

Are you working with German companies? Get ready for changes! 2/38/22



ESG Tax Practice, PwC Latvia
Alina Ruskova

Germany has adopted the Supply Chain Due Diligence Act (the “Act”) with effect from 1 January 2023. This article explores how the new requirements will affect Latvia.

What are the Act’s requirements in Germany?

The Act aims to prevent risks associated with potential breaches in business supply chains. The adoption of such laws is not a new requirement. For example, in 2017 France adopted rules requiring companies to prevent risks and serious infringements of fundamental rights (human rights) and human health, safety and environmental breaches in their supply chains. The Due Diligence Act effective in the Netherlands since 2019 specifically targets child labour, so companies are required to make sure their supply chains are not using child labour.

The German Act pays special attention to human rights and environmental breaches, which cover a wide range. For example, a human rights and environmental breach within the meaning of the Act is:

- Forced labour
- Slavery
- Unauthorised employment of children
- Unequal treatment
- Inadequate pay
- Handling environmentally harmful waste
- Exporting hazardous waste

Early on (i.e. from 1 January 2023) the Act’s requirements will apply to large German companies with a minimum headcount of 3,000. The Act does not distinguish between full-time and part-time employees and covers all staff employed for at least six months. From 2024 the Act’s requirements for supply chain due diligence reviews will apply to German companies with 1,000 employees. If an entity is registered outside Germany but is in the same group with a large German company, the entity (e.g. in Latvia, Estonia or elsewhere outside Germany) will be subject to the same requirements as the large German company. Thus, such large German companies and their group members will be required to examine their supply chain (regardless of the size of a transaction and whether or not the supplier is a related party).

A supply chain within the meaning of the Act comprises all of the company’s goods and services. This includes all stages that are necessary to produce goods and provide services, from obtaining raw materials to delivery to the end consumer. This also includes necessary services, such as transport or temporary storage of goods.

How are the Act’s requirements applicable in Latvia?

The Act’s requirements are applicable to all stages of a supply chain whether or not any stage relates to

the German territory or another country's territory. So, if a Latvian-registered company, say, provides transport services to a large German company (or to one that is outside Germany but in the same group with the German company), the Latvian company too will be covered by the Act's requirements, meaning the German company will run checks on the Latvian company as well.

What should we prepare for?

Since the Act prescribes stringent requirements for how German companies should mitigate the risk of human rights and environmental breaches in their supply chains, including setting up a risk management system, conducting regular risk analyses and taking corrective measures in their supply chains, such companies are expected to introduce tight checks on all their suppliers. Also, many Latvian companies within multinational groups have introduced certain checks in their supply chains but those checks often actually involve suppliers filling in questionnaires and signing statements. The Act introduces even tighter requirements and does not permit responsibility being shifted to suppliers. The Act makes it insufficient for a supplier to sign a statement that he has taken steps mitigating the risk of human rights and environmental breaches.

Having discussed this with German companies, we understand that most of them will introduce factual and detailed reviews to prove their supply chains are reliable and have a minimal risk of human rights and environmental breaches. So, even though responsibility lies with a German company, we believe that if a Latvian supplier is not so important for the German company and is not ready for such risk reviews, the German company may potentially give up the relationship with such a Latvian company.

If you are working with a German company (or with one that is in the same group with a German company) and want to prepare yourself for the new Act's requirements and potential checks, please reach out to our experts (Aija Panke and Alina Ruskova) to make sure your future business relationship and services go on uninterrupted. We are happy to help you also if your company is in the same group with a German company and your company is subject to the Act's requirements.