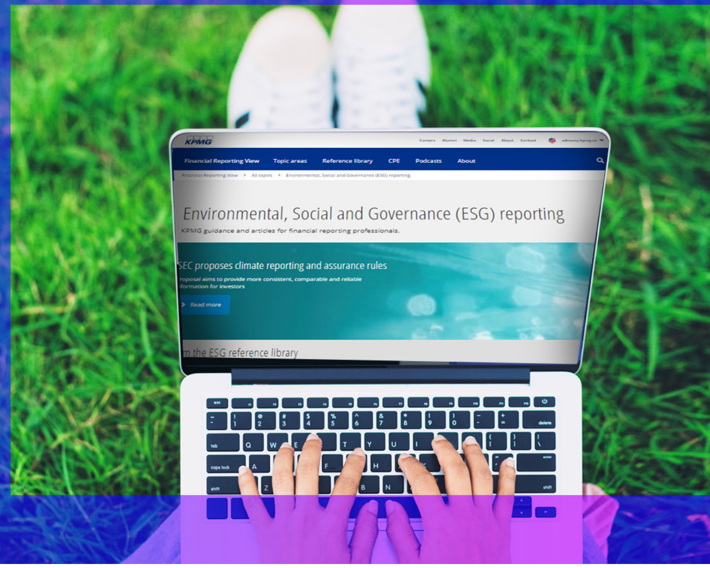
HOT TOPIC

ESG in Europe

Global implications of supply chain due diligence acts

February 2024



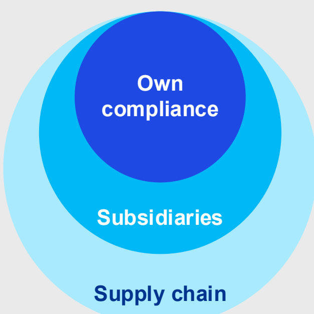
A German supply chain due diligence act is already effective, with an EU-wide directive in the final stages of approval.

Source and applicability

- The Supply Chain Due Diligence Act (SCDDA) applies to companies with a certain number of employees in Germany.
- The European Commission's proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) would apply to companies that meet certain revenue and/or employee thresholds.

Fast facts, impacts, actions

Germany's SCDDA is already effective as of January 1, 2023. The EU-wide proposed CSDDD is progressing through the legislative process but still awaits final approvals. These acts seek to enforce corporate supply chain due diligence obligations, both human rights- and environment-related.



- Compliance with such laws requires extensive due diligence and risk management throughout a company's supply chain.
- It isn't enough to ensure an organization's **own compliance** with the legal requirements. Companies also have to make a reasonable effort to ensure that **subsidiaries** and relevant companies within the **supply chain** are compliant.
- This may require embarking on new due diligence processes with other companies in the supply chain and in some cases parting ways with suppliers.

Despite these supply chain due diligence acts being non-US directives, they have implications for US (and other non-EU) companies. Get started by assessing the obligations that may be relevant to your own company and its subsidiaries – either directly or indirectly as a part of the supply chain.

This Hot Topic was updated in February 2024 to reflect the latest developments as the proposed CSDDD moves through the EU legislative process.

Background

Complex global supply chains present environmental and social risks ranging from waste management, water usage and emissions to modern slavery, human trafficking and discrimination. Companies are increasingly subject to scrutiny from consumers and shareholders that are holding companies responsible for activities in their supply chains. Further, more governments are seeking to regulate this area with laws aiming to prevent and mitigate environmental and social risks within company supply chains.

In June 2021, Germany passed the SCDDA, which took effect on January 1, 2023, for certain companies operating in Germany. The SCDDA is designed to prevent human rights- and environment-related violations in the supply chain. The act applied to an estimated 700 companies in 2023, and 2,900 companies from 2024 onwards.

Separately, in February 2022, the European Commission (EC) adopted a proposal for the CSDDD, which is intended to be an EU-wide solution for supply chain due diligence – complementary to other EU laws that regulate conflict minerals, deforestation and human trafficking. Once final, the directive is expected to apply to at least an estimated 13,000 EU and 4,000 non-EU companies.

Global implications

Non-EU companies are impacted by supply chain due diligence laws in the following ways.

- **Own compliance.** Non-EU companies directly subject to such laws face reporting obligations.
- **Subsidiaries.** Non-EU companies with subsidiaries that are directly subject to such laws may need to support their subsidiaries in establishing due diligence processes and managing reporting obligations.
- **Supply chain.** Non-EU companies that do business with (i.e. fall in the supply chain of) companies that are subject to such laws may be asked for data, including contractual assurances over that data. Compliance with these laws requires extensive due diligence and risk management throughout a company's supply chain. In addition to ensuring its own compliance, a company also has to make a reasonable effort to ensure that each of its suppliers complies. This may require embarking on new due diligence processes with other companies in the supply chain and in some cases parting ways with suppliers.

The remainder of this Hot Topic focuses on the SCDDA and the proposed CSDDD, both of which are expected to have a significant impact on US companies. They join other similar developments (e.g. Norway's Transparency Act, Canada's Fighting Against Forced Labor and Child Labor in Supply Chains Act, US proposed Federal Supplier Climate Risks and Resilience Rule) and are signals for what may become more common around the world. As their impact is felt, other countries have already begun (and others likely will follow) to boost their due diligence laws.

US companies should look for efficient ways to implement due diligence operating models that address multiple jurisdictional requirements simultaneously. An overall risk management approach, supported by a cross-functional team, can allow a company to collect and manage relevant data and stay abreast of new laws.

Germany's Supply Chain Due Diligence Act

Scoping

Beginning in 2023, companies with > 3,000 employees in Germany applied the SCDDA. Beginning in 2024, this threshold was lowered to > 1,000 employees in Germany. The number of employees includes temporary workers whose assignment duration exceeds six months as well as employees posted abroad. These thresholds apply to all companies, regardless of legal form or sector, that are either headquartered, or have a domestic branch, in Germany.

US parent companies with German subsidiaries need to consider the number of employees at their German locations to assess whether they meet the scoping thresholds. An in-scope German subsidiary must apply the act to all its subsidiaries, but any upstream ownership (e.g. a US parent) is not subject to the SCDDA.

Obligations

The company's supply chain includes all steps in Germany and abroad that are necessary to produce the products and/or provide the services – from raw material extraction to end customer delivery. This includes the actions of the company in its own business area and the actions of direct suppliers ('Tier 1') and indirect suppliers ('Tier n'). Tier 1 suppliers are suppliers related to value creation and Tier n suppliers are suppliers to direct suppliers.

Obligations under the SCDDA aim to:

- prevent or mitigate human rights and environment-related risks; and
- end violations of human rights and environment-related obligations.

The following table summarizes the relevance of each obligation to the parties in the supply chain.

Due diligence obligation	Company	Tier 1 suppliers	Tier n suppliers
Establish a risk management system	✓		
Designate a responsible person	✓		
Issue a policy statement	✓		
Establish a complaints procedure	✓	✓	✓
Perform regular risk analyses	✓	✓	✓[1]
Take remedial action	✓	✓	✓[1]
Establish preventive measures	✓	✓	✓[1]
Note 1: If there is substantiated knowledge of violations at indirect suppliers, the company is required to perform event-based risk analysis, take remedial action (e.g. develop and implement a prevention, cessation or minimization plan) and establish preventive measures (e.g. implement controls).			

These due diligence measures need to be implemented at varying levels of granularity depending on the nature and extent of the company's business activities (e.g. sector, geographic area, size).

Reporting and noncompliance

Companies are required to report annually on their due diligence measures. The report must be publicly available on the company's website. Certain forms of noncompliance may result in fines of up to 2% of average global annual turnover and/or exclusion from public contracts.

US parent companies are not in scope simply because a subsidiary is in scope. However, if the US parent is in the supply chain of an in-scope German subsidiary, it is subject to the due diligence obligations that its German subsidiary has to impose on its entire supply chain.

The EU's proposed Corporate Sustainability Due Diligence Directive

Scoping

Based on the provisional agreement between negotiators of the Council of the EU ('Council') and the European Parliament ('Parliament'), there would be different scoping requirements for EU-based and non-EU companies. The EU-based scoping requirements would be based on average number of employees and net turnover (revenue), the non-EU scoping requirements would be solely based on net turnover.

The following table summarizes the provisionally agreed scoping requirements.

Scoping scenario	Average employees	Annual revenue	Revenue generated in certain sectors[1]
EU-based companies			
EU 1	> 500; and	> €150 million worldwide in the last financial year.	N/A
or			
EU 2	> 250;	> €40 million worldwide in the last financial year; and	≥ €20 million.
Non-EU companies[2]			
Non-EU 1	N/A	> €150 million in the EU in the financial year preceding the last.	N/A
or			
Non-EU 2	N/A	> €40 million in the EU in the financial year preceding the last; and	≥ €20 million.

Notes:

1. The sectors defined in the provisional agreement include, for example, the manufacturing of textiles, agriculture, forestry, fisheries, the extraction of mineral resources and construction.
2. Non-EU companies that meet the above thresholds would be in scope irrespective of whether they have subsidiaries or branches in the EU. It is expected that the Commission will publish a list of non-EU companies that meet the scoping criteria.

Even if a company is not directly in the scope of the provisionally agreed CSDDD, it could nonetheless be impacted by its obligations as a contractor or subcontractor (direct or indirect business partner) to a company that is in scope.

Obligations and reporting

The provisionally agreed CSDDD would introduce due diligence obligations for companies related to actual and potential adverse human rights and environmental impacts (collectively, 'impacts'), with respect to their own operations, the operations of their subsidiaries, and operations carried out by direct and indirect business partners in their value chain.

Due diligence obligations for all parties throughout the value chain would be aligned with the UN Guiding Principles on Business and Human Rights and the Organization for Economic Cooperation and Development guidelines. These principles or guidelines include integrating due diligence into policies, identifying impacts, preventing or mitigating impacts, terminating actual impacts, establishing and maintaining a complaints procedure, and monitoring the effectiveness of measures.

Timeline

In late 2023, Council and Parliament completed their negotiations on the proposed CSDDD and reached a provisional agreement. The following timeline summarizes these activities.

Feb 2022	The EC submitted the proposed CSDDD to the Council and Parliament.
Dec 2022	Council adopted its position on the proposal.
June 2023	Parliament adopted its position on the proposal.
Dec 2023	Council and Parliament reached a provisional agreement.
2024 and beyond	The provisional agreement needs to be endorsed and formally approved by the Council and Parliament. The vote in the Council was postponed in February with no new date scheduled for the vote. Once approved, the Directive will be published in the Office Journal of the EU and will enter into force 20 days later. Member States will likely have two years from when the Directive is entered into force to transpose it into national law. If it is not approved, negotiations will continue. Under a phased timeline, companies may need to comply with a final CSDDD as early as three years following its entry into force.

Comparison to Germany's SCDDA

Compared to Germany's SCDDA, the provisionally agreed CSDDD would have, for example, the following effects.

- **Cover a wider range of impacts.** Companies would be required to assess a broader range of environmental impacts including, for example, adverse impacts on biological diversity, unlawful disposal of waste and pollution from ships.
- **Look more deeply into the value chain.** Companies would be required to assess a broader range of upstream value chain activities extending beyond direct suppliers.
- **Introduce tougher penalties.** Member States would be responsible for imposing 'dissuasive, proportionate and effective' noncompliance penalties and establishing rules governing the civil liability of companies for damages. Victims of human rights and environmental harms could claim compensation for damages arising due to a company's failure to comply with the CSDDD.

Interactions with other EU legislation

The provisionally agreed CSDDD is just one component of several sustainability-related regulations under the European Green Deal that include reporting obligations. For additional information, see our European Green Deal Policy Guide. A final CSDDD would complement EU legislation including, but not limited to, the following.

Corporate Sustainability Reporting Directive (CSRD)	EU Taxonomy	Carbon Border Adjustment Mechanism (CBAM)
To meet the reporting requirements of the CSRD, companies would likely have to set up information collection processes.	The detailed information that may be required by the proposed CSDDD is intended to benefit the EU Taxonomy's common language for sustainable economic activities.	The proposed CSDDD would provide added transparency into information about non-EU companies in an EU company's value chain.

Corporate Sustainability Reporting Directive (CSRD)	EU Taxonomy	Carbon Border Adjustment Mechanism (CBAM)
The provisionally agreed CSDDD would provide a framework for collecting information on certain due diligence activities across the company's entire value chain.	For example, companies with taxonomy-aligned activities would need to comply with minimum safeguards, including adequate human rights due diligence processes.	This would complement the EU's CBAM, which imposes a carbon adjustment price for select imported products not subject to the carbon price from the EU Emissions Trading System.
Read more: Hot Topic, ESG in Europe – Global implications of EU sustainability reporting	Read more: Get ready for the EU Taxonomy regulation	Read more: Carbon Border Adjustment Mechanism (CBAM)

KPMG resources

For further guidance on ESG developments in the EU, we recommend the following KPMG resources as a starting point.

- ESRS Resource Center
- Talk book, Get ready for ESRSs.

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