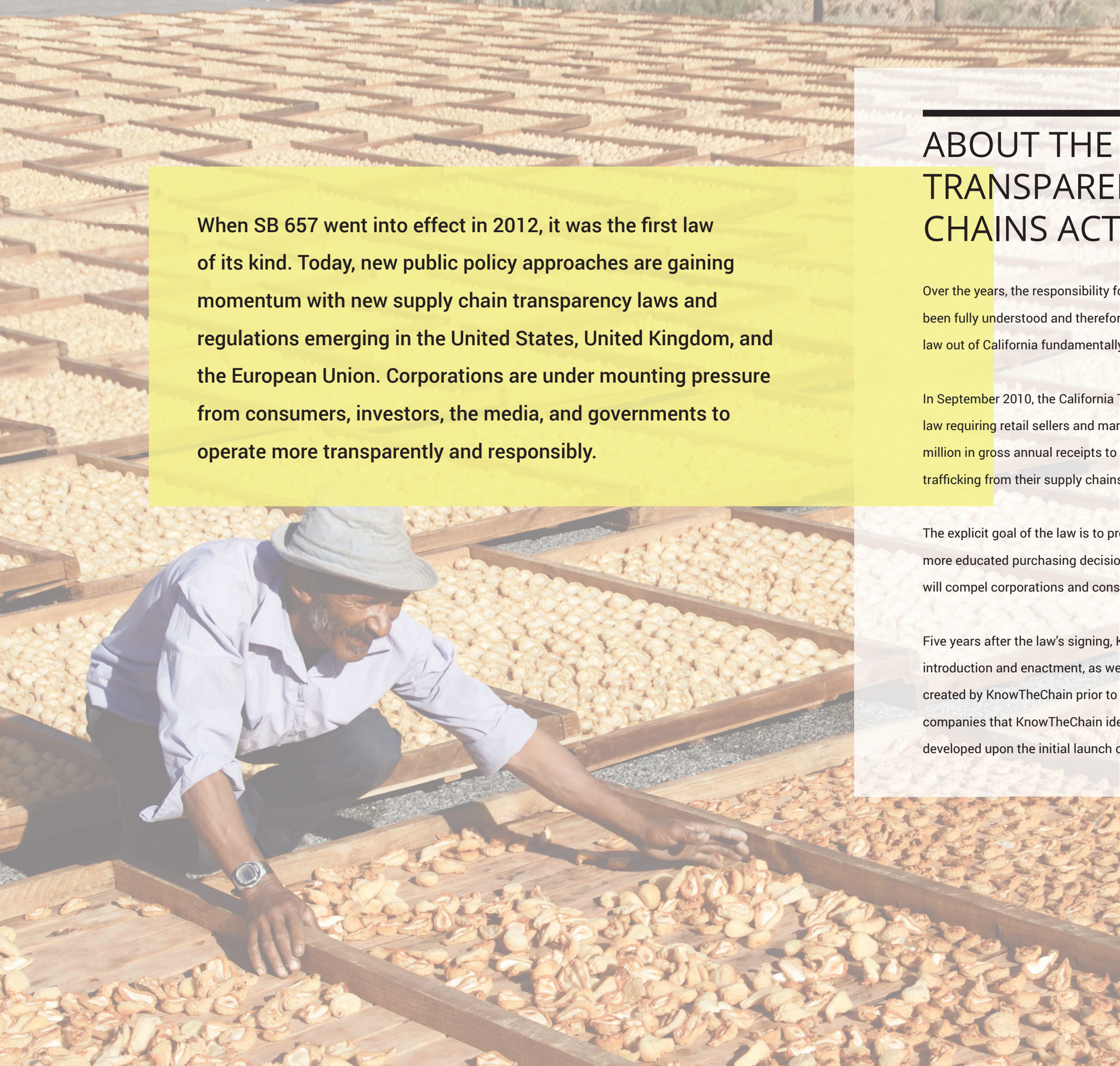


KNOW THE CHAIN

Insights Brief

Five Years of the California Transparency in Supply Chains Act

September 30, 2015



When SB 657 went into effect in 2012, it was the first law of its kind. Today, new public policy approaches are gaining momentum with new supply chain transparency laws and regulations emerging in the United States, United Kingdom, and the European Union. Corporations are under mounting pressure from consumers, investors, the media, and governments to operate more transparently and responsibly.

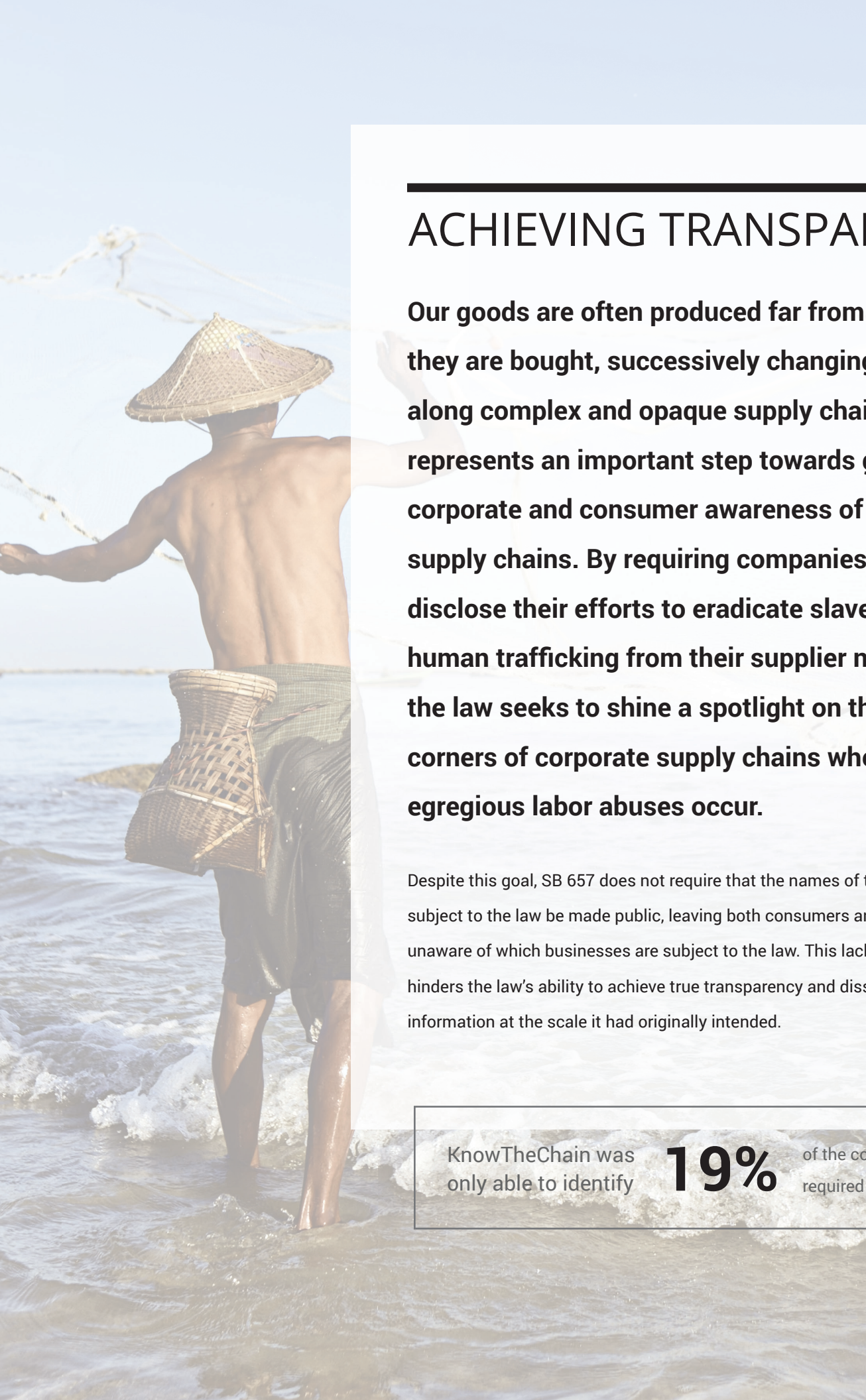
ABOUT THE CALIFORNIA TRANSPARENCY IN SUPPLY CHAINS ACT (SB 657)

Over the years, the responsibility for working conditions within corporate supply chains has not been fully understood and therefore has been largely ignored by the public. However, a pioneering law out of California fundamentally changed that.

In September 2010, the California Transparency in Supply Chains Act (SB 657) was signed into law requiring retail sellers and manufacturers that do business in California and have over \$100 million in gross annual receipts to publicly disclose their efforts to eradicate slavery and human trafficking from their supply chains.

The explicit goal of the law is to provide consumers with new information to enable them to make more educated purchasing decisions. The underlying hope is that the simple act of disclosure will compel corporations and consumers to truly engage in this human rights issue.

Five years after the law's signing, KnowTheChain has identified key lessons from SB 657's introduction and enactment, as well as ways to improve future laws. The Insights Brief was created by KnowTheChain prior to its expansion in the fall of 2015. It is based on a set of 500 companies that KnowTheChain identified as being affected by SB 657 using a methodology developed upon the initial launch of KnowTheChain in 2013.



ACHIEVING TRANSPARENCY

Our goods are often produced far from where they are bought, successively changing hands along complex and opaque supply chains. SB 657 represents an important step towards greater corporate and consumer awareness of slavery in supply chains. By requiring companies to publicly disclose their efforts to eradicate slavery and human trafficking from their supplier networks, the law seeks to shine a spotlight on the deep corners of corporate supply chains where the most egregious labor abuses occur.

Despite this goal, SB 657 does not require that the names of the companies subject to the law be made public, leaving both consumers and corporations unaware of which businesses are subject to the law. This lack of information hinders the law's ability to achieve true transparency and disseminate information at the scale it had originally intended.

KnowTheChain was only able to identify **19%** of the companies required to comply.

As a result, little to no information is available on the overall corporate response. When the law went into effect, guidance for how to comply was not provided to corporations impacted by the law.

Because of this inaction by the California Attorney General, who is charged with the law's enforcement, KnowTheChain developed a research methodology that allowed us to identify 500 companies that we believed were required to comply. Of these companies, only 31 percent had a disclosure statement available that was in compliance with all the requirements of the law.

Recommendation

Public reporting and information sharing gives consumers and investors a choice in what practices—and businesses—they want to support. SB 657 limited its own ability to create an environment of true transparency by not requiring that a list of companies subject to the law be publicly available. KnowTheChain recommends that the California's Attorney General's office, as well as future legislative and regulatory efforts, address this transparency barrier.

Companies should also proactively understand and address the risks within their supply chains and publicly disclose these efforts. Even if a company is not currently subject to this law, scrambling to meet the expectations of a changing disclosure environment is not a sustainable corporate strategy.

INCONSISTENT DISCLOSURE

Global businesses have a unique opportunity to contribute to the eradication of forced labor within their supply chains. SB 657 embeds this opportunity into a regulatory framework.

Although a disclosure statement alone does not measure a company's level of engagement on these issues, it does provide a standardized platform through which a corporation can share its actions.

Companies subject to SB 657 were required to comply on January 1, 2012. Unfortunately, the California Attorney General did not provide guidance on how to comply until April 2015. Lack of direction has made companies unclear on how they should interpret and implement the requirements of the law. In our research, we found a significant number of inconsistencies between the law's requirements and what was actually being publicly displayed. Moreover, although KnowTheChain identified approximately 500 companies subject to the law, the California Attorney General's guidance was sent to an estimated 2,600 companies. This list of companies has still not been disclosed.

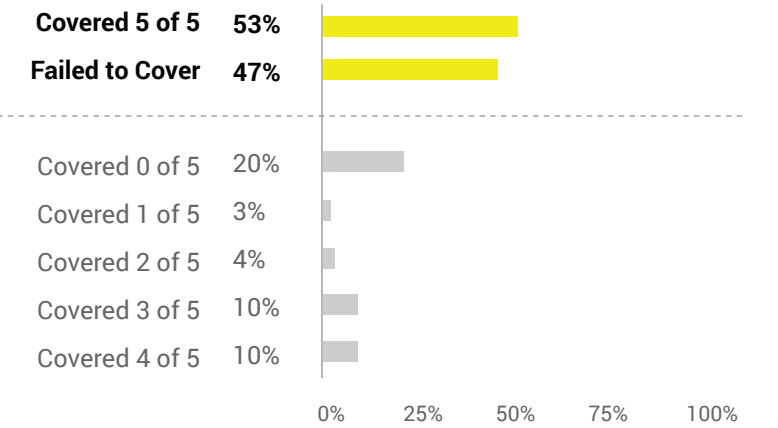
SB 657 requires that a disclosure statement include the extent to which a company engages in the following five categories: verification, auditing, certification, internal accountability, and training.

47% of the original 500 companies identified by KnowTheChain did not disclose sufficient information in all five categories.

10 percent of corporations did provide information on their websites about how they manage forced labor abuses within their supply chains. However, this information was not specifically located within a disclosure statement.

The law also requires that statements be made available on the homepage of each company's website, thereby ensuring the information is not only available, but also accessible. We found that only 46 percent of disclosure statements were linked from the homepage of a company's site.

Company Coverage of 5 Categories Required in the Law



Recommendation

There is an obvious lack of understanding of which companies are subject to the law and what they need to do to officially comply. Impacted companies were not given the timely guidance necessary to ensure they accurately met all legal expectations. Rather than focus on the substance of their statements, corporations have devoted time and resources to forming their own interpretations of the law.

The California Attorney General issued a resource guide recently that can help corporations draft and modify their statements. In order to comply, disclosure statements need to address all five issue areas identified by the law. Statements should also be easily accessible from a company's homepage. KnowTheChain has also identified resources that companies may find helpful if they would like to fulfill the spirit, in addition to the letter, of the law.

Future transparency laws should require enforcement agencies to release clear and timely guidance prior to the law taking effect. This guidance should also highlight ways that companies can go above the requirements of the law. This guidance should be provided to companies when they are informed that they are required to comply.

LEGISLATIVE LIMITATIONS

SB 657's disclosure requirement was intended to standardize how businesses disclose their responsible supply chain management practices. The goal was to allow consumers to compare comparably-structured statements.

However, impacted companies are selected based on their California State Tax Classification and not the similarity of their supply chains. In other words, if two companies have identical supply chains, but different tax classifications, one would be subject to the law, while the other one is not. This criteria is not based on a company's assumed risks and creates an uneven playing field for competitors.

SB 657 impacts companies based on their state tax filing (e.g., "retail seller" or "Manufacturer"). This creates an uneven playing field where some companies are held to a higher standard than their competitors.

Furthermore, the SB 657 reporting requirement does not specify how often a businesses needs to update their statement. If a company posts a statement once and never revisits it again, they would be nonetheless in compliance with the law. This one-time reporting requirement ignores the dynamic nature of supply chains and the environments in which they operate.



Recommendation

SB 657 and future legislative transparency laws should take the realities of the business landscape into consideration. Companies with similar supply chains share similar risks and therefore also share a responsibility to comply.

Furthermore, as business decisions and sourcing strategies adapt to competition and markets, so should disclosure statements. Reporting laws should require annual filings rather than one-time disclosure statements.

By aligning statement requirements with how businesses manage their supply chains, companies will be better-positioned to disclose and respond to risks within their supply chains.

CONCLUSION

SB 657 introduced a new legal requirement and by doing so has made companies more responsible for labor abuses within their supply chains. The law provides a great deal for legal counsels to decipher, brand managers to grapple with, investors to consider, and executives to manage. Whether these conversations have focused on the logistics of evaluating newer suppliers, figuring out who exactly was in charge of auditing, or pushing the boundaries for what each company can do to ensure their product production is not supporting forced labor abuses, each discussion is valuable. Five years after the passing of SB 657, its legacy is that the conversation is growing.

Since its enactment in 2012, multiple laws inspired by SB 657 have either been introduced or passed. This trend towards increased reporting and transparency is not only influencing what legal requirements exist for companies, as it pertains to management of their supply chains, but also impacting how multinationals think about their supply chain management more broadly.

Following SB 657 compliance has given KnowTheChain some insights into what is needed to create an environment of transparency. Laws need to be coupled with clear guidance, and regulations must work to never create imbalanced requirements for competing companies. Companies need

clear resources and support for their efforts. Consumers and stakeholders need to know how they can participate and how they can lend their voices, purchases, or investments to support the business practices that align with their values.

KnowTheChain will continue to work with companies to improve their supply chains management practices and with governments to think through the holistic processes necessary to make this transparency shift a cohesive reality.

KnowTheChain is a resource for businesses and investors who need to understand and address forced labor abuses within their supply chains.

Contact Info

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A project of Humanity United

METHODOLOGY

The Insights Brief was created by KnowTheChain prior to its expansion in the fall of 2015. It is based on a set of 500 companies that KnowTheChain identified as being affected by SB 657 using a methodology developed upon the initial launch of KnowTheChain in 2013.

Based on KnowTheChain's methodology, the companies included in the KnowTheChain dataset appeared at that time to meet all three criteria outlined in the law:

- 1. Retailer seller or manufacturer**
- 2. Annual worldwide gross receipts that exceed \$100 million**
- 3. Doing business in California**

Identifying Dataset

Three channels were used to identify these companies. First, a research team from the Coalition to Abolish Slavery and Trafficking, Not For Sale, and Verité used the Hoovers D&B database and relied on criteria developed by an outside law firm specializing in corporate and financial law to identify companies that meet the law's criteria. The team then researched each company and identified a number of disclosure statements. All companies with posted disclosure statements identified through this process were included on KnowTheChain's site.

Second, using the S&P Capital IQ database, Sustainalytics and Humanity United identified a second group of companies that also meet all three criteria in the law. This dataset was cross-referenced with the findings of the original research team. Companies that appeared in both datasets were also included on our site.

Third, in conducting additional due diligence to develop and populate the website, the KnowTheChain team identified a small number of additional companies with posted disclosure statements. These companies are also included on KnowTheChain. Using this final dataset, compiled through the process outlined above, the KnowTheChain team conducted an additional round of research to ensure all disclosure statements were appropriately captured. Using a standard search methodology, the team searched each company website for information outlining the procedures, if any, a company had established regarding human trafficking in their supply chains.

In the evaluation process, companies were given the benefit of the doubt. If they disclosed information within a specific SB 657 statement that generally talked about management practices, but it did not explicitly mention human trafficking or slavery, they were determined to disclose sufficient information to meet the requirement. However, if information for a company was found outside of a disclosure statement the information had to explicitly reference that such practices related to addressing forced labor, human trafficking, or slavery.

KnowTheChain recognizes that its dataset does not fully reflect all the companies subject to SB 657 and may reflect some companies not subject to SB 657. With the public information available, it is not feasible to definitively determine all of the companies that are subject to the law.



Research for this insights brief was prepared in part through the support of Concordia. Concordia's mission is to identify new avenues of collaboration for governments, businesses, and nonprofits through issue-based campaigns, year round programming, and the Partnership Index. Concordia promotes effective public-private collaboration to create a more prosperous and sustainable future.