

# The new German law on corporate due diligence in supply chains

## GERMAN BUNDESTAG PASSES CONTROVERSIAL SUPPLY CHAIN DUE DILLIGENCE ACT BEFORE PARLIAMENTARY SUMMER RECESS IN "SUPER ELECTION YEAR 2021".

### Executive Summary

- On Friday, June 11, 2021, the German Bundestag approved the government draft bill on the Supply Chain Due Dilligence Act ("Lieferkettensorgfaltspflichten-gesetz / LkSG") with several amendments.
- As of January 1, 2023, German companies, regardless of their legal form, with more than 3,000 employees will be directly obliged under the LkSG; as of January 1, 2024, this will also apply to companies with more than 1,000 employees.
- In addition, foreign companies will also be subject to the obligations under the LkSG if they have the same number of employees in Germany.
- The competent authority will be the Federal Office of Economics and Export Control in Eschborn ("BAFA").
- Domestic trade unions or non-governmental organisations ("NGOs") will be authorised to take legal action by way of a special statutory procedural status (*Prozessstandschaft*).
- For the first time, this new law prescribes the protection of human rights and of the environment as a corporate duty and imposes specific transparency, documentation and risk management obligations within corporate supply and value chains, which explicitly do not only include their own production sites but also those of their direct suppliers ("Tier 1").
- As a result, a large number of companies will be directly obliged to expand their compliance management systems ("CMS") to include the new risk dimension supply chain compliance.
- In particular, a suitable internal complaints process (whistleblowing system/"WBS") must be established and operated.

- In future, before investments, transactions or cooperations, it must be ensured that an appropriate M&A and business partner compliance due diligence is carried out.
- All in all, the corporations' internal capabilities for adequate risk analysis and active risk management will be put to the test.
- Besides the companies directly obligated by the LkSG, a contractual cascading-down effect for smaller companies can already be expected today.
- Not only "suppliers" are in scope. The entire value chain of a company must be consistently analysed, i.e. also upstream contractual partners up to the final customer must be taken into account.
- The sanction instruments include, in addition to penalty payments, severe fines, disgorgement of profits, records in the competition register and debarment from public tenders.
- Irrespective of this, serious reputational damage is at stake.
- For this summer of 2021, additional EU legislative acts are to be expected which could likely extend the German legislative framework much further - and expand legal action powers and increase liability consequences.

### Background

In the second year of the pandemic and "super election year" of 2021, three major compliance law initiatives are still being discussed, in some cases very controversially. While the ongoing efforts to reform corporate liability for white-collar crime in a new associations sanctions act ("Verbandssanktionengesetz/ VerSanG") and to deal with



whistleblowers in a law on the protection of whistleblowers ("Hinweisgeberschutzgesetz/HinSchG") are unlikely to proceed, at least before the federal elections on September 26, 2021, the government's draft bill on a law on corporate due diligence in supply chains<sup>1</sup> – now called the "Supply Chain Due Diligence Act" (*Lieferkettensorgfaltspflichtengesetz*, "LkSG") with a new abbreviated title – was adopted in an amended version with the votes of the ruling conservative and socialdemocratic parties together with the greens and against the votes of the socialistic and liberal parties and the far right. on Friday, June 11, 2021.<sup>2</sup>

Based on the United Nations' Guiding Principles on Business and Human Rights ("UNGPs")<sup>3</sup> of 2011 via the German National Action Plan for Business and Human Rights of 2016<sup>4</sup> („NAP“), human rights and environmental protection were reintroduced as a corporate responsibility goal in the Coalition Agreement of 2018<sup>5</sup> after survey data had suggested the need for a legally binding and "internationally compatible" corporate due diligence standard at the same time as German companies are becoming more and more intertwined in global procurement and distribution markets.

The ministerial draft bill published on February 28, 2021 led to the government draft bill, initially called the "Due Diligence Act", by Federal Minister of Labour Hubertus Heil (SPD) and Federal Minister of Development Gerd Müller (CSU), which was passed on March 3, 2021.

<sup>1</sup> Bundestag Drucksache BT DRS 19/30505

<sup>2</sup> In a roll call vote, 412 members of parliament voted in favour of the LkSG, 159 against and 59 abstained.

<sup>3</sup> *UN Guiding Principles on Business and Human Rights* (UNGP), UN doc A/HRC/17/3, available at: [https://www.giz.de/en/downloads/A.HRC.17.31\\_en.pdf](https://www.giz.de/en/downloads/A.HRC.17.31_en.pdf)

<sup>4</sup> <https://www.bundesregierung.de/breg-de/service/publikationen/nationaler-aktionsplan-wirtschaft-und-menschenrechte-735164>

<sup>5</sup> „Ein neuer Aufbruch für Europa Eine neue Dynamik für Deutschland Ein neuer Zusammenhalt für unser Land“, *Coalition Agreement between CDU, CSU und SPD*, 19th Legislative Period, March 12, 2018, p. 156, line 7380, available at: <https://www.bundesregierung.de/resource/blob/975226/847984/5b8bc23590d4cb2892b31c987ad672b7/2018-03-14-koalitionsvertrag-data.pdf?download=1>

<sup>6</sup> *California Transparency in Supply Chains Act*, Senate Bill No. 657, available at: [https://oag.ca.gov/sites/all/files/agweb/pdfs/cyber-safety/sb\\_657\\_bill\\_ch556.pdf](https://oag.ca.gov/sites/all/files/agweb/pdfs/cyber-safety/sb_657_bill_ch556.pdf); *UK Modern Slavery Act*, 2015 c. 30,

Previously, comparable national laws with extraterritorial applicability had already been introduced in California in 2010, in the United Kingdom in 2015, in France in 2017 and in the Netherlands in 2019.<sup>6</sup> Eventually, the European Commission's own proposal on EU-wide corporate due diligence requirements in the supply chain is expected for the early summer of 2021.<sup>7</sup>

### Key Provisions

The Supply Chain Due Diligence Act will be for the first time in Germany introducing a corporate duty to respect human rights and observe environmental requirements. These due diligence obligations do not only apply to the respective company's own operations, but also to contractual partners such as the explicitly listed direct suppliers (Tier 1).

However, the legal term **supply chain** needs to be construed as comprehensive **value chain** for the purposes of this law. According to sect. 2 V. LkSG-E, the legal definition extends to all corporate contributions to the manufacturing of a product or the provision of a service, starting from the extraction of raw materials up to the distribution to the end customer. And the substantiated knowledge of possible human rights violations of indirect suppliers also triggers due diligence obligations according to sect. 10 II. LkSG-E.

Pursuant to sect. 1 of the LkSG, all companies, irrespective of their legal form, whose headquarters administration or

<https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted>; LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (1) (FR "Loi de Vigilance"),

<https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000034290626/>; Child Labour Due Diligence Law („NL Wet Zorgplicht Kinderarbeid“); [https://www.eerstekamer.nl/behandeling/20170207/gewijzigd\\_voorstel\\_van\\_wet](https://www.eerstekamer.nl/behandeling/20170207/gewijzigd_voorstel_van_wet)

<sup>7</sup> *European Parliament Resolution of 10.03.2021 with Recommendations to the Commission on Corporate Due Diligence and Corporate Accountability*. See also press release of the European Parliament of January 28, 2021; <https://www.europarl.europa.eu/news/de/press-room/20210122IPR96215/lieferketten-unternehmen-fur-schaden-an-mensch-und-umwelt-verantwortlich>



registered office are located in the Federal Republic of Germany and employ more than 3,000 employees in Germany (from January 1, 2024 with at least 1,000 employees), including all assignments abroad and temporary employment relationships with a duration of more than six months, are the **addressees** of the LkSG. The scope of application also extends to foreign companies of any legal form that operate branches with at least 3,000 employees (from January 1, 2024 with at least 1,000 employees) in Germany.

The LkSG contains a comprehensive catalogue of **human rights-related prohibitions** with the explicit inclusion of international treaties listed in the annex.<sup>8</sup> Examples include the prohibition of child labour; slavery; forced labour; disregard for occupational safety; discrimination on the grounds of age, ethnicity or religion; withholding of adequate remuneration or violations of freedom of association (*Koalitionsfreiheit*) or unionization (*Gewerkschaftsbildung*).

The **environmental corporate obligations** are based on explicitly listed multilateral agreements. As a result, the production or use of mercury<sup>9</sup> and persistent organic pollutants<sup>10</sup> is prohibited. Likewise, environmentally hazardous handling, including the import, export and trade of waste<sup>11</sup>, is banned.

The new due diligence obligations described by the legislator as **duties of best effort** according to sec. 3 LkSG-E et seq., cover a precisely formulated, very detailed portfolio of the most differentiated prevention, detection and response measures. These include:

- Implementation of appropriate **risk management**
- Establishment of a **corporate function**, e.g. by means of a **human rights officer** (*Menschenrechtsbeauftragter*)

- Performance of appropriate, regular and additional event-driven **risk assessments**<sup>12</sup>
- Adoption of a **policy statement** on their human rights strategy authorized by corporate management
- Implementation of appropriate **preventive measures**, specifically named are **procurement policies** protecting human rights, **purchasing practices** and **training**
- Risk-based **controls**
- Passing-on of compliance expectations in **contractual audit and special termination rights** ("Compliance Clauses")
- **Reviewing the effectiveness** of the preventive measures once a year as well as on an ad hoc basis in the event of significant changes such as strategy shifts, market entries, new products or corporate take overs and investment activities
- Implementation and operation of a **complaints process**, which will eventually have to comprise a whistleblowing hotline
- **Intervention to remedy** any human rights violations identified, from a remediation plan to be agreed with the contractual Tier 1 business partner to a **temporary suspension or termination of the business relationship** as a last resort<sup>13</sup>
- Continuous **documentation** and **communication requirements**, including an annual reporting obligation on the company's website<sup>14</sup>

The **sanctions** can include **penalties** of up to 50,000 Euros, twice as high as the usual range in administrative enforcement proceedings.<sup>15</sup> The **finances** can be very high and range from 100,000 to 800,000 Euros. Following a current trend, as in the case of the European General Data Protection Regulation ("GDPR") or in anti-trust law, **up to 2%**

<sup>8</sup> For example, in the case of child protection alone, Art. 24 I International Covenant on Civil and Political Rights (ICCPR) or UN Covenant III, Art. 10 No. 3 International Covenant on Economic, Social and Cultural Rights (ICESCR) or UN Covenant I, International Labour Organization (ILO) Convention No. 138, ILO Convention No. 182.

<sup>9</sup> Minamata Convention on Mercury 2017

<sup>10</sup> Stockholm Convention on Persistent Organic Pollutants ("POPs") 2004

<sup>11</sup> The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal 1989

<sup>12</sup> See sect. 5 LkSG-E: the wording of the law on the definition of risk extends to two entire A4 pages for one paragraph alone.

<sup>13</sup> As explicitly demanded in sec. 8 II. LkSG-E.

<sup>14</sup> See sect. 11 IV. LkSG-E

<sup>15</sup> Sect. 22 LkSG-E; sec. 11 III. German Act on Administrative Enforcement (*Verwaltungsvollstreckungsgesetz; VwVG*)



of the average annual turnover of the past three years can be fined in the case of companies with more than 400 million Euros in annual global or group turnover. In addition, a disgorgement of profits<sup>16</sup> and an entry in the **competition register**<sup>17</sup> can also pose potentially severe sanction risks.

### Implementation recommendations for companies

Despite all the ongoing criticism, companies must take this new law very seriously. Extreme responses such as market exits or portfolio cuts are equally inappropriate as complete ignorance or stalling for time.

The complexity should not be underestimated, especially due to the very detailed catalogue of specific corporate obligations in this new law spelled out in much more clarity than for instance in the draft association's sanctions act., as well as through the inclusion of a large number of international conventions. Thus, the time required for the design and implementation of an effective CMS must be realistically considered depending on the specific business model and thus the according risk exposure of the entire value chain. Therefore, it should not be waited until January 1, 2023. The required passing-on of the new corporate due diligence obligations is already impacting many companies today that are not directly obliged via standardised contract clauses of international customers with ample negotiating power.

It remains to be seen to what extent the new public authority BAFA actually can and will exercise its new regulatory powers. The coordination with already introduced and future international and supranational (EU) regulations also requires attention. Whether human rights litigation is really going to shift from the USA to Germany or whether civil liability will essentially be introduced through the back door by this new law, the role of trade unions and NGOs certainly is gaining in importance. They have already been important (compliance) stakeholders before – and can become opponents in proceedings here in Germany going forward.

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<sup>16</sup> Sect. 29a German Act on Regulatory Offences (*Ordnungswidrigkeitengesetz*; OWiG)

All in all, many good reasons to reconsider an appropriate corporate organization for these new responsibilities - as for instance from a current duty of investor relations or corporate communications to the compliance or legal function - and to thoroughly review the actual process capabilities regarding risk analyses and M&A or business partner compliance due diligences.

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<sup>17</sup> Sect. 125 German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*; GWB)



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