



Germany's New Supply Chain Act – Part 2 of 4 – Compliance

22 June 2021

On 11 June 2021, the German parliament approved the Federal Act on Corporate Due Diligence Obligations in Supply Chains (*“Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten – Lieferkettensorgfaltspflichtengesetz – LkSG”*) – **German Supply Chain Due Diligence Act.**

The Act imposes a mandatory obligation on certain companies operating in Germany to establish, implement and update due diligence procedures to assess compliance with specified fundamental human rights and, to a more limited extent, certain environmental standards in supply chains.

The Act will apply to companies with their registered office or principal place of business in Germany, as well as to foreign companies that have a branch office in Germany. The Act will come into force on 1 January 2023, giving companies a transitional period to review their existing compliance systems, adapt them or establish new systems and train their employees. Non-compliance with the Act may trigger fines, reputational damage as well as public and private enforcement risks.

In-scope companies

The German Supply Chain Due Diligence Act applies to all companies having their head office or their principal place of business or their administrative headquarters or a branch office in Germany, irrespective of their legal form and the jurisdiction in which they are incorporated or registered.

Such companies fall under the scope of the new rules if they employ regularly 3,000 individuals, a number that will be decreased to 1,000 individuals with effect as of 1 January 2024. As the case may be, employees working outside Germany will be considered as well as employees of other group-companies (irrespective of the jurisdiction in which such companies are incorporated) and temporary employees.

In-scope suppliers

The definition of supply chain in terms of the German Supply Chain Due Diligence Act refers to all products and services of an in-scope company and encompasses all the steps inside and outside Germany that are necessary to manufacture the company's products or to provide the company's services; starting from the extraction of raw materials, ending with the delivery of finished goods to the company's customer, regardless of whether such steps are taken as part of the company's own operations and on its own sites or by a direct supplier or by an indirect supplier.

In contrast with previous proposals, the final version of the German Supply Chain Due Diligence Act is restricted to the supply chain and not extended to the value chain of in-scope companies.

Own operations, direct and indirect suppliers, sub-contractors

The German Supply Chain Due Diligence Act differentiates between three different "risk areas":

- the company's own operations and its own sites;
- direct suppliers, meaning suppliers having contractual relationships with the company; and
- indirect suppliers, meaning those stakeholders who do not qualify as direct suppliers ("*suppliers of the suppliers*").

Basically, an in-scope company shall be responsible for its own operations and its own sites as well as for activities and omissions of its direct suppliers. The obligations with respect to indirect suppliers are less strict – and less clear. The Federal Ministry for Labour and Social Affairs is expected to issue a by-law to define in more detail how in-scope companies will have to deal with indirect suppliers.

Interestingly, the legislature neither mentions nor clarifies at all the role of subcontractors. As the case may be, subcontractors may either qualify as direct suppliers or their activities and omissions will be deemed as being activities and omissions of the in-scope company itself. In any case, in-scope companies should thoroughly consider how to deal with their subcontractors.

Human & environmental rights

The German Supply Chain Due Diligence Act differentiates between human rights related risks and environmental related risks.

The relevant human rights related risks derive from 11 international treaties, namely

- ILO Conventions¹ 29 and 105 (forced labour), 87 (freedom of association), 98 (collective bargaining), 100 (equal remuneration), 111 (discrimination), 138 (minimum age), 182 (child labour) and the protocol to Convention 29;
- International Covenant on Civil and Political Rights – ICCPR²; and

¹ ILO Conventions can be found [here](#).

² ICCPR can be found [here](#).

- International Covenant on Economic, Social and Cultural Rights³ – ICESCR.

The German Supply Chain Due Diligence Act lists specific elements of those international treaties to be considered as relevant risks but this list is not exhaustive and severe infringements of the international treaties will be relevant as well.

Further, in-scope companies have to consider potential infringements of environmental related international treaties. These are:

- Minamata Convention on Mercury⁴;
- Stockholm Convention on Persistent Organic Pollutants (POPs)⁵; and
- Basel Convention to reduce the movements of hazardous waste⁶.

With regard to all these conventions and international treaties, the legislature clarified that the mere fact that a foreign state has not yet ratified a convention or treaty shall not mean that operating in such foreign state automatically implies an increased risk in terms of the German Supply Chain Due Diligence Act. In turn, the fact that a foreign state has ratified any of the said conventions and treaties does not exempt in-scope companies from their obligations under the German Supply Chain Due Diligence Act.

Requirements for in-scope companies

Starting from 1 January 2023, all in-scope companies have to comply with the following minimum requirements:

- Establish an effective Risk Management System (RMS) – which may be integrated into a company's broader compliance management system (if already existing).

- Appoint an individual responsible for monitoring the RMS – the legislature proposes appointing a Business Human Rights Officer.
- Establish a complaint procedure, allowing employees and other stakeholders to confidentially raise potential infringements.
- Preserve of internal documentation of efforts taken to comply with the German Supply Chain Due Diligence Act (and such records must be kept for seven years at least).
- Report externally by way of a yearly report on, *inter alia*, whether relevant risks have been identified and what measure have been taken in relation to those risks; this practice will show to what extent this report becomes a part of companies' broader non-financial disclosure.

In terms of due diligence, companies must:

- Analyse the risk that the company and its direct suppliers may infringe or contribute to the infringement of the relevant human and environmental rights.
- The scope and the level of detail required of the due diligence depends, *inter alia*, on the specific business of the in-scope company, the in-scope company's influence on the stakeholder actually causing the risk or the infringement and the severity of a (potential) infringement.

The authority competent for the enforcement of the German Supply Chain Due Diligence Act, has been requested to publish guidance papers helping in-scope companies to comply with their statutory obligations. Compliance will undoubtedly be challenging.

³ ICESCR can be found [here](#).

⁴ Minamata Convention can be found [here](#).

⁵ Stockholm Convention can be found [here](#).

⁶ Basel Convention can be found [here](#).

Additional requirements where risks are identified

If the risk analysis revealed risks with regard to human and environmental rights in their supply chain, in-scope companies are obliged to adopt a Policy Statement including, *inter alia*:

- description of the procedure that the in-scope company is pursuing to ensure compliance with the German Supply Chain Due Diligence Act;
- list of material risks revealed in the course of the risk analysis;
- statement on what the in-scope company expects from its employees and suppliers;
- outline and implementation of measures aiming to prevent infringements of relevant human and environmental risks including, for examples, the company's procurement strategy, trainings and risk-based control mechanisms or contractual agreements with direct suppliers; and
- yearly reviews and up-dates (and earlier in case new risks arise and require an adaption).

Additional requirements where infringements are identified

Where risks turned into actual infringements, in-scope companies are obliged to implement appropriate measures aiming to put an end to such infringements. Such measure shall be laid down in a comprehensive concept, including a timetable.

The concept shall provide for a plan on how to remediate the existing situation; measures may be different depending on whether the risk or impact is in the company's or group's own operations as opposed to in a direct supplier's or even in an indirect supplier's sphere. Collaboration with companies active in the same industry might be a pillar of this concept – but engaging in industry initiatives does not provide for a 'safe-harbour', meaning that the

in-scope company cannot rely on this engagement, whilst refraining from further efforts.

While the legislature expects in-scope companies to consider a temporary interruption of business relationships with (indirect) suppliers that do not comply with the relevant human and environmental rights, the termination of business relationships shall be the last resort, and only in cases where the (indirect) supplier commits severe infringements and where no further measures are available that make it likely that infringements may be diminished or stopped.

Risks triggered by non-compliance with the new rules

Despite the broad and vague concept of the German Supply Chain Due Diligence Act and the obvious difficulties that in-scope companies will encounter (even if they adopt a best-effort approach), the risks triggered by non-compliance with the new rules are quite high as the German Supply Chain Due Diligence Act provide for the following stipulations in particular:

- The competent authority is entitled to order all measures that are necessary and proportionate to ensure compliance with the law.
- The competent authority can impose administrative fines of up to EUR 800,000 or of up to 2% of the yearly worldwide turnover, in case of in-scope companies with a yearly turnover of more than EUR 400 million.
- The competent authority will publish a yearly report listing cases of non-compliance and reporting on its enforcement measures; it is not yet clear, if and to what extent, this report will deal with names and details of in-scope companies (reputational risks).
- Exclusion from public procurement procedures and the need for "self-clearance measures"⁷.

⁷ Cf. Art. 57 (6) Directive 2014/24/EU of 26 February 2014 on public procurement ([here](#)).

There was an intense discussion on private enforcement by civil litigation which even led to a temporary halt of the legislation process. The final version of the Act contains an explicit clarification that it does not affect potential civil liability which will be typically governed by foreign tort law. However, the Act provides for the possibility of representative actions (*Prozessstandschaft*) by German trade unions and NGOs on behalf of people claiming to have been violated in important rights. For more details, see part 3 of the series.

Our briefings on the German Supply Chain Due Diligence Act

This briefing is Part 2 of a series of briefings aiming at providing an overview of the key elements of the new German Supply Chain Due Diligence Act.

Our series will consist of the following briefings:

Part 1: Introduction (updated 22 June 2021)⁸

Part 2: Compliance

Part 3: Litigation

Part 4: FAQs

Key points/15 seconds read/summary

The German Supply Chain Due Diligence Act will enter into effect on 1 January 2023 and provides for a tighter regulatory environment on supply chain management for companies incorporated in Germany, or having subsidiaries or branches in Germany, and employing 3,000 or more people (decreased to 1,000 in 2024). These in-scope companies will have to analyse their supply chains to avoid human and environmental rights related risks and infringements. While conducting the underlying risk analysis will be difficult, non-compliance with the new rules may trigger even more severe disadvantages to in-scope companies.

⁸ Part 1 can be found [here](#).

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