct penalty for non-compliance, but allows for an injunction by the California Attorney-general to correct corporate behaviour (Gonzalez Marcos 2011). An injunction or the mere threat thereof may affect the reputation of a retailer or manufacturer and therefore be an effective incentive for complying with the CTSCA. In

addition, the CTSCA will indirectly prompt companies to enhance clauses in supply contracts, ultimately leading to greater protection for companies from liability caused by the behaviour of their suppliers. In this situation, it is advisable to refer explicitly, in disclaimers of liability clauses of supply agreements, to the company's policies, procedures, and standards regarding the provenance of a product, especially with regard to slavery and human trafficking. Companies that cannot account for the provenance of their products may soon find themselves losing competitiveness to companies that can. They may also be exposed to costly litigation.

The CTSCA is a regulatory compliance mechanism that relies mainly on market incentives. In requiring disclosure of a practice that is already common among big retailers and manufacturers, the government takes advantage of existing know-how, infrastructure and trained personnel. However, criticism has argued that this required disclosure increases the cost of entry for new actors in that market. The success of the CTSCA depends on the development of consumer awareness. It is difficult to imagine it working in societies where consumer awareness is still developing.

### **Supporting organizations**

The CTSCA was proposed by Senate President *pro tem* Darrell Steinberg (D-Sacramento) with the Alliance to Stop Slavery and End Trafficking (ASSET) as the source and the Coalition to Abolish Slavery and Trafficking (CAST) as the co-sponsor (Gebauer 2011a). It was also supported by the Consumer Federation of California. The not-for-profit organizations that sponsored and rallied for the CTSCA argued that it would create an opportunity for Californian companies to demonstrate leadership in eradicating slavery and human trafficking from their supply chains, and empower consumers to reward companies that engage proactively in such efforts. Its main goal was to improve corporate responsibility practices, refine traceability technologies and create more informed and discerning consumer preferences.

Opponents of the bill, such as industry associations – the California Grocers Association and the California Manufacturers and Technology Association – argued that the lack of resources, especially on the side of grocers, would prevent them from effectively monitoring supplier employment. Furthermore, the associations noted that the CTSCA provided no details as to what constituted compliance with the legal framework. This last point of criticism will become apparent when reviewing the legal requirements (Gebauer 2011a).

### **Companies' response to the CTSCA**

Even before the CTSCA was enacted, many large retail companies had already implemented standards along their supply chains to ensure the quality and the environmental and ethical compliance of products. Large retailers and manufacturers in particular already require certification on enforcing global compliance with basic human rights standards, with particular attention given to stopping abuses, through formal agreements with their suppliers. In addition, third parties have been monitoring and analysing company practices so that individual company claims regarding their products and practices along the supply chain can be verified reliably (Galland 2010). A study supported

by a network of 20,000 retailers analysed and compared data on the compliance programmes of major apparel companies in the US market (ibid.). According to this report, Levi's, Wal-Mart, Gap Inc., Hanesbrands, Nordstrom and Gildan Activewear fared well with regard to compliance programmes because they were 'not only doing the basics of auditing facilities but also committing significant resources to remediation, continuous improvement, and collaboration at many levels. They allow substantive third-party critiques and furnish public reporting.'

In line with the CTSCA, major manufacturers and retailers recognize the pervasiveness of practices that could be construed as slavery and human trafficking and are committed to addressing the issues within their supply chains. For many larger companies, supply chain transparency and compliance with company or third-party codes and standards has been common practice for a number of years.

For example, since its social and environmental responsibility (SER) supply chain programme began in 2000, Hewlett Packard (HP) has undertaken continued efforts to ensure and verify the absence of forced labour and child labour in its supply chain. In response to the five key requirements of the CTSCA, HP's efforts to eradicate slavery and human trafficking in its supply chain include: risk-based supplier assessments, supplier audits, supplier agreements, capability building programmes, and procurement professional training (HP 2011).

PUMA has in place a factory monitoring system to ensure compliance with its Code of Conduct, which covers issues such as maximum working hours, basic wage, respect, equality and restriction of forced labour, among others. Furthermore, according to the PUMA Safe programme, within its manufacturing agreements, every factory that manufactures PUMA products is audited for compliance with all PUMA standards and the relevant national and local laws – including those related to anti-slavery and human trafficking. Its factories are also subject to compliance audits by the FLA,, which at present are all unannounced visits. In accordance with the CTSCA, PUMA is dedicated to expanding its standards and scope, taking measures to cover the necessary efforts needed to eradicate slavery and human trafficking in its immediate supply chain, and eventually beyond. This includes strengthening and making more explicit PUMA's workplace standards and policies for the manufacturers (PUMA 2011).

General Electric's Supplier Responsibility Program, to ensure compliance along its supply chain, includes on-site audits of suppliers in the developing world. Between 2008 and 2011, General Electric conducted on-site assessments in 67 countries (General Electric Company 2011).

Agilent Technologies, a company located mainly in California that designs and manufactures electronic and bio-analytical measurement instruments and equipment for measurement and evaluation, has also disclosed its efforts in response to the CTSCA, including written policies and procedures strictly prohibiting the use of slavery or human trafficking in its direct supply chain, supplier certifications, third-party audits, accountability standards and employee training (Agilent Technologies 2011).



## **Impacts beyond California**

Between the CTSCA being signed into law in 2010 and it coming into effect in January 2012, companies were given a short time to update their auditing mechanisms to ensure compliance in their direct supply chains. US-based manufacturers and retailers with overseas supply chains now have to ensure compliance with all aspects of: the code of conduct, federal and state-level law, eradicating slavery and human trafficking and protecting basic human rights along their entire supply chains. The overall goal of the regulation is to ensure companies operate with a much greater level of caution in supplier selection and when making decisions regarding sourcing. The CTSCA also has direct impacts on foreign companies that do a significant amount of business in California. Companies such as Asus Computer Inc. and Lenovo Group Ltd. must also abide by the Act to operate in California or to supply retail partners within the state (Herman 2011).

The results to date are indeterminate, with no cases yet coming before the courts. The legal services organization LexisNexis responded by creating the 'Due Diligence Dashboard' (DDD) to help companies identify potential sources of problems in their supply chains. They claim DDD 'synthesizes data from more than 20 global databases including public records and news and company filing information to uncover risks in supply chains. For example, a DDD search of Foxconn, the contractor utilized by Apple to produce its products in China, uncovered 1,500 negative news articles dating back to 1997' (Goswami 2012).

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Capturing the Gains brings together an international network of experts from North and South. The research programme is designed to engage and influence actors in the private sector, civil society, government and multi-lateral organisations. It aims to promote strategies for decent work in global production networks and for fairer international trade.

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