Supply Chain Due Diligence Act
Effective and cost-efficient implementation for companies
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The Supply Chain Due Diligence Act (SCDDA) comes into force on 1 January 2023. Applicable to all sectors, it requires German companies with more than 3,000 employees in Germany to prevent or at least minimize human rights and environmental rights infringements in their supply chains. In this document, we will give a brief overview of the due diligence requirements companies must meet in future, their options for implementing these obligations in effective and cost-efficient ways, and how we can support you in doing so.
SCDDA requirements
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The supply chain for which companies must implement measures to prevent human rights and environmental rights infringements includes all steps in the domestic and international markets that are required to manufacture products and provide services, starting with the extraction of raw materials and ending with delivery to end customers. This covers not only the activities of the company’s own business operations, but also the actions of direct and indirect suppliers. The term ‘supply chain’ is therefore defined in the widest possible sense.

SCDDA presents the companies it applies to with a repeated cycle of process steps that build on and relate to each other. Once SCDDA comes into force, companies must be able to provide evidence of having implemented the following measures and processes to avoid sanctions against the company as well as liability risks for its management team:

- Establish a risk management system with the aim of identifying, preventing, ending, or at least minimizing risks to and infringements of human and environmental rights along its supply chains, including setting clear responsibilities within the company for the purpose of monitoring the risk management system (Section 4 SCDDA)

- Conduct a risk analysis for the purpose of identifying, assessing, and prioritizing relevant human rights and environmental risks (Section 5 SCDDA)

- Adopt a Management Board policy statement on the company’s human rights strategy and communication with its employees, the Works Council, direct suppliers, and the public (Section 6 SCDDA)

- Establish appropriate preventive measures for its business activities and its direct suppliers for the purpose of implementing the human rights strategy set out in its policy statement (Section 6 SCDDA)

- Take remedial actions if an infringement of protected legal positions is identified in the company’s business area or at a direct supplier (Section 7 SCDDA)

- Establish a company-internal complaints procedure to enable reporting of human rights and environmental law infringements (Section 8 SCDDA)

- Continuous documentation and reporting requirements with regard to the measures implemented (Section 10 SCDDA)
Fig. 1 – Implementing the Supply Chain Due Diligence Act (SCDDA)

Risk analysis (Section 5 SCDDA)
- Identify, assess, prioritize
- Updates: Regular, Event-related

Policy statement (Section 6.2 SCDDA)
- Description of risk management system
- Presentation of relevant risks
- Expectations of employees and suppliers

Preventive measures (Section 6.1/3/4 SCDDA)
- Implementation of human rights strategy described in policy statement
- Implementation of appropriate purchasing strategies and practices

Complaints procedure (Section 8 SCDDA)
- Internal or possibly external
- Must allow reports by individuals affected
- Regular updates

Documentation (Section 10 SCDDA)
- Ongoing documentation
- Annual public report

Remedial measures (Section 7 SCDDA)
- In the company’s business area, infringements must be stopped as a rule.
- The closer the company is to the infringement, the greater its effort to stop it should be.

Monitoring
- Implementation of risk-based control measures in company’s business area
- Agreement with direct suppliers on contractual control mechanisms
SCDDA implementation options for companies
Two potential options for implementation that some companies are already discussing internally and others could consider are integrating SCDDA into an existing Compliance Management System (see No. 04), or assigning SCDDA to the Sustainability Office if one exists (see No. 05). When it comes to implementing SCDDA requirements, it is also recommended that companies review and optimize their supply chains as needed (see No. 06). Finally, SCDDA impacts contractual agreements with direct suppliers and therefore requires legal knowledge (see No. 07).

As mentioned, SCDDA applies to a great number of companies from a variety of sectors. Whether the measures intended for the purpose of implementing due diligence obligations are appropriate depends on the type and scope of the company's business activities, in particular its size and number of employees, sales volume, plant and working capital, and risks specific to its country, sector and commodity group (see Section 3.2 SCDDA). It is also clear that there will not be a single supply chain management system in the sense of a 'one size fits all' solution. The implementation proposals presented below therefore always require adaptation to the circumstances of each specific case.
Fig. 2 – Relevant departments in a company

- **Sustainability Office**: Familiar with human rights and environmental risks.
- **Compliance Office**: Experience with risk analyses and implementation of whistleblower systems.
- **Purchasing**: Familiar with supplier relationships, purchasing processes and the market environment.
- **Supply Chain Management**: Knows the supply chain and supplier relationships.
- **Legal Office**: Experience with drafting supply contracts.
Integration in Compliance Management Systems
One obvious pathway for implementing SCDDA is to integrate its requirements into an existing Compliance Management System (CMS). This is primarily due to the fact that the (regular and ad hoc) risk analyses required by SCDDA, as well as the whistleblower system (to be precise: the complaints procedure in accordance with Section 8 SCDDA), are essential components of any effective CMS.

SCDDA prescribes annual and event-related risk analyses in the tried-and-tested three-step process of “identify – assess – prioritize” as a central step towards fulfilling the due diligence obligations. Similarly, risk analyses provide a starting point for the CMS and are a key prerequisite for its effectiveness. This is because implementing adequate risk minimization measures requires knowledge of the risks specific to the company. This parallel suggests that the risk analysis required by SCDDA should be embedded in the existing CMS risk analysis, allowing the resources and experiences of the Compliance Office to be utilized.

However, the supply chain risk analysis required by SCDDA contains some particular features: First of all, the legally defined scope covers not only the company’s own operations, but also its direct suppliers. In addition, human rights infringements often take place in the shadows, so that a complete identification of the corresponding risks will not always be possible with the usual (less labor-intensive) processes of a classic compliance risk analysis. Depending on the region in which the company in question itself or its direct suppliers operate, individual cases may require greater cooperation with direct suppliers and stakeholder groups such as local employees, NGOs, and trade unions, as well as potential on-site inspections.

As well as risk analyses, the complaints procedure as per Section 8 SCDDA contains another parallel with CMS. The complaints procedure is ultimately a whistleblower system, which is also a central element and effectiveness requirement of any CMS, therefore it is correctly and explicitly recommended by the German Corporate Governance Code (Rec. A.2). The SCDDA complaints procedure, however, contains some specific features: On the one hand, in addition to a complaints
process for company employees, there must also be a complaints option for all parties involved in the supply chain. The process for submitting complaints must be set up in such a way that any potentially affected individual is able to make use of it in practice. In the case of (low-waged) workers in developing countries, for example, a grievance mechanism that relies on emails, telephones, or letters is unlikely to serve the legal purpose. Instead, they may need suitable local contacts (ombudspersons) to whom individuals could present their complaints verbally and with little time expenditure.
Integration with Sustainability Office
Another suggestion is to involve the sustainability function in implementing SCDDA obligations. While the Compliance Office usually has the necessary methodological expertise for implementation, it is the Sustainability Office that generally has the required technical expertise.

Until now, any issues relating to occupational safety and human rights in the supply chain have been primarily assigned to company sustainability departments, so that the following existing knowledge can be used here:

- Materiality analyses, with stakeholder involvement as required, for sustainability reporting (incl. reporting on occupational safety and human rights)
- Large capital market-oriented companies, banks, and insurance companies with more than 500 employees must prepare non-financial reporting under commercial law that includes information on environmental, employee and social issues, respect for human rights, and combating corruption and bribery. These statements also affect the supply chain; in particular, related concepts and due diligence processes must be described.

  • For the 2021 financial year, these companies must provide additional information on ‘environmentally sustainable’ sales revenues, CapEx, and OpEx. To this end, they must conduct a Group-wide survey of compliance with minimum standards of occupational safety and human rights in line with internationally recognized standards.

  • Existing relationships with stakeholders, professional associations, and topic-based working groups, in combination with a good overview of best practices and the pitfalls of implementation

The non-financial reporting requirements under commercial law (incl. taxonomy reporting requirements) are currently being revised. It is becoming apparent that all large corporations (as defined in Section 267 of the German Commercial Code) will have to make corresponding disclosures for the first time in the 2023 financial year.
Supply chain concepts for implementing SCDDA requirements
As mentioned, most companies will (and must) now act and take appropriate measures or set up processes to implement the SCDDA requirements by the start of 2023. On the one hand, it is advisable to fall back on already established concepts, while on the other, it is sensible to also use newly emerging concepts in order to achieve the highest possible (revision) security. We will present some of these concepts as examples in the following:

a. Optimization by integrating blockchains and Control Towers

Many SCDDA requirements could be met by using blockchains, as they facilitate direct and tamper-proof traceability along the entire supply chain. Used correctly, blockchain concepts lead to transparency, which enables direct traceability and can provide uncontested, unforgeable proof of a particular product’s origin. The consensus principle ensures that data information can only be changed with the agreement of all individuals, further increasing the security level.

With regard to representing traceability and the actual flow of goods, it is also possible to draw on Supply Chain Control Towers in addition to blockchains. In an ideal case, this would involve ‘digital twins’, which mirror the supply chain digitally. These are usually set up by companies themselves and also enable them to ensure transparency along the supply chain. However, unless Supply Chain Control Towers are used in combination with blockchain technology, the advantages of automated and tamper-proof data storage may not be provided.

b. Preventive measures and continuous, documented supply chain improvements due to Connected Supply Chain platforms

With the help of Connected Supply Chain platforms, supply chain partners like the company’s direct suppliers can be connected to a kind of control or coordination center. This results in a variety of starting points for operationalizing SCDDA. When an infringement of protected legal positions is identified in the company’s business area or with its direct suppliers, both preventive measures (Section 6 SCDDA) and remedial measures (Section 7 SCDDA) can be defined and their implementation tracked. In addition, the
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implemented measures can be documented in the Connected Supply Chain platform (Section 10 SCDDA). The complaints procedure (Section 8 SCDDA) for notifications of human rights and environmental law infringements can be mapped via the integrated Service Desk. This provides both the company’s employees and anyone affected within the supply chain with an opportunity to submit their concerns, which can then be processed and tracked via a ticket system. Real-time performance management then makes it possible to measure and transparently present the overall ticket volume (number of complaints) and other sustainability and quality indicators.

The Connected Supply Chain platform thus offers the option of integrating SCDDA requirements into regular supplier quality management.

c. SCDDA integration in purchasing organization processes and activities

Forward-looking organizations set up the purchasing function to manage the external ecosystem. With its strategic buyers and supplier managers, purchasing therefore plays a key role in the context of SCDDA. This applies to the supplier selection process as well as ongoing supplier and contract management.
Tendering and supplier selection processes
Purchasing is responsible for tendering and supplier selection processes (source to contract) from a technical perspective and in close coordination with internal demand drivers and content-driven process participants (e.g. development, production, quality). SCDDA-related activities begin early on in the risk analysis phase in relation to the material available for tendering. Due diligence and a screening mechanism must be established here. As a next step of the supplier risk analysis, suppliers need to be categorized at the beginning of the tendering process with regard to compliance with the indicators according to Section 7 SCDDA. This analysis is carried out in two steps: Prior to submission of tenders, an evaluation is performed based on a supplier survey and other external sources. Only those suppliers who do not present any risk are taken into consideration for the subsequent tendering process. After offers are submitted, a detailed check is carried out for each supplier and its production sites in order to submit a final evaluation. The results of each risk analysis are shared with suppliers so that they can improve in future as required. This makes it possible to identify ambitious suppliers for strategic supplier development.
Strategic supplier management
The strategic supplier management already established in many purchasing functions must be supplemented with SCDDA elements. As a rule, the process goes through circular, recurring steps (see figure). What is important here is that new criteria (due diligence) for assessment and classification are introduced and thus enable monitoring. In subsequent contract drafting, the framework conditions of the due diligence obligations must again be taken into account and secured in the long term. Once these obligations are declared, an orderly reporting of metrics can be established for continuous monitoring.
How can Digital Procurement assist?
Digital Procurement capabilities have improved tremendously since about 2018. Established technology providers as well as many start-ups have brought attention to Upstream Procurement. From tools for optimizing tenders to supplier collaboration platforms and contract management tools, buyers have means at their disposal that simplify, automate, and eliminate operational overhead, especially with regard to collecting supplier data and documenting due diligence compliance.
Contract management
SCDDA not only imposes due diligence obligations on the companies it applies to in their own business areas. They are also required to obtain contractual assurances from their direct suppliers that these will comply with certain standards, including relevant control mechanisms for their enforcement (see Section 6.4 SCDDA). A direct supplier within the meaning of SCDDA is any direct partner in a contract for the supply of goods or the provision of services whose supplies are necessary for the creation of the company’s product or the provision and use of the service in question (Section 2.7 SCDDA).

Whether and to what extent direct suppliers agree to corresponding contractual changes depends on a variety of factors: A situation in which the particular direct supplier is itself subject to SCDDA and therefore obliged to comply with the due diligence obligations is likely to be comparatively unproblematic. Where this is not the case, it will be necessary to examine whether and to what extent a (secondary) obligation can be derived from the existing contract to provide corresponding assurances and permit control mechanisms. In addition, the relative bargaining power of both parties will also play a role; suppliers who are interchangeable are likely to be more willing to make corresponding contractual concessions than those who have a (de facto) monopoly position.
How can we help you?
From the point of view of the companies affected, SCDDA does not provide any clearly manageable criteria with regard to sometimes complex implementation issues. Meanwhile, it cannot be predicted at present whether and to what extent the European legislative initiative will provide a remedy. One thing is certain, however: SCDDA will come into force on 1 January 2023.

The safe implementation of legal requirements requires sound and constantly updated knowledge of the law, which is then used to draw organizational conclusions – ideally tailored to the specific company. To ensure that SCDDA leads to as few cost increases on the operational side as possible, it is vital for companies to map the new tasks both efficiently and in an audit-proof manner.

At Deloitte, we offer the necessary legal expertise as well as experience in conducting risk analyses and setting up risk management systems with a view to new regulatory requirements for companies of all sizes and in all industries – combined with sound supply chain management expertise and the necessary technical (tool-based) implementation skills. Because we are able to put together multidisciplinary and cross-functional teams that fit you perfectly, we offer what it takes to successfully implement the SCDDA requirements from a single source. This means you can start preparing robust steps now to meet the requirements in 2023 – without jeopardizing your competitiveness in the market, especially in international comparison.
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