Mandatory Human Rights Due Diligence Laws: Germany takes another step towards global value chain regulation

Germany is taking another step on the road to mandatory human rights due diligence legislation. In July, two federal ministries published a Term Sheet for a German “Federal Bill on the Strengthening of Corporate Due Diligence to Avoid Human Rights Impacts in Global Value Chains” (“Entwurf für Eckpunkte eines Bundesgesetzes über die Stärkung der unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in globalen Wertschöpfungsketten (Sorgfaltspflichtengesetz)” (the Due Diligence Act). The proposed Due Diligence Act would impose a due diligence obligation on large companies based in Germany backed by severe fines for non-compliance and uncapped liabilities to enable private enforcement. It is expected that the German government will launch the legislative process within the next few weeks.

Mandatory human rights due diligence in Germany – background

Germany started on the road to mandatory human rights due diligence legislation back in 2016. That year, the German government published a National Action Plan (NAP) for the Implementation of the UN Guiding Principles of Business and Human Rights (UNGPs). The NAP stated that, if fewer than 50% of all companies based in Germany with more than 500 employees were undertaking human rights due diligence processes with respect to their value chains by 2020, legislation should require them to do so.

Draft legislation was leaked in 2019, suggesting that at least some members of government expected that the 2020 target would not be achieved. The leaked bill, the draft “Law to Regulate Human Rights and Environmental Due Diligence in Global Value Chains” (“Entwurf eines Gesetzes zur Regelung menschenrechtlicher und umweltbezogener Sorgfaltspflichten in globalen Wertschöpfungsketten (Sorgfaltspflichtengesetz)” (2019 Draft) was drafted by the federal Ministry for Economic Cooperation and Development, which is run by the Bavarian Christian Social Union, one of the three parties in the governing coalition.

The new Term Sheet for a Due Diligence Act was released by the same ministry, this time together with the Federal Ministry of Labour and Social Affairs, which is run by the German Social Democratic Party. The Minister of Economy and Energy, a member of the third party in the ruling coalition, chancellor Merkel’s Christian Democratic Union (CDU), has expressed concerns about certain elements of the Term Sheet. Internal discussions within the government have been delaying the process since then. Despite this, the CDU is expected to endorse the Term Sheet in the coming weeks, so that the process for drafting the legislation can still begin this autumn. In their 2018 coalition agreement, the three parties pledged to enact human rights related legislation prior to the next federal election in autumn 2021.

The human rights due diligence obligation

The human rights due diligence obligation set out in the 2020 Term Sheet is similar to that set out in the leaked 2019 Draft. The definition of human rights is comprehensive. It refers to all “internationally recognised human rights”, followed by a list of examples including modern slavery, child labour, discrimination, violation of the freedom of association, problematic employment conditions and non-compliance with local laws on these subjects. In addition, the Term Sheet mentions the fight against corruption as well as environmental-related issues such as water, soil or air pollution, and occupational health and safety.
As its title suggests, the Act would require due diligence on the entirety of a company’s value chain. That means undertaking due diligence to avoid human rights impacts in a company’s own operations and business relationships, including with respect to both suppliers and customers.

According to the Term Sheet, the proposed legislation would require companies to undertake ongoing due diligence proportionate to the risk – that is, the likelihood and potential severity – of impacts in their global value chains. Companies would be required to establish human rights grievance mechanisms as early warning systems.

While the proposed law would not impose a corporate duty to prevent human rights impacts, its due diligence obligation would require companies to act when they identify impacts or risks of impacts. It is not clearly spelled out what actions shall be required, but it is to be expected that such actions may range from using leverage with suppliers to get them to cease their involvement in human rights impacts or terminating business relationships.

The proposed Due Diligence Act would apply to all companies (or groups of companies) based in Germany that employ more than 500 people. A company will be considered to be “based in Germany” if its key entrepreneurial decisions are made in Germany. Thus, like tax laws, the proposed due diligence law would cover some companies that are registered outside of Germany. However, foreign companies that do business in Germany, but make key business decisions abroad, would not be caught by the proposed law. It is unclear whether each company in a group of companies subject to the proposed law would need to comply on a standalone basis or whether it will be sufficient if the parent company ensures compliance on the group level.

Public and private enforcement

Companies will also be obliged to report publicly and transparently on an annual basis about their human rights due diligence processes to an “experienced” federal authority. That authority will be entitled to impose fines for non-compliance with due diligence obligations. While the 2019 Draft suggested that fines should be up to EUR 5 million, the 2020 Term Sheet does not set an amount. The 2019 Draft also proposed criminal penalties for non-compliance, but the 2020 Term Sheet does not go that far. Both documents propose that non-compliant companies should be excluded from public procurement contracts.

The Term Sheet provides for the private right to sue companies in German courts where non-compliance with due diligence obligations has caused foreseeable harm to human rights or the environment anywhere in the world.

Companies that commit to a government-recognised set of industry standards and implement it can limit their civil liability to claims for intentional torts or gross negligence. These industry standards will be elaborated in due course. The Term Sheet explains that to gain government recognition, the standards will need to “cover the entire supply chain; take into account all core elements of the duty of care; and form part of a multi-stakeholder process”. Compliance must be verified externally.

Comment

If the coalition government approves the Term Sheet in the coming weeks, as is expected, the proposed law is likely to become a hot topic on the legislative agenda in the run-up to next year’s federal elections in Germany. The German legislative process will run alongside a process at the EU level, as European Commissioner for Justice Didier Reynders has announced that the European Commission will introduce legislation in 2021 to make human rights due diligence mandatory for all EU companies. Germany assumed the rotating Presidency of the EU in July.

Companies based in Germany and beyond would do well to establish due diligence processes on their value chains now. Not only are legislators inching closer to requiring them to do so, but consumers and other stakeholders are increasingly demanding access to more accurate information on the origin, journey and use of goods, as well as the conditions throughout the value chain. They expect companies to identify and act on their findings of risks and adverse impacts.
Conducting meaningful due diligence on global value changes is undoubtedly challenging. There are some helpful frameworks and innovative techniques to assist companies as they grapple with this new and complex area of legal compliance. Still there is no getting around the need for companies to undertake some relatively unfamiliar and daunting tasks. These include learning about international human rights standards, as well as gaps in national legal frameworks and risks to human rights in the countries where they operate or maintain business relationships. Unless they obtain such information, it will be difficult for companies to take effective steps to avoid involvement in violations of internationally recognised human rights.

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