

Supply chain due diligence law in force from 2023! How should you prepare

Supply chain due diligence law passed in June 2021, the German Bundestag and the Bundesrat. The recommended resolution and the report of the Committee for Labour and Social Affairs of the German Bundestag, in which version the Act was passed, can be found here: <https://dserver.bundestag.de/btd/19/305/1930505.pdf> .

The Supply Chain Due Diligence Act imposes extensive obligations on companies to protect human rights and the environment in the supply chain. Along the supply chains, the internationally applicable standards for labour and health protection as well as for the observance of human rights must be followed. All people involved in a product should be able to participate in the creation of value under acceptable, generally recognised ethical and economic standards.

Scope of the Act

The law will come into force on 1 January 2023 for companies with at least 3,000 employees and their suppliers. From 1 January 2024 then for companies with at least 1,000 employees and their suppliers.

The law also covers foreign companies, provided they employ the specified number of workers on German soil. The legislator itself assumes that the law will affect about 3,000 companies. Explicitly built into the law is an evaluation between now and 30 June 2024 at the latest as to whether this threshold should be lowered further. This means that in future suppliers of customers with fewer than 1,000 employees may also be affected by the law as suppliers.

The new Supply Chain Due Diligence Law will thus also have an impact on German companies in China. For this reason, the AHK Greater China has developed a template with concrete recommendations for action, especially for small and medium-sized enterprises.

These can be downloaded free of charge from the AHK website in both English and Chinese:

<https://china.ahk.de/de/news/news-details/german-chamber-template-for-a-code-of-conduct-for-sustainable-supply-chains-in-china> . However, the tool can also be easily adapted to other regions and individual sectors.

Although the Supply Chain Due Dilligence Law is not directly aimed at companies with fewer than 3,000 or 1,000 employees - small and medium-sized enterprises (SME) are also involved in the issue as suppliers for larger buyers of their products and services. In practice, these companies in particular are currently still faced with many questions when it comes to tracking international supply chains.

For this reason, further initiatives have been launched at federal level in recent months and tools have been created to support small and medium-sized enterprises in particular with questions relating to the audit of the existing supply chain or a planned realignment.

The [Business & Human Rights Helpdesk](#) of the German Agency for Economic and Development (AWE) deserves special mention. The initiative of the German government offers interested companies, among other things, individual and free advice on the implementation of human rights due diligence in business processes. In addition, the Business & Human Rights Helpdesk provides two free tools to companies that want to integrate human rights due diligence processes into their core business:

- [SME Compass](#): The free info portal for SMEs navigates you step by step through the five pillars of care based on the National Action Plan on Business and Human Rights (NAP). With the help of the free online tool, small and medium-sized enterprises can identify and manage sustainability risks. It supports taking a close(er) look at business processes and the supply chain. In addition to a guide, the tool also contains a seal compass.

- [CSR Risk Check](#): The free online tool supports companies in assessing the local human rights situation as well as environmental, social and governance issues along their supply and value chain.

Scope of responsibility for the supply chain

The degree of concern for suppliers of companies with at least 3,000 or than 1,000 employees will vary:

On the one hand, it depends on the customer structure of your company:

- How many of your direct and indirect customers are subject to the Supply Chain Act?
- What share of turnover do deliveries to these customers contribute to your company's total turnover?

And on the other hand, it depends on what requirements these customers have to place on you as a supplier according to the law. This in turn depends on three factors:

1. how risk-prone does the legislator consider the supply chain of the company you supply to be regarding violations of human rights and related environmental risks?
2. what influence does the legislator expect the company to have on its suppliers and on your company in particular?
3. how important are public tenders for your customers? (An exclusion of up to three years from public tenders is possible for your customer according to § 22 in the case of certain violations of the law, which can also result from the dealings with its suppliers).

From the legislator's point of view, the susceptibility to risk therefore results primarily from three types of risk. These are country-specific, sector-specific and commodity group-specific risks.

The legislator particularly addresses the country-specific risks: According to this, companies "very strongly affected" by the law are those "which import goods from outside Europe". The legislator makes this risk assessment across the board. It also applies if you are the non-European supplier - for example, if one of your non-European subsidiaries supplies the customer company. This also includes cases in which this delivery goes to a non-European subsidiary of your customer company. From the legislator's point of view, companies that import goods from European countries but not from non-European countries are strongly affected. Thus deliveries from your European parts of the company to your customers are also strongly affected.

Regarding the sector affiliation, the legislator assumes that there is a small group for which the human rights risks are rather low because the value creation takes place predominantly in the Federal Republic of Germany. These include companies in the "mining and minerals", "waste disposal", "forestry", "real estate" and "water supply" sectors. These companies are not likely to be affected by the new provisions of the Act.

Companies from the sectors "construction", "agriculture and fisheries", "personnel, cleaning and security services" as well as "transport and logistics" also have a lower international integration, but higher human rights risks. In the opinion of the legislator, the risks for these groups of companies are mainly within the Federal Republic of Germany and less abroad.

Due diligence obligations of companies

Respect for human rights is to be ensured through the implementation of certain due diligence obligations. In this context, the legislator requires a comprehensive risk analysis as well as preventive and remedial measures that build on each other and are interlinked:

- the establishment of a risk management system (§ 4 paragraph 1 LkSG),
- the definition of an in-house responsibility for human rights protection (§ 4 paragraph 3 LkSG),

- the performance of regular risk analyses (§ 5 LkSG),
- the adoption of a policy statement (§ 6 para. 2 LkSG),
- the establishment of preventive measures in its own business area (§ 6 paragraph 1 and 3 LkSG) and vis-à-vis direct suppliers (§ 6 paragraph 4 LkSG),
- taking remedial action in the event of a violation of a protected legal position (section 7 (1) to (3) LkSG),
- setting up a complaints procedure (Section 8 LkSG) to report human rights violations,
- the implementation of due diligence regarding risks at indirect suppliers (§ 9 LkSG) and
- documentation (Section 10(1) LkSG) and reporting (Section 10(2) LkSG) regarding the fulfilment of due diligence obligations.

Effects on suppliers

For you as a supplier, this means that you can first make a good assessment of whether you will also be affected by the law based on the industry affiliation of your customer company. Then you can say that the more international the customer company is, the more you as a supplier will be affected.

The law also distinguishes between "direct" and "indirect" suppliers. "Direct" suppliers will be significantly more affected because the legislator assumes a significantly greater possibility of influence by the customer.

"A direct supplier is a contractual partner whose supplies are necessary for the production of the (customer's) product or for the provision and use of the (customer's) service in question" (§ 2, para. 7).

"Indirect supplier...is any enterprise which is not a direct supplier and whose supplies are necessary for the manufacture of the enterprise's product or for the provision and use of the service in question" (§2, para. 8).
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The fact that a company is a direct supplier results from the requirements that the legislator places on companies directly subject to the law when dealing with their direct suppliers. The legislator places corresponding requirements on the companies directly affected by the law in almost all activities required by the law. They are explicitly named in relation to the preventive measures to be taken (§ 6, para. 4):

"The company must embed appropriate preventive measures towards a direct supplier, in particular:

1. the consideration of human rights and environmental expectations in the selection of a direct supplier,
2. the contractual assurance of an immediate supplier that it will comply with the human rights and environmental requirements demanded by the company's management and address them appropriately along the supply chain,
3. the agreement of appropriate contractual control mechanisms and the implementation of training and education to enforce the contractual assurances of the direct supplier in accordance with point 2,
4. the implementation of risk-based monitoring measures, based on the agreed monitoring mechanisms in accordance with point 3, to verify compliance with the human rights strategy at the direct supplier's premises."

The first impact on direct suppliers, is that their customers, who are subject to the law, "should take into account the human rights-related expectations of the enterprise" ... when selecting a potential contractual partner. In doing so, "the company should establish human rights expectations as an integral part of a supplier evaluation as a fixed component of a supplier assessment in order to evaluate the initiation of a contractual relationship in advance."

The legislator also defines its expectations regarding contractual assurances more precisely in its explanatory memorandum to the law:

The supplied company should contractually stipulate based on its supplier code which requirements the contractual partner (direct supplier)

must observe when accepting a contract to prevent or minimise certain human rights and environmental risks identified in the risk analysis. The obligation should be designed in such a way that the requirements can also be adjusted after conclusion of the contract depending on the results of the risk analysis.

The company should ensure through contractual arrangements that the human rights-related expectations are also fulfilled in the further supply chain - i.e., by upstream suppliers - for example through the agreement of transfer clauses. Through these, the contractual partner (direct supplier) is obliged to enforce the Supplier Code also vis-à-vis its own contractual partners through suitable contractual regulations. If necessary, the company can additionally stipulate in the contract that the contractual partner may only purchase certain products from selected (previously audited) suppliers or must prove that certain products come from certified regions or raw materials.

The legislator also defines these in more detail: "The verification of compliance with one's own human rights-related standards at direct suppliers can be carried out, for example, through one's own on-site inspections, through third parties commissioned with audits, as well as using recognised certification systems or audit systems, insofar as they guarantee the implementation of independent and appropriate controls. The commissioning of external third parties does not release the company from its responsibility under this Act." In implementation practice, the question arises as to how control measures or audits are to be implemented in the supply chain in concrete terms.

One possibility could be to demand certification from suppliers (and thus outsource the audits).

(and thus outsource the audits), for example in accordance with ISO 37301. With ISO 37301 (Compliance Management Systems), which comes into force in April 2021, an internationally certifiable ISO standard is available.

In the case of indirect suppliers, "strategically relevant intermediaries and suppliers" are of particular importance from the legislator's point of view. The legislator defines

how to deal with indirect suppliers in § 9. The legislator requires companies subject to the law to take action, especially in relation to indirect suppliers, if the company becomes "aware of a possible violation of a protected legal position or an environmental obligation at indirect suppliers". (§ 9, para. 3). In this case, a risk analysis must be carried out immediately, appropriate preventive measures must be taken vis-à-vis the originator, a concept for minimising and avoiding the violation of a protected legal position or environmental obligation must be drawn up and implemented and, if necessary, the declaration of principles must be updated. Direct suppliers between the indirect supplier concerned and the client company will presumably be included in this.

A little more clarity as to when "substantiated knowledge" is to be assumed is explained by the legislator in the explanatory memorandum to the law. It is given "if the company has factual indications that make a human rights or environmental violation at an indirect supplier appear possible - for example, through the complaints procedure according to section 8, through its own findings, through the competent authority or through other sources of information". Factual indications may include, for example, reports on the poor human rights situation in the production region, the fact that an indirect supplier belongs to an industry with particular human rights or environmental risks, and previous incidents at the indirect supplier.

Unlike the companies directly subject to the law, suppliers themselves can neither be fined nor excluded from the award of public contracts.

However, the legislator encourages companies directly subject to the law to establish contractual penalties in their relations with their direct suppliers: "If it is foreseeable that the direct supplier will not comply with the requirements developed in the concept, the company should enforce a contractual penalty, temporarily suspend business relations in accordance with contractual agreements or remove the company from possible award lists until the contractual partner has ended the violation".

Liability of companies

The Supply Chain Due Diligence Law does not introduce additional civil liability, but violations are subject to fines. As an innovation, German trade unions and NGOs can represent the interests of workers of foreign companies against German principals in court proceedings in Germany.

Control and enforcement

A control body has been established at the Federal Office of Economics and Export Control to control and enforce the law. If the due diligence obligations are not implemented, there is a risk that administrative offence proceedings will be initiated.