

Supply Chain Due Diligence Act

Requirements and Risks Especially in Relation to Logistics

On Jan. 1, 2023, the Supply Chain Due Diligence Act (“LkSG”) came into force in Germany. The objective of the LkSG is to improve the international human rights situation. For the first time, binding requirements are set for responsible supply chain management by companies.

The starting point for the national legal regulation was the UN Guiding Principles on Business and Human Rights from 2011, which included as basic principles the obligation of states to protect human rights, the corporate responsibility to respect human rights and corporate due diligence to prevent violations and the implementation of remedial measures have been established. In Germany, these Guiding Principles have been implemented through a National Action Plan 2016 – 2020 (NAP). However, this was merely a call for voluntary commitments, which did not include any sanctions for non-compliance. After it was determined in 2020 that only a fraction of German companies met the stan-

dards set out there, a mandatory legal regulation was established in the form of the LkSG.

Protected Legal Positions

The aim of the LkSG is to prevent, minimize or end risks related to human rights and the environment. The affected legal positions are defined in the form of comprehensive prohibitions, which cover the core areas of human rights protection, employee protection and environmental protection. However, according to Sec. 2 (2) No. 12 LkSG, protection also extends to other legal positions that are not specifically defined and whose need for protec-

tion is “obvious when all relevant circumstances are reasonably considered”.

Compliance with Duties of Care

According to the definitions in the LkSG, due diligence obligations consist, among other things, of the obligation to establish a risk management system, conduct regular risk analyses, anchor preventive measures (also for direct suppliers), documentation and also, which is very important, “the implementation of due diligence obligations with regard to risks at indirect suppliers.”

These are process-oriented obligations that require companies to develop effective and appropriate due diligence measures. The LkSG does not provide for an obligation to succeed or even a guarantee obligation. However, companies must take the objectively necessary measures within the scope of what is concretely feasible and appropriate.



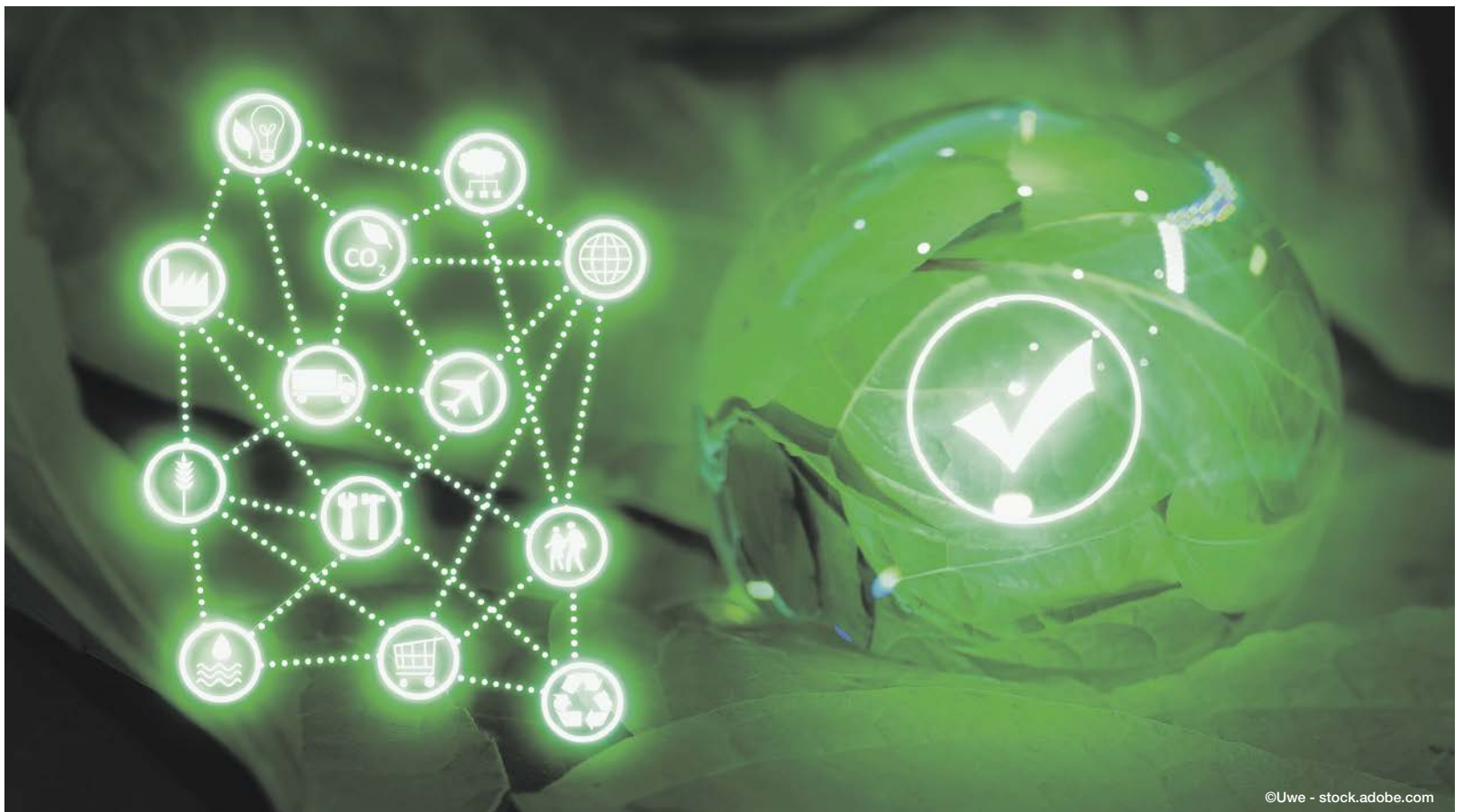
Andreas Fuchs,
Arnecke Sibeth
Dabelstein

Official Monitoring

The authority responsible for monitoring is the Federal Office of Economics and Export Control (BAFA). Pursuant to Sec. 14 of the LkSG, BAFA carries out risk-based monitoring either upon application or ex officio.

The rights of the authorities under the LkSG are summarized as follows:

- Right to audit and order annual report
- Right of inspection with regard to compliance with the duty of care



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- General authority to issue appropriate orders and take appropriate measures
- Rights of access (properties, business premises)
- Right to inspect documents and records
- Search and seizure as investigative measure

The controlled companies have the following obligations or rights:

- Obligation to provide information
- Right to refuse to provide information in the event of imminent self-incrimination or incrimination of relatives within the meaning of Sec. 52 (1) of the Code of Criminal Procedure
- Obligation to surrender
- Obligation to tolerate and cooperate

Sanctions for Violations

Violations of the provisions of the LkSG are subject to various and quite substantial sanctions.

According to Sec. 23 LkSG, a penalty payment of up to EUR 50,000.00 can be imposed.

Sec. 24 (1) LkSG sets out a large number of different administrative offenses for different types of violations. Depending on the type and significance of the specific violation, fines of up to EUR 800,000.00 or up to 2% of the average annual profit are possible!

In addition, companies that are fined at least EUR 175,000.00 (with exceptions) shall be excluded from the award of public contracts. Furthermore, an entry in the competition register may be threatened.

Who Is Affected by the LkSG?

The LkSG applies to companies with their administrative headquarters, main office or branch office in Germany. As of Jan. 1, 2023, the LkSG will initially apply to companies with at least 3,000, and as of Jan. 1, 2024, also to companies with at least 1,000 employees in Germany.

Small and medium-sized enterprises below these thresholds are therefore not directly affected by the provisions of the LkSG. However, Sec. 2 (5) of the LkSG stipulates that the companies directly affected are also responsible for their “direct and indirect suppliers”. This in fact leads to an indirect inclusion of all suppliers.

Expanded Definition of “Supply Chain”

For the purposes of the LkSG, a direct supplier is a “partner to a contract for the supply of goods or the provision of services whose supplies are necessary for the manufacture of the company’s product or for the provision and use of the service in question.” An indirect supplier is “any company that is not a direct supplier and whose supplies are necessary for the manufacture of the company’s product or for the provision and use of the relevant service.”

This broad interpretation means that transport service providers, forwarders and other logistics service providers, among others, are also affected at least indirectly by the requirements of the LkSG as an essential part of the supply chains.

Contractual Inclusion of Suppliers/Logistics Service Providers

For the aforementioned reasons, the respective clients directly affected are de facto forced to (also) oblige the logistics service providers they commission to comply with the requirements of the LkSG.

From the perspective of the directly obligated parties, it will not be sufficient to receive a simple declaration from their suppliers in which compliance with the requirements of the LkSG is promised more or less across the board, as can currently be observed in practice. The level of requirements here differs, for example, from the situation when implementing the requirements of the Minimum Wage Act. Compliance regulations customary in the industry (such as in the German ADSp 2017) can certainly be used as a starting point, but fundamentally fall short with regard to the specific requirements of the LkSG.

Rather, in order to provide suitable protection for the directly obligated parties, it will be necessary to specifically obligate suppliers to set up risk management systems, audit rights, employee training, etc., combined with suitable sanction mechanisms (special termination rights/compensation and indemnification provisions). It should be noted that implementation will be a considerable challenge for the logistics service providers concerned.

The form of contractual implementation depends on the specific situation in practice. As a rule, supplementary agreements will be suitable

for existing contracts, and supplementary clauses for new contracts.

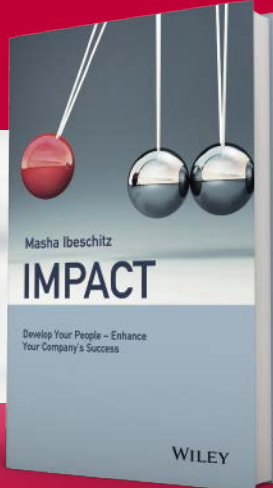
Outlook: “EU Supply Chain Directive”

The EU published a draft EU Directive on corporate due diligence in the area of sustainability (EU 2019/1937) (“EU Supply Chain Directive”) in February 2022. The planned EU Supply Chain Directive will go considerably beyond the requirements and consequences of the LkSG.

The EU Supply Chain Directive must first be adopted by the EU Commission and subsequently transposed into national German law. This will probably not be the case until 2024 at the earliest. Nevertheless, it is advisable to proactively keep in mind that it will be necessary to adapt the approach to these new requirements in the medium term.

Andreas Fuchs, Lawyer, Arnecke Sibeth Dabelstein Rechtsanwälte Steuerberater Partnerschaftsgesellschaft mbB, Frankfurt am Main, Germany

- a.fuchs@asd-law.com
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