

Europe Newsletter



Steps Towards a Sustainable Society: The German Due Diligence Act on Human Rights and Environmental Issues in Supply Chains

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I Overview

On 11 June 2021, the German Parliament passed the Supply Chain Due Diligence Act (*Lieferkettensorgfaltspflichtengesetz – LkSG*; the “**Supply Chain Due Diligence Act**” or the “**Act**”) with provisions obliging companies to conduct due diligence on human rights and environmental issues in their supply chains. This timing is apt, as the Supply Chain Due Diligence Act is expected to serve as a tailwind for a parallel initiative underway at the EU level. Of course, as with any regional initiative, the level of consistency between the requirements of legislation enacted at the regional level and the level of each national government remains to be seen.

1. The Purpose of the Due Diligence Act

The main purpose of the Supply Chain Due Diligence Act is to protect human rights and the environment by imposing legal obligations on companies to conduct due diligence on human rights and environmental issues throughout their supply chains and, by introducing fines and certain sanctions for non-compliance, effectively prevent and resolve those issues.

2. Background

The necessity of human rights and environmental due diligence in supply chains has been long discussed as one of the key measures for creating a sustainable society and achieving healthy economic growth. In fact, at the international level, various organizations have already provided related principles and guidelines including but not limited to: the “OECD Guidelines for Multinational Enterprises” by the Organization for Economic Co-operation and Development (OECD; 2000/2011), the “ILO Declaration on Fundamental Principles and Rights at Work” by the International Labor Organization (ILO; 1998), and the “Ten Principles of the UN Global Compact” by the United Nations Global Compact Office (2000).

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At the national level, the German Government adopted the “National Action Plan for Business and Human Rights” (2013/2016),¹ which implemented homogeneous and verifiable global standards while clarifying German companies’ responsibilities in protecting human rights (including specific due diligence and monitoring requirements). However, as none of these principles and guidelines are legally binding, implementation levels remain at the discretion of the individual companies, which leads to uneven implementation and practices. As such, some companies and NGOs have raised concerns that such voluntary commitments are not sufficient, insisting that the German Government enact mandatory human rights and environmental due diligence legislation.² The Supply Chain Due Diligence Act was drafted in response and, as noted, clarifies companies’ legal responsibilities and specific obligations as well as sanctions for non-compliance, to ensure legal certainty, predictability and efficiency.

3. Impact on Companies

Once the Supply Chain Due Diligence Act comes into force on 1 January 2023, companies will be obliged to establish a governance system to protect human rights and the environment, and be subject to sanctions in cases of non-compliance. The key feature of the Supply Chain Due Diligence Act is that companies owe an obligation of due diligence, creating a positive duty to make best efforts ensuring adherence to such rights in their own business activities and those of their supply chains. Therefore, depending on circumstances, companies need to reconsider and amend their supply contracts to comply with the requirements under the Supply Chain Due Diligence Act (ex. including due diligence clauses).

Non-German companies could also be affected by the Supply Chain Due Diligence Act if they have an office or a group company in Germany which meets the criteria described in Section II below. In particular, the number of Germany-based employees of group companies is taken into account in assessing the threshold for application of the Supply Chain Due Diligence Act. Also, upon calculating fines, the global annual turnover of the group companies will be taken into consideration. Therefore, the Supply Chain Due Diligence Act will have significant impacts for foreign companies.

II Outline of the Due Diligence Act

1. Scope

The Supply Chain Due Diligence Act will be applicable to companies which satisfy certain geographic and size criteria.

(1) Legal Form of Companies

The Supply Chain Due Diligence Act applies to any company, regardless of their legal form (ex. stock corporation, limited liability corporation, branch office, etc.) as long as they meet both the geographic and size criteria described below.

(2) Location of Companies

The Supply Chain Due Diligence Act shall be applied to those companies which have their head office, principal place of business or registered office in Germany.

(3) Company Size (Number of Employees)

The Due Diligence Act shall be applied to companies with a certain number of employees. The timing of the application

¹ In response to publication of the UN Guiding Principles on Business and Human Rights (2011), another example of an international soft law instrument calling for corporate supply chain due diligence (see commentary to Principle 17), the European Commission called on EU Member States to develop their own National Action Plans for “Business and Human Rights” implementation.

² See <https://www.business-humanrights.org/en/big-issues/mandatory-due-diligence/gesetz/>

depends on the number of employees (as follows):

1. Companies with more than 3000 employees: January 1, 2023.
2. Companies with more than 1000 employees: January 1, 2024.

When determining the number of employees, all group companies are in scope. However, only employees based in Germany, as well as employees that have been seconded from Germany to outside of Germany, are taken into account. Locally hired employees outside of Germany are not included in the calculations.

2. Obligations

The scope of the due diligence and specific obligations under the Supply Chain Due Diligence Act are as follows.

(1) Scope of the Due Diligence

Companies shall undertake the due diligence for all their own business activities and those of their direct suppliers. In addition, a company must perform the due diligence with regard to the rest of the supply chain if they have substantiated information concerning potential human rights violations and/or environmental problems caused by indirect suppliers.

The human rights and environmental risks analyses to be covered by the due diligence include, for example, infringement of fundamental human rights, child labor, forced labor, slavery, excessive working hours, the lack of health and safety measures, infringement of fundamental labor rights, discrimination, exploitation, lack of a minimum wage, and environmental issues such as water pollution, air pollution and/or soil contamination.³ As the scope of obligation is very broad, companies should determine the appropriate scope of their due diligence depending on their respective business activities.

(2) Specific Obligations under the Due Diligence Act

According to the Supply Chain Due Diligence Act, companies have the following obligations in regard to human and environmental rights:

1. Establishing risk management systems (ex. clarifying responsible persons, establishing monitoring systems, etc.)⁴
2. Performing regular human rights and environmental risk analyses⁵
3. Establishing basic principles for protecting human rights and the environment, and implementing related preventive measures in their own business activities and those of their direct suppliers⁶
4. Establishing remedial measures⁷
5. Establishing a complaint mechanism⁸
6. With respect to indirect suppliers' risks, establishing a compliance mechanism and adjusting their existing risk

³ Section 2 of the Supply Chain Due Diligence Act

⁴ Section 3 paragraph 1 nos. 1-2, Section 4 of the Supply Chain Due Diligence Act.

⁵ Section 3 paragraph 1 no. 3, Section 5 of the Supply Chain Due Diligence Act.

⁶ Section 3 paragraph 1 nos. 4-5, Section 6 of the Supply Chain Due Diligence Act.

⁷ Section 3 paragraph 1 no. 6, Section 7 of the Supply Chain Due Diligence Act.

⁸ Section 3 paragraph 1 no. 7, Section 8 of the Supply Chain Due Diligence Act.

management system (including certain measures otherwise reserved for direct suppliers)⁹

7. Filing reports on performance of the above mentioned obligations to the relevant authority (Bundesamt für Wirtschaft und Ausfuhrkontrolle; BAFA)¹⁰

3. Sanctions

The Supply Chain Due Diligence Act stipulates administrative sanctions in case of non-compliance depending on the nature of the infringement and the specific circumstances.

(1) Fines

The amount of fines shall be determined depending on average annual global turnover. Annual global turnover of the group companies (including the parent company) shall be taken into account in this context.

1. In principle, fines up to EUR 800,000 (for legal entities, up to EUR 8 million).
2. For companies with average annual global turnover of more than EUR 400 million in the last three years, fines up to 2% of the average global turnover.

(2) Exclusion from Public Procurements

Companies in breach of the obligations under the Supply Chain Due Diligence Act can be excluded from the public procurement processes for up to three years if the violations are serious.

(3) Civil Liabilities

The Supply Chain Due Diligence Act does not stipulate civil liability specific to breach of the due diligence obligation. However, the infringed parties may still pursue infringing parties under German law's general principles of civil liability (in particular, those based in duties of care). Also, infringed parties may authorise trade unions and/or NGOs to represent them in pursuing infringing parties' general civil liability failures in Germany. Such disputes can result in serious reputational harm for the infringing parties.

III Conclusion

Corporations' critical roles in protecting human rights and the environment have long been discussed in various channels, for example, in relation to ESG (Environmental, Social and Governance) and SDGs (Sustainable Development Goals) frameworks. However, the lack of effective mechanisms to make companies behave in a cohesive way to protect human rights and the environment has been one of the biggest challenges of both national and international governance. The Supply Chain Due Diligence Act is expected to lead companies to act for protecting human rights and the environment by providing specific obligations and sanctions in case of breaches.¹¹

⁹ Section 3 paragraph 1 no. 8, Section 9 of the Supply Chain Due Diligence Act.

¹⁰ Section 3 paragraph 1 no. 9, Section 10 of the Supply Chain Due Diligence Act.

¹¹ There are some criticisms of the Supply Chain Due Diligence Act regarding the balance between the purposes and effects (including sanctions). For example, some feel that non-compliance due to negligence should not be subject to the same sanctions as non-compliance due to willful misconduct or gross negligence.

Whereas many companies already engage in various activities related to human rights and environmental issues as a part of CSR (Corporate Social Responsibility) initiatives, judging from recent movements in Europe, it has become increasingly important for companies to take a more proactive approach towards human rights and the environment by integrating those perspectives into their purposes and management strategies. Such attitude is crucial not only for a sustainable society, but also for their own business growth and economic success.

We will continue to monitor and update readers on developments in implementation of the Supply Chain Due Diligence Act and the EU level legislation on mandatory human rights and environmental due diligence in supply chains.



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