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Germany's New Supply Chain Act – Relevance for Singapore Companies

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The Supply Chain Act covers all companies that are based or do business in Germany including Singaporean companies. This includes companies that have their headquarters in Germany, their head office or a branch office, and that regularly import products into Germany but have their headquarters abroad. In addition, the due diligence obligations of companies under the Supply Chain Act generally extend to the entire supply chain – from raw materials to the finished sales product and also extend to direct suppliers and can therefore also apply to Singaporean suppliers.

On 11 June 2021, the German parliament passed the “Federal Act on Corporate Due Diligence for the Prevention of Human Rights Violations in Supply Chains¹” (the **Supply Chain Act**) which will enter into force on 1 January 2023. The Supply Chain Act creates a legal framework to improve the protection of the environment and human rights along global supply chains. Similar laws are already in place in the US,² the UK³ and in France⁴ with the EU to follow suit. The German Supply Chain Act imposes a set of due diligence obligations on companies with a certain number of employees operating in Germany. As these German companies will pass on their obligations to suppliers in their supply chain, it is clear that suppliers abroad and, in turn, their suppliers, will be affected in the future. With Asia being at the root of supply chains for industrialised countries and Singapore being one of Germany's key trade partners in South-East Asia, Singaporean companies need to get to grips with what is only just the beginning of an inevitable wave across western countries.

The Supply Chain Act

The Supply Chain Act will apply to all companies registered in Germany that employ at least 3,000 employees, and from 2024 at least 1,000 employees, in Germany. The number includes employees who have been posted abroad. Foreign companies that maintain at least one subsidiary in Germany also fall under the Act.

The Supply Chain Act establishes a canon of obligations for the compliance with human rights in its own company and down their supply chains. Areas protected include the following:

- The prohibition of child labour;
- The prohibition of forced labour, slave labour and slavery;
- Compliance with worker's rights, including occupational health and safety, and organisational and trade union rights;
- The prohibition of discrimination and unequal treatment;
- The prohibition of withholding an adequate living wage; and
- Compliance with environmental standards and other environmental rights.⁵

The specific protected legal position is determined by referring to an extensive catalogue of international conventions, such as the International Covenant on Civil and Political Rights and the ILO Conventions.⁶ These conventions would usually only impose obligations on States and not on companies. However, the Supply Chain Act, at least indirectly, obligates companies to comply with the agreements, making human right breaches no longer simply a matter for governments, but an urgent business priority. The legislature has also clarified that foreign states that have not yet ratified a convention or treaty shall not be considered to have an increased risk in terms of the Supply Chain Act.⁷ Vice versa, the mere fact that a foreign state has ratified a convention or treaty does not mean companies get to ignore their obligations under the Supply Chain Act.

The definition of supply chain covers all steps inside and outside Germany that are necessary to manufacture the company's products or to provide their services, starting with the acquisition of raw materials and ending with the delivery of finished products to the end user.⁸ The Supply Chain Act differentiates between three different business areas:

- The company's own business area;
- Its direct suppliers, that is suppliers which the company has entered into contractual relationships with, and
- Indirect suppliers, enterprises which are not direct suppliers, the "suppliers of the suppliers".⁹

The responsibility of companies is measured according to the degree of knowledge and degree of influence with regard to the respective supplier.¹⁰ Naturally, a company's influence on its direct suppliers is greater than on its indirect suppliers. As a result, a company shall have an increased level of responsibility when it comes to its direct suppliers. Obligations with respect to indirect suppliers reach only as far as the company receives substantiated knowledge of possible violations. However, such knowledge is already considered to have been received if the indirect supplier is located in a region or operates in an industry known for inadequate human rights or environmental risks.

Obligations Under the Supply Chain Act

Companies falling under the Act are required to implement the following obligations:

Risk Management System

As a first step, companies are required to establish an appropriate and effective risk management system¹¹ which must be monitored by an appointed individual, whereas the act recommends designating a Human Rights Officer.¹² The company must analyse its risk and that of its direct suppliers of infringing or contributing to an infringement.¹³ This risk analysis must be performed at least once a year and on an ad hoc basis, meaning whenever a new product or service is introduced.¹⁴ In cases where an enterprise has

abusively engaged in an indirect supplier relationship with the intention to circumvent the due diligence requirements with respect to the direct supplier, it shall be considered a direct supplier.¹⁵

Measures to eliminate risks and infringements

If risks are identified companies must take preventative measures to prevent, minimise and remedy any identified risks to human rights and the environment. For instance, directors or management must adopt a policy statement which outlines the human rights strategy and preventative measures which are being pursued to ensure compliance with the Supply Chain Act.¹⁶

The preventative measures vis-à-vis a direct supplier may include:

- The consideration of a direct supplier's compliance with human rights and environmental standards during their selection;
- Contractual assurances from a direct supplier that it will operate according to the human rights and environment-related standards;
- Conducting training to implement said contractual assurances made by its direct suppliers; and
- Setting appropriate contractual control mechanisms with its suppliers.¹⁷

Further, if a company has detected an actual violation of a protected legal position (as opposed to a mere risk), it must take immediate countermeasures to stop or minimise the violation. Measures may vary depending on whether the infringement is within the company's own operations or in a direct supplier or indirect supplier's sphere.¹⁸ If it turns out the company is unable to end the violation, it must execute a strategy to minimize it, for example by developing solutions within the framework of industry standards to increase the company's ability to impact the supplier infringing the legal position.¹⁹ Only as a last resort shall the business relationship be terminated, and only in cases where the supplier has committed serious human rights violations that cannot be alleviated any other way.²⁰

Complaint Procedure

Companies also need to establish a complaint procedure allowing persons whose rights have been violated, and persons aware of such violations, to notify the company of such risks and violations.²¹

Documentation and Reporting

Compliance with due diligence obligations is to be documented internally on an ongoing basis. The relevant records must then be retained for at least seven years.²² Further, companies must prepare an annual report which includes an outline of the risks the company has identified and the measures which have been taken to combat those risks. The report must be made publicly available free of charge on the company's website.²³

Germany's Federal Office for Economic Affairs and Export Control then reviews the company's reports and monitors their compliance.

Large Fines for Non-compliance

If a company fails to comply with its obligations, fines of up to EUR 800,000 may be incurred.²⁴ If the company has an annual revenue above EUR 400 million, the regulatory offence may even be punished with an administrative fine of up to two per cent of the company's yearly worldwide turnover.²⁵ In severe cases, exclusion from public procurement contracts is envisaged.²⁶

It is important to keep in mind that a company's obligation to analyse risks and impose follow-up measures are to be met with a best-effort approach. Meaning that companies do not need to eradicate all human rights and environmental risks throughout their entire supply chain but rather that they are required to take the proportionate and reasonable steps based on their ability to influence within the supply chain.²⁷

Criticism

The Supply Chain Act has been overall well received with 75 per cent²⁸ of the German public supporting it. However not all stakeholders are happy with the way the new law is structured, from economists who believe the law is too burdensome to NGOs who criticise a lack of sufficient protection.

Business Associations

Business associations criticise that the fines for violations as well as the bureaucratic effort are too high and disproportionate. They also doubt the practical enforceability of effectively monitoring production standards in their supply chain. Moreover, business circles are worried that because German companies have to comply with standards that do not apply in other countries they could suffer a competitive disadvantage among European countries.

Human Rights Organisations

On the other hand, human rights organisations criticise the fact that a company's due diligence obligations only apply, without restriction, to their own business operations and direct suppliers, whereas it is well known that the most serious human rights violations often occur precisely at the beginning of the supply chain, in the extraction of raw materials, where the law only applies to a limited extent.

Furthermore, the Supply Chain Act does not provide for a provision to hold companies liable for any damage caused by failure to comply with their obligations. This makes it difficult for those affected to take legal action and reduces deterrence on companies.

Environmental Associations

Another point of critique is that environmental and climate aspects are hardly taken into account by the new law. The Act limits the protected environmental legal positions to three conventions. Soil, water and air are only protected in so far as they have direct consequences for the health of humans, for example, if chemicals are discharged into water thereby endangering the drinking water supply. The Act does not provide for protection of the climate in general nor is there a shield against massive environmental destruction.

Why Singapore Needs to Act

Singapore is amongst the top five least corrupt countries in the world²⁹ and has many safeguards and rigorous audit controls to ensure compliance with its many laws to protect workers, such as the Employment Act, the Employment of Foreign Manpower Act, the Foreign Employee Dormitories Act, the Employment Agencies Act, the Workplace Safety and Health Act and the Work Injury Compensation Act. There does not appear to be any significant human right and environmental risks occurring in Singapore itself.

However, the Supply Chain Act not only concerns direct suppliers but also indirect suppliers, that is to say suppliers all the way down the supply chain – raw materials, agriculture, components of components of components – and although the provisions on indirect suppliers within the Supply Chain Act are not yet overly onerous, they are only going to get more so with each iteration.

Singapore is one of Germany's largest trading partners in South-East Asia with exports to Germany being worth roughly EUR 4.7 billion in 2020.³⁰ However, the indirect components of this are considerable with Singapore outsourcing production in other countries throughout Asia and these countries are, on the whole, not as ardent as Singapore in ensuring high human rights and environmental standards.

The Supply Chain Act is, in most likelihood, just the beginning as other territories, notably the EU will follow shortly, and with any major disruption, there will be winners and there will be losers.

The challenge is not merely to be compliant on the Act's human rights and environmental requirements – which any upstanding company from an upstanding country such as Singapore should be – but, perhaps even more onerously, to be able to demonstrate said compliance.

And it should be said that, even for the thousand German companies which will soon start to live the Act, there exists uncertainty as to how to demonstrate compliance, especially as they are far removed, both geographically and culturally from many of their suppliers, both direct and indirect, which are scattered across Asia.

Therefore, the more that direct suppliers in Singapore can do to aid their German customers in demonstrating compliance, the more that this will turn into a differential advantage. After all, ease of doing business with Singapore has always been one of its unique selling points. Those companies not being able to demonstrate compliance, either of themselves or of their own suppliers, are likely to lose business whilst those making it easier for their German customers are likely to win business, and not just from other competitors in Singapore but from other competitors from around the world.

Being compliant with the Supply Chain Act will become a component of most supply contracts with German companies, with likely consequences in the event of non-compliance.

How Singapore Needs to Act

The more that is implemented the better, but obviously, always keeping an eye on the bottom line. Depending on the industry or sector, a mixture of the following could be beneficial:

- Clear documentation of supply chain from origination onwards;
- Training and education across all companies within the supply chain and documentation of such;
- Clear tracking of data across the entire supply chain, especially of volumes so as to be able to rule out co-mingling;
- Regular audits, both scheduled and impromptu across various stages of the supply chain; and
- Integration of supplier contracts with human rights and environmental requirements commensurate with those in the Supply Chain Act.

In any case, Singaporean companies will need to apply increased vigilance when selecting third-party suppliers. Identifying key risk areas in third-party relationships and assessing what potential suppliers know about the legal requirements of the market can help select suppliers that comply with regulatory standards.

Conclusion

The Supply Chain Act is Germany's first step to ensure companies in Germany increase their protection of the environment and human rights along global supply chains. Companies will have to oblige with a canon of obligations such as the implementation of risk management systems and measures to prevent and combat human rights violations. With the Supply Chain Directive at the EU level expected to come into force by 2024, further, wider-reaching regulations of supply chains will ensue.

Singapore is one of Germany's largest trading partners in South-East Asia and maintains its function as a logistical intermediary, trading with the West and outsourcing production in the East. As a result of the Supply Chain Act, Singaporean companies may need to prepare for requests and obligations imposed by their large German customers, even if the law does not apply directly to their business.

Singaporean companies should – at the very least – be able to confirm that no human rights and environmental risks occur within their own business area. However, issues such as child labour, modern slavery, and environmental risks need to be considered beyond pure compliance. The more Singaporean companies can do to help their German customers by demonstrating compliance not just of themselves but of their own suppliers, the more this will transform into opportunities for increased sales, expansion of market and stronger relationships with customers. Those companies not willing to meet their duties may expect to be replaced by others.

Endnotes

Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten ("Supply Chain Act") <Act on Corporate Due Diligence Obligations in Supply Chains Germany (bmas.de)> (accessed 6 March 2022).

See California Transparency in Supply Chains Act (2012)

See UK Modern Slavery Act (2015)

See France Corporate Duty of Vigilance Law (2017)

See sections 2(2) and 2(3) of the Supply Chain Act.

See annex to section 2(1), section 7(3) sentence 2 of the Supply Chain Act.

See section 7(3) of the Supply Chain Act.

See section 2(5) of the Supply Chain Act.

Ibid.

See sections 3(2) and 9(3) of the Supply Chain Act.

See section 4(1) of the Supply Chain Act.

See section 4(3) of the Supply Chain Act.

See section 5(1) of the Supply Chain Act.

See section 5(4) of the Supply Chain Act.

See section 5(1) of the Supply Chain Act.

See section 6(2) of the Supply Chain Act.

See section 6(4) of the Supply Chain Act.

See section 7(1) of the Supply Chain Act.

See section 7(2) of the Supply Chain Act.

See section 7(3) of the Supply Chain Act.

See section 8(1) of the Supply Chain Act.

See section 10(1) of the Supply Chain Act.

See section 10(2) of the Supply Chain Act.

See section 24(2) of the Supply Chain Act.

See section 24(3) of the Supply Chain Act.

See section 22(1) of the Supply Chain Act.

See section 3(2) of the Supply Chain Act.

According to a survey conducted by Infratest dimap, 75 % of respondents were in favour of a law that would require German companies to ensure that their products are not manufactured abroad in violation of human

rights law < Repräsentative Umfrage: Drei Viertel der Bevölkerung für ein Lieferkettengesetz – klarer Handlungsauftrag an die Bundesregierung – Initiative Lieferkettengesetz > (accessed 6 March 2022).

See < 2020 Corruption Perceptions Index – Explore the... – Transparency.org > (accessed 6 March 2022).

See < Germany and Singapore: Bilateral relations – Federal Foreign Office (auswaertiges-amt.de) > (accessed 6 March 2022).

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