

PERSPECTIVES

SUPPLY CHAIN ACCOUNTABILITY: NEW DIMENSIONS OF BUSINESS AND LEGAL RISK

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By now, businesses that operate in the global marketplace should be well aware of the expanding collection of 'name and shame' regimes that multiple governments have adopted, imposing supply chain transparency obligations on companies within their jurisdiction. These programmes include conflict minerals reporting requirements and human trafficking/slavery diligence mandates at the federal and state level in the United States and, increasingly, other countries. While compliance with the basic terms of these legal obligations is challenging enough, new types of business and legal risk are emerging as third parties closely scrutinise – and are finding ways to act upon

– what they see as false claims or underperformance by reporting companies.

One area posing specifically increased risk relates to the California Transparency in Supply Chains Act of 2010. This law, which went into effect in 2012, directs companies that have \$100m in annual gross receipts worldwide and manufacture or sell products in California to disclose on their websites what steps they have taken to eliminate human trafficking and slavery in their supply chains, using a format set forth in the law and elaborated upon in a Resource Guide published in 2015. The only enforcement authority under this law is injunctive action by the California Attorney General, which has yet to be invoked. Seeking sharper 'teeth', citizen-activists have

now turned to California anti-fraud and consumer protection laws to bring class action litigation against companies they believe are not properly complying with the Transparency Act or are otherwise making false or fraudulent claims related to the use of forced labour in their supply chains. These cases, discussed below, bear close watching; if these claims survive motions to dismiss, more litigation of this type is sure to follow.

In *Sud v. Costco Wholesale Corp.*, filed in federal district court in the Northern District of California on 19 August 2015, plaintiff Monica Sud claims, on her own behalf and that of similarly situated Californians, that Costco knowingly purchased farm-raised prawns from certain Thai fishing companies that use forced labour. The complaint alleges that Costco's disclosures under the Transparency Act are false and misleading, including its statement that the company adheres to a Code of Conduct that prohibits human trafficking and slavery. According to the complaint, these false statements are subject to private class action relief under California laws regulating unlawful business practices, misleading and deceptive advertising, and unfair and deceptive practices.

Two class action lawsuits were filed on 10 September 2015, in the Central District of California, against Mars, Iams, Proctor & Gamble, and Nestlé,

alleging consumer harm from the companies' failure to disclose the use of slave labour in their production of Thai seafood-based cat food (*Wirth v. Mars*). These

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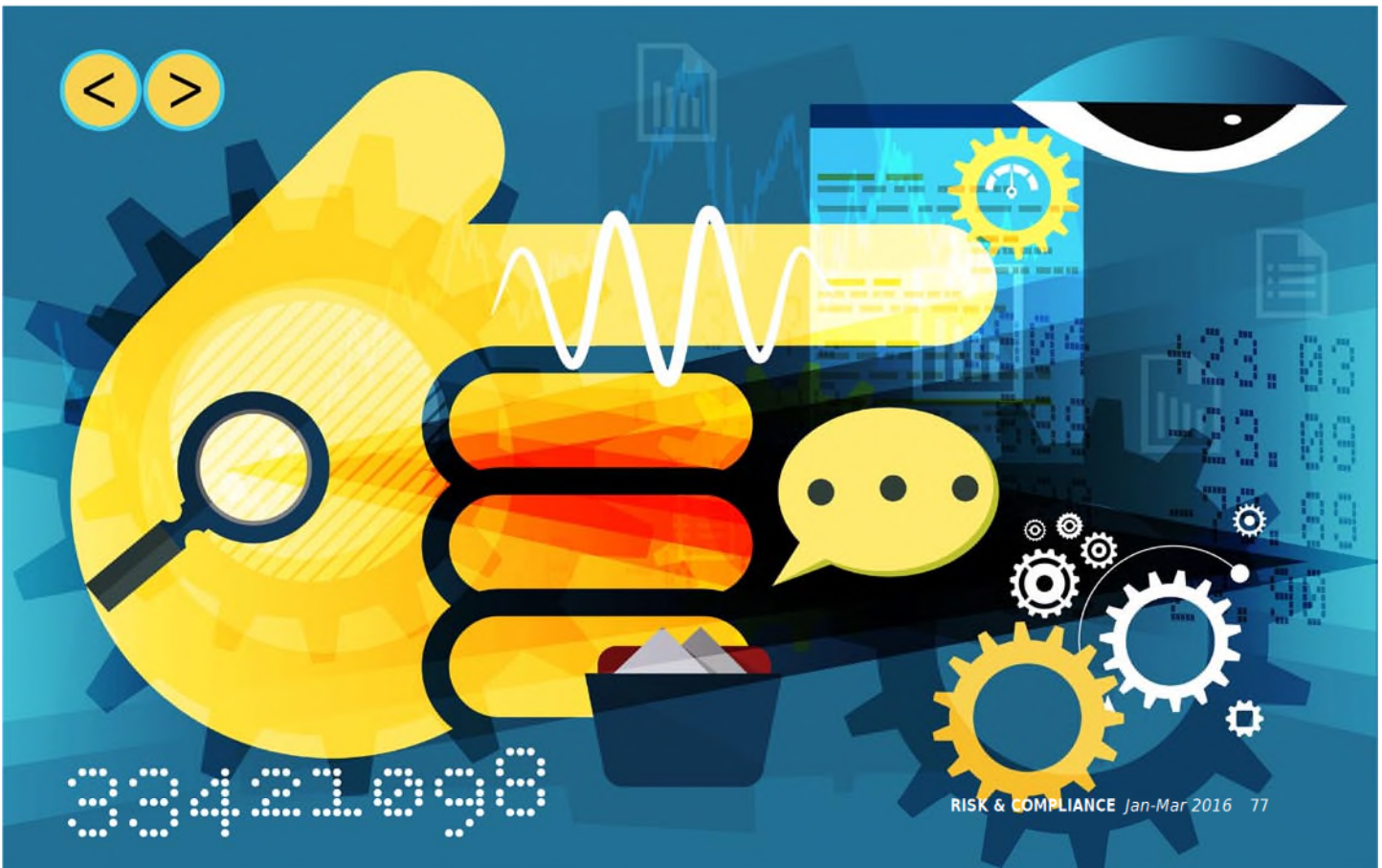
complaints are not tied to the Transparency Act, but more generally assert that the defendants had a duty to disclose the use of slave labour in their supply chains, and failure to do so constituted a material misrepresentation, fraud and deceptive advertising. The requested remedies include injunctive relief, monetary damages and attorneys' fees.

A third set of cases target Mars, Nestlé and Hershey with allegations that these companies use forced child labour in the production of cocoa products in West Africa, contrary to their codes of ethics (*Hodsdon v. Mars et al.*). These class actions were filed 28 September 2015, and are pending in the Northern District of California. Like the other suits, these claims allege violations of California's Unfair Competition

Law, Consumers Legal Remedies Act, and False Advertising Law and seek damages and attorneys' fees.

This spate of litigation should spur businesses that have operations or sales in California to take a close look at the representations on their websites, labels and advertising, to ensure they are not open to challenge under the California Transparency in Supply Chains Act and broader California consumer

protection, unfair business practices and false advertising laws. But California is not the only source of concern. Other states may not (or not yet) have a specific supply chain transparency law or the activist 'private Attorney General' tradition of California, but most have consumer protection, false advertising and anti-fraud statutes that can be pressed into service against businesses that say one thing and do another.



To be sure, alleging and proving that a company knowingly relied upon forced labour while saying it did not are two very different things, but the risk is not simply theoretical. In a slightly different context, the State of New York recently settled a case against the world's largest coal producer, after charging it with making false and materially incomplete statements in Securities and Exchange Commission filings. The company's submissions had said management could not predict the impact of climate change regulation on profitability, while at the same time the company had publicly released market projections that provided metrics concerning those risks.

Supply chain transparency concerns are not confined to the US. The UK recently enacted the Modern Slavery Act of 2015, which went into effect 29 October 2015. This law, modelled on the California Transparency in Supply Chains Act, applies to companies that conduct any business in the UK and have total gross worldwide revenues of £36m. Businesses subject to the law must publish an annual 'slavery and human trafficking statement' identifying their efforts to eradicate slavery and human trafficking from their business operations and supply chain. Enforcement of the law involves an action by the Secretary of State in the courts to force compliance, with contempt of court and an 'unlimited fine' backing up the subsequent court order.

Other supply chain accountability risks are less direct but no less pressing. Watchdog groups are undertaking review and ranking of companies'

disclosures. The 2 November 2015 report by Development International, 'Corporate Compliance with the California Transparency in Supply Chains Act of 2010', for example, rated the disclosure statements of 1504 companies. The results, with close to 50 pages of individual company specifics, indicated that most companies' compliance fell well short of the law's requirements and great variation was observed in performance among businesses. The report's appendices provide a rich source of benchmarking comparisons that should be carefully reviewed by market participants.

Similar reports have been released in the area of conflict minerals compliance rankings, and these kinds of market pressures are finding their way into consumer and investor purchasing decisions, commercial supply chain relationships and overall reputational risk considerations. Companies cannot afford to view the proliferating array of supply chain reporting schemes as individual compliance obligations, but must instead get used to approaching them as multidimensional legal and business risk paradigms requiring the full attention of senior corporate leadership. **RC**



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