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The German Supply Chain Act: Challenges and opportunities for LATAM companies

By Melina Llodrá and Maria Florencia Romariz

Adopted by the Bundestag (German parliament) in June 2021, the Supply Chain Due Diligence Act (Supply Chain Act) came into force on January 1, 2023.[1] The Supply Chain Act requires supply chain due diligence regarding human rights and environment-related obligations. It covers all the steps necessary to manufacture products and render services, starting from the extraction of the raw materials to end-customer delivery in Germany or abroad. These additional due diligence obligations trigger new challenges vis-à-vis direct and indirect suppliers.

What you need to know about the Supply Chain Act

The Supply Chain Act applies to businesses with 3,000 or more employees whose headquarters, principal place of business, statutory seat, or domestic branch is in Germany. In January 2024, this threshold will be reduced to 1,000 employees, extending the scope of the act considerably. When calculating the number of employees, temporary agency workers with an assignment exceeding six months and employees posted abroad are also included. Furthermore, employees of all enterprises belonging to the same group employed in Germany must be accounted for.

Businesses under the scope of the act must set up grievance mechanisms and report on their activities to prevent or minimize risks and violations. The due diligence obligations include:

1. Establishing a risk management system;
2. Designating a responsible person or persons within the enterprise;
3. Performing regular risk analyses;
4. Designing and adopting human rights policies;
5. Establishing preventive measures in its own business area and vis-à-vis direct suppliers;
6. Taking remedial action in the event of an imminent or actual violation of a human rights or environmental obligation to end, minimize, or prevent such violation, as the case may be;
7. Establishing a complaint procedure for the reporting of human rights violations;
8. Implementing due diligence measures with regard to risks at indirect suppliers; and

9. Documenting and reporting due diligence measures.

If any of these requirements are not met, severe consequences are triggered. Companies can be excluded from being awarded public contracts and may be subject to economic fines of up to €8 million or up to 2% of their annual turnover (only applicable to those companies with a yearly turnover of more than €400 million)—not to mention negative publicity and reputational damages.

In line with the Supply Chain Act, on February 23, 2022, the European Commission of the European Union (EU) published the draft of its corporate sustainability and due diligence directive that aims to promote sustainable and responsible corporate behavior by incorporating human rights and environmental considerations into company operations and corporate governance.[2] The proposed directive marks a shift from voluntary to mandatory sustainability due diligence in the EU and represents a step toward greater corporate accountability for environmental and social impacts. The directive must now be approved by the European Parliament and the Council of the EU. According to the proposed directive, once approved, the new obligations would apply after three or four years, depending on the company's size and turnover. This is expected to lead to an extension of the Supply Chain Act's scope.