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October 26,
2022

By [IBM](#)
[Envizi](#)

7 min read

“Garments come from Asia, cocoa and fruit from Africa, and coffee from South America —the new Supply Chain Act (Lieferkettengesetz) aims to protect the rights of people who produce goods for the German market.”

This preface to the German Supply Chain Due Diligence Act (SCDDA) on the German Federal Government's [website](#) captures why governments are stepping in to place emphasis on the human aspect of the supply chain, beyond environmental impacts like [supply chain emissions](#).

In 2021, Germany passed the Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten, LkSG or the German Supply Chain Due Diligence Act (SCDDA). This is a defining moment in environmental, social and governance (ESG) accountability as this is the first time that German organizations will be held legally responsible for respecting human rights in their global supply chains.

Although the Act focuses heavily on the 'S' in ESG, it does consider that environmental risks and their negative impact on human health within supply chains are deeply intertwined. As a result, the SCDDA requires organizations to comply with international agreements focusing on environmental risks—such as the Minamata and Basel Conventions—to limit harm caused by pollutants, toxic chemicals and the handling and disposal of hazardous waste.

In this article, we delve into who the SCDDA affects, what organizations must do to comply, and how they can prepare for due diligence obligations.

What is the German SCDDA?

The German Supply Chain Due Diligence Act applies due diligence obligations on enterprises that have their central administration, principal place of business, administrative headquarters, statutory seat or branch office in Germany to comply with environmental and human rights standards in their supply chains.

The SCDDA introduces a comprehensive list of obligations, which includes the development of a risk management system for compliance. It also details the requisite preventive and remedial measures and makes mandatory complaint procedures. The law requires regular documentation and reporting, and violations are subject to major fines.

What do organizations need to do to comply with SCDDA?

Organizations must monitor and act on violations both within their own operations, as well as those of their direct suppliers (from the extraction process of raw materials to

the delivery of the goods to the customer) regardless of whether the activity was performed in Germany or abroad.

Similarly, if an organization becomes aware of a possible violation of environmental standards or human rights by one of their indirect suppliers, it is required to perform a risk analysis of the possible violations immediately.

The Act establishes not only a very **clear onus** on organizations over their supply chain performance, but mandates **action** and meaningful **remediation**.

Key takeaway:

For company executives, this means that their supply chains now command the same attention as financial performance as pressure mounts for them to be aware of what is occurring upstream—or face very real reputational, investor and financial risk.

Which organizations fall under the scope of the SCDDA cover?

There will be two phases to bring organizations under the scope of the SCDDA.

Phase 1: From January 2023

The German Supply Chain Due Diligence Act will apply to enterprises based in Germany with more than 3,000 employees, or German-registered branches of foreign companies with over 3,000 employees. The employee count also includes any personnel posted abroad for domestic companies. Group companies are included in the calculation of the number of employees of the parent company and the Act considers employees as “any worker with an employment contract for longer than six months.” This criterion applies to about 600 companies.

Phase 2: From January 2024

The scope will broaden to enterprises based in Germany employing over 1,000 employees, or German-registered branches of foreign companies with greater than

1,000 employees. Once this scope is enacted, the criterion will apply to roughly 2,900 companies.

Will the SCDDA impact small and medium-sized enterprises (SMEs)?

It is important to acknowledge that the German Supply Chain Due Diligence Act will have a cascading effect. SMEs that may not be in-scope are still expected to be affected in the coming months and years, because larger firms will likely pass on due diligence obligations imposed on them by the Act to their suppliers.

Key dates in the full rollout of the German Supply Chain Due Diligence Act

- **June 2021:** German parliament passes “Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten” (LkSG aka SCDDA) requiring large companies to carry out supply chain due diligence activities
- **February 2022:** European Commission adopts proposal for a Directive on corporate sustainability due diligence
- **October 2022:** EU to adopt the [Corporate Sustainability Reporting Directive \(CSRD\)](#)
- **January 2023:** SCDDA regulations come into force for enterprises with more than 3,000 employees
- **January 2024:** SCDDA regulations come into force for enterprises with more than 1,000 employees
- **2024:** Companies must report under the CSRD in line with mandatory EU sustainability reporting standards
- **2026:** The German government will carry out an evaluation of SCDDA’s effectiveness

What human rights risks does the German Supply Chain Due Diligence Act apply to?

A risk related to human rights is defined in the SCDDA as “a situation in which there is a sufficient degree of probability based on factual indications that a violation of one of the following prohibitions will occur:”

- Employment of a child of 15 years or younger
- Child labor of children under 18 in accordance with the [ILO Convention on Worst Forms of Child Labor, 1999 \(No. 182\)](#)
- Forced labor
- All forms of slavery or similar practices of domination or oppression at work
- Disregard of the local applicable rules on workplace safety and working conditions if this could lead to workplace accidents or work-related health risks
- Disregard of freedom of association
- Employment discrimination
- Wage discrimination
- Causing harmful changes to the soil, polluting water, polluting air or causing harmful noise emission
- Acquiring, developing or otherwise using land, forest or water from unlawfully evicting persons from or depriving them of the use of such land, forest or water
- Commissioning or using private or public security forces to protect a business project if the security forces will infringe the prohibition on torture, harm life or limb, or interfere with freedom of association and the right to collective bargaining
- Actions or inactions that are directly capable of infringing a protected legal interest

What environmental risks does the German Supply Chain Due Diligence Act apply to?

As per the SCDDA, a risk related to the environment is defined as “a situation in which there is a sufficient degree of probability based on factual indications that a violation of one of the following prohibitions will occur:”

Minamata Convention

- Manufacture of mercury-added products in accordance with article 4 of the Convention
- Use of mercury or mercury compounds in manufacturing processes in accordance with article 5 of the Convention after the phaseout date

- Handling of mercury waste contrary to the requirements of article 11 of the Convention

Stockholm Convention on Persistent Organic Pollutions (POPs)

- Production and use of chemicals according to article 3
- Non-environmentally sound handling, collection, storage, and disposal of chemical waste contrary to the requirements of article 6 of the POPs Convention

Basel Convention

- Export of hazardous wastes and other wastes according to article 1
- Export of hazardous wastes from states listed in annex VII of the Basel Convention to states not listed therein
- Import of hazardous wastes and other wastes from non-state parties of the Convention

How can organizations prepare for the implications and reporting requirements of the SCDDA?

The due diligence obligations under the Act include several high-level requirements which are listed below. Most noteworthy is that the categories and reporting requirements symbolize a shift towards an approach of more holistic reporting that goes beyond traditional environmental metrics and indicators and includes other factors, particularly employee working conditions.

Risk management and risk analysis reporting requirements

All enterprises must implement appropriate or adapt existing risk management accordingly. They must determine whether there is a risk that their business activities or business activities in the supply chain violate human rights.

Policy statement

Enterprises need to adopt a policy statement concerning their human rights and environmental strategy. It is necessary that the policy statement includes the procedure for abiding by human rights and environmental due diligence obligations in the supply chain, the specific risks identified, and the company's human rights and environmental expectations of its employees and suppliers.

Preventive and remedial measures

Based on the risk analysis, enterprises are required to take or review appropriate preventive and remedial measures. This applies to supplier selection and supplier monitoring, the creation of codes of conduct, the implementation of training courses, as well as sustainable contract drafting.

Complaints procedure

Companies must develop, implement and publish a complaint mechanism in writing through which (potentially) affected persons and persons with knowledge of possible violations can point out human rights risks and violations. It is also necessary that the effectiveness of the complaints procedure is reviewed annually, and when necessary, on an ad hoc basis.

Documentation and reporting obligations

All due diligence obligations must be documented, and a report is required to be prepared and published annually. This report must also be submitted to the [Federal Office for Economic Affairs and Export Control](#) aka BAFA (Bundesamt für Wirtschaft und Ausfuhrkontrolle).

Related reading: [Guidance on creating a Sustainability Action Plan \(with a free downloadable template\)](#)

What are the consequences of non-compliance?

Respecting SCDDA requirements is critical for companies to protect not only their reputation, but also their bottom-line as penalties for violations are substantial.

- **Fines:** Monetary penalties of up to EUR 8 million can be assessed depending on the nature and gravity of the violation. Moreover, companies with an average annual turnover of over EUR 400 million can be fined up to 2% of their average annual turnover.
- **Ban from public tenders:** Perhaps an equally, if not more important consequence is that violating companies can be excluded from winning public contracts in Germany for up to three years.

Additionally, trade unions and NGOs can also be granted the authority to conduct litigation for an affected party.

BAFA has been equipped with effective enforcement abilities to monitor companies' supply chain management and can act on its own initiative or at the request of an affected person. The authority possesses the right to enter business premises, demand information and inspect documents.

Preparing sustainability data to satisfy the SCDDA reporting requirements

[IBM Envizi ESG Suite](#) can support an organization's GSCA reporting requirements by providing finance-grade data within an auditable system.

Specifically, IBM Envizi's [Value Chain Surveys and Assessments](#) is a single portal that can easily and securely collect ESG metrics from across your value chain to ease the reporting process. The module can help unlock valuable insights to support organizations with their materiality and risk assessments with the following:

- **Gather quantitative and qualitative metrics** from internal and third-party suppliers in a single digital system of record
- **Manage data** collection, track progress and view responses
- **Assess risk** with a customized ESG risk assessment tools and visualization of scoring for suppliers, portfolio and sectors to help you identify where to prioritize and drive performance

In summary

For companies, a robust sustainability approach across their supply chain is now a business imperative. Firms that fail to meet their due diligence requirements for

environmental standards and human rights will suffer both economic and reputational damage and face obstacles operating in Germany.

Given that the European Parliament has recently adopted a proposal for a directive on corporate sustainability due diligence, a unifying supply chain due diligence process is likely just around the corner. This would then take precedence over national due diligence laws.

Combined with the introduction of the [EU Corporate Sustainability Reporting Directive \(CSRD\)](#), which will come into effect in 2024, the direction of travel with regard to sustainability reporting and supply chain due diligence is becoming increasingly clear as governments begin demanding more accountability from companies.

The time is now for organizations to begin working to ensure that they are compliant with environmental, labor, and health and safety legislation to futureproof themselves from emerging legislation.

Note: The information in this article was last updated in October 2022. Organizations should refer to the [Official SCDDA FAQs](#) for latest information and updates.

Build your sustainability data foundation, streamline reporting and accelerate decarbonization with the IBM Envizi ESG Suite

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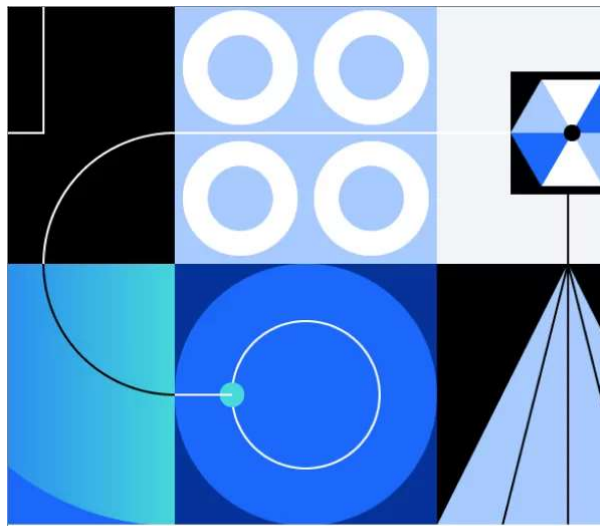
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