Advances in Social Science, Education and Humanities Research, volume 659
2nd Riau Annual Meeting on Law and Social Sciences (RAMLAS 2021)

The German Supply Chain Due Diligence Act 2021 and Its Impact on Globally Operating German Companies

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***Abstract*—The German Supply Chain Due Diligence Act 2021 aims to enforce human rights standards in the entire supply chain from raw material to end product. It applies to bigger companies that have their administrative headquarters or registered office in Germany, including companies which have a branch office in Germany. The SCDDA will lead to companies having to make considerable adjustments in compliance, contract design with supplier companies and purchasing. If internal company control procedures and risk assessment, especially to direct suppliers are not sufficiently adapted, a considerable liability risk may arise, which will be exacerbated by the future introduction of special civil liability under future European supply chain law. The paper gives an overview over the SCDDA and discusses strengths and weaknesses of the German legislation.**

Keywords—corporate social responsibility, human rights, due diligence, supply chains, corporate law

I. INTRODUCTION

The new German Supply Chain Due Diligence Act (SCDDA) (‘*Lieferkettensorgfaltspflichtengesetz’* ‘LkSG’) [1] aims to enforce human rights standards in the supply chain from raw material to end product. After France (however, this law does not provide for fines for violations) [2] and the Netherlands (limited to child labour) [3], Germany is the third EU-state to introduce such a law. The new law is only comparable to a limited extent with corresponding laws in other countries, such as the Modern Slavery Act 2015 in the United Kingdom [4] and the Modern Slavery Act 2018 in Australia [5], as these only provide for transparency and reporting obligations, but do not establish any substantive requirements for companies to act.

The SCDDA will apply directly to enterprises with at least 3000 employees as of 1.1.2023 (affecting approx. 600 enterprises) and to enterprises with at least 1000 employees on 1.1.2024 (affecting then approx. 2900 enterprises). The law applies to companies that have their administrative headquarters or registered office in Germany. Importantly, it also covers companies that have a branch office in the Federal Republic of Germany and the corresponding number of employees in Germany. Smaller supplier companies will also be affected by the law to the extent that they must comply with the *Code of Conduct* that the German companies bound by the law impose on them by contract. In this way, compliance obligations become part of the contract, which strengthens the effect of the law.

The law will lead to companies having to make considerable adjustments in compliance, contract design with supplier companies and purchasing. If internal company control procedures are not sufficiently adapted, a considerable liability risk may arise, which will be exacerbated by the future introduction of special civil liability under future European supply chain law. Companies should therefore already adjust their organisational structures to this.

The idea of ethically compliant working conditions is not the same in all countries. Germany has particularly high social standards and an employee-friendly labour law, for example with regard to employee-friendly protection against dismissal and social security for sick workers. With this law, however, the German legislator is not aiming at the *unrestricted* export of German social and labour standards to other countries. Such a goal would not be realistically achievable. It could be seen as an *excessive extension of extraterritorial economic regulation* by powerful industrialised countries [6]. Instead, essential human rights standards, such as the avoidance of forced labour and child labour, should be implemented abroad for German companies. The same applies to fundamental environmental standards. These are relevant to human rights because they affect people's immediate lives in the environment of production and trade and are covered by the law on the recording of human rights violations as a result of severe environmental damage and on the imposition of environmental obligations.

II. The Human Rights-Related Obligations of Companies in the SCDDA as a Legislative Implementation of the UN-Guiding Principles on Business and Human Rights of 2011

German companies will be "*obliged to better fulfil their global responsibility to respect human rights and environmental standards*" [7]. These standards are globally valid and recognised by international conventions. The law thus implements the *UN-Guiding Principles on Business and Human Rights of 2011* [8], which are based on international human rights obligations, in particular the *International Bill of Human Rights and core labour standards of the International Labour Organization (ILO)*. The UN Guiding Principles consist of three basic areas, the so-called "*Ruggie-Principles*" [9]:

- States have a duty to protect human rights.
- Companies have a responsibility to respect human rights and to comply with all applicable laws
- Those affected by human rights violations must be granted appropriate and effective access to remedial options.

The SCDDA falls short of the Guiding Principles on Business and Human Rights in part insofar as it requires companies to conduct systematic and ongoing due diligence only with regard to *direct suppliers* and diminishes the obligations with regard to *indirect suppliers* in the supply chain. In the case of indirect suppliers, the company only has to carry out an *incident-related risk analysis* if it has "*substantiated knowledge*" of potential human rights infringements. This was the subject of criticism of the act by human rights organisations, since it is precisely at the level of *indirect* suppliers that human rights violations typically occur, at the beginning of the supply chain [10]. Another point of criticism was the failure to take climate protection into account when the act was conceived [11].

III. The Scope of Application of the SCDDA

Corporate responsibility following the SCDDA basically covers the entire supply chain from raw materials to the final product. It covers serious human rights violations without making German social standards universal. For example, the law covers the employment of children under the age of 15 in general (sec. 2 par. 2 no. 1) and of adolescents under the age of 18 in the presence of certain aggravating circumstances such as slavery, including forced recruitment of adolescents, prostitution, drug trafficking and activities harmful to the health or immoral for adolescents (sec. 2 par. 2 no. 2). It also covers forced labour (sec. 2 par. 2 no. 3) and slavery (sec. 2 par. 2 no. 4), as well as the prohibition on organising for example in unions (sec 2 par 2 no 6). Furthermore, the law refers to the prohibition of unequal treatment in employment on the grounds of national or ethnic origin, social origin, health status, disability, age, political opinion, religion or belief, sexual orientation and gender (sec. 2 par. 2 no. 7).

The latter two grounds of discrimination in particular can lead to problems for companies insofar as the equal treatment of women and men or of homosexual or diverse persons is not recognised in societies of certain producing countries. Some states, for example, have declared reservations to the Convention on the Elimination of All Forms of Discrimination against Women of 18 December 1979 [12], e.g. based on assumed contradictions of the interpretation of the Convention with Islamic religious rules (an overview and a case study on the example of Singapore gives *Keller* [13]). Here, the law can force German companies, specifically in these states, to actively work towards establishing discrimination-free working conditions at companies within the supply chain as part of the individual risk assessment. The SCDDA and similar laws of other states could thus prove to be a possible instrument of effective - at least selective, related to individual local companies - international enforcement of human rights even where human rights protection based on international conventions is not or only incompletely implemented.

Environmental aspects are directly covered insofar as environmental damage leads to a direct deterioration of living conditions which is relevant to human rights (sec. 2 par. 2 no. 9). In addition, certain environmental risks are covered which result from impending violations of the Minamata Convention (risks from involvement in the production and disposal of mercury-containing products), the PoPs-Convention (risks from the production or use of certain persistent organic pollutants) and the Basel Convention (risks from the import and export of hazardous waste) (§sec. 2 par. 2 no. 3).

IV. Legal Fixation of Corporate Social Responsibility Obligations in the SCDDA: Entrepreneurial Obligation of Means

Ultimately, the law is about establishing CSR-rules by formulating concrete human rights-related due diligence obligations of the companies. These are based on the due diligence standards of the UN Guiding Principles on Business and Human Rights [8]. Companies must implement 'adequate' risk management and take preventive and remedial measures depending on the outcome of the risk analysis. Only an obligation to make effort is imposed on companies (*obligation of means*), not an *obligation of result*. Nor do companies have any guarantee liability.

The SCDDA addresses several areas with regard to corporate obligations:

- Risk management and risk analysis
- Preventive and remedial measures
- Establishment of a complaint mechanism
- Annual documentation and reporting obligations to the competent authority.

In addition, the German Federal Office of Economics and Export Control (BAFA) is assigned powers of intervention against companies, which the authority can exercise at the request of affected persons or *ex officio*. It is important to note that persons within the entire supply chain are considered potentially affected persons. Affected persons can authorise domestic trade unions or NGOs to take legal action in civil proceedings (‘*Besondere Prozessstandschaft*’ sec. 11 par. 1) if a "paramount legal position", for example life or limb, is affected. However, the practical significance of this is limited because civil claims will regularly fail due to the lack of applicability of the German Civil Code under conflict of laws rules and the unfavourable distribution of the burden of proof for victims of human rights violations in civil proceedings (see below). The *termination of existing business relations*, which is not merely temporary, will only rarely be necessary. The law provides for this as a last resort, if there are particularly serious human rights violations, concepts for remedial action do not promise success, no milder means are available to the company and an increase in the company's ability to exert influence does not appear promising (sec. 7 par. 3).

The law does not provide for any special *civil liability claims* by affected persons. Originally, the responsible Federal Ministry of Labour and Social Affairs had provided for a civil liability clause. The deletion of this clause is one of the main points of criticism of the SCDDA [14], especially since the introduction of *private law enforcement as an instrument of economic and socio-political steering* has proven to be quite effective in other areas (for example, in the EU anti-discrimination law). This is likely to change with the future supply chain regulation at the level of EU law (see below). Civil law claims for damages are theoretically possible at present. However, these do not arise from the SCDDA itself but from general civil tort law (sec. 823 BGB). Therefore, such claims will not play a significant role in the result, because in the case of damage outside Germany, the respective foreign tort law will mostly apply (Art. 4 para. 1 Rome II-Regulation [15]. The importance of such claims is currently also to be regarded as low because the burden of proof for a claim for damages lies with the injured party. The legislator moreover made clear, that the SCDDA is not to be understood as ‘*Schutzgesetz*’ (protective rule) in the sense of sec. 823 par. 2 [16]. However, the SCDDA could in the future also influence the assessment of the concretisation of an *organisational fault* within the framework of general civil liability for damages by the civil courts, insofar as German private law is called upon to apply under conflict of laws rules. It is not excluded that organisational fault could be assumed insofar as a company cannot prove to have implemented the risk assessment and remediation mechanisms provided for by law.

As sanctions, the SCDDA provides for fines of up to 800,000€ if due diligence or reporting obligations have been violated. If a company fails to initiate remedial measures in breach of its duties or does not implement a remedial concept vis-à-vis a direct supplier, the fine can be up to 2% of the average annual turnover if the company has an average annual turnover of more than 400.000.000€. In addition, companies can be excluded from public tenders for up to three years.

V. The Regulatory Approach of the SCDDA

The regulatory approach of creating effective protective structures by concretising organisational obligations in companies makes perfect sense here. It takes into account that in complex organisational structures, be it companies or supply chains, the direct influence of individual participants on hazardous situations is often not verifiable.

For companies, increased liability risks arise from the fact that the term ‘*Angemessenheit*’ (adequacy, see sec. 3 par. 1) of the measures imposed on companies is undefined. It depends, for example, on the respective stage of the supply chain and also on the company's actual possibilities to influence the direct perpetrators of human rights violations. Companies must carry out an individual risk assessment for *direct suppliers*, which also includes the social and political framework conditions of the place of work, such as the actual prevalence of child labour or cultural or legal gender-based issues. The risk assessment must be renewed regularly, at least annually. The greater the company's actual ability to influence working conditions and the higher the typical severity of human rights violations in a particular area of production, the stricter the company's due diligence obligations are to be considered. An extension of the due diligence obligations can also result from the fact that risk analyses and corresponding measures must also be carried out for *indirect suppliers* if the company obtains ‚*substantiierte Kenntnisse*‘ (substantiated knowledge, sec. 9 par. 3) of human rights violations. It will have to be clarified here how sufficient substantiation is to be determined.

It is interesting to note that the obligation to establish an effective internal complaints procedure (sec. 8) means the mandatory establishment of an institutionalised whistle-blower system. It is not only those personally affected by human rights violations who can act as whistle-blowers, but anyone who has knowledge of such violations. This is systematically connected to the EU Whistle-blower-Directive of 2019 [17], which is not yet directly applicable to the SCDDA because it only directly refers to the reporting of EU-law violations. However, a clear assessment of the importance of whistleblowing can be derived from the directive. Whistle-blowers must not suffer any disadvantages under labour law, namely dismissal. This already follows from the fact that the SCDDA allows whistleblowing and thus excludes a breach of duty under the employment contract. However, there is a loophole with regard to the question of whether the employee has to prove whether reprisals against him are based on the whistleblowing. This burden of proof is reversed in the Whistle-blower-Directive to the detriment of the employer. The Federal Government's draft bill on the implementation of the Whistle-blower-Directive [18] unfortunately makes no reference to the SCDDA [19] and does not extend its provisions to whistleblowing outside the violation of the regulations specifically covered by the Directive, which would be desirable in the interest of a consistent whistle-blower law [20].

VI. CONCLUSION: PERSPECTIVES FOR A EUROPEAN UNION SUPPLY CHAIN LAW

The SCDDA is only an intermediate step towards a future stricter supply chain law harmonised at European Union level. On March 10, 2021, the European Parliament presented a resolution on the creation of a European *Supply Chain Due Diligence Directive* [21]. A proposal for the Directive from the European Commission is expected before the end of 2021. If the Directive enters into force, Germany will be obliged like all other member states to adapt its existing supply chain law to comply with the new EU-law within two years. In contrast to the SCDDA, the future regulatory framework under EU-law is also likely to provide for *special civil liability* and *extend the scope of application to smaller companies*. It may also apply to aspects of environment and good governance. It is likely that the provisions, including the civil liability rules, of such a directive will be declared *overriding mandatory provisions* within the meaning of Art. 16 of the EU-Rome II-Regulation [15]. This would have the consequence that these provisions would be *compulsorily applicable*, even to the extent that the tort law of another state would be applicable under conflict of laws rules. A *reversal of the burden of proof* in favour of the plaintiffs is also to be expected. This would increase the pressure on companies to effectively enforce human rights within the supply chain through the considerably *increased civil liability risk* compared to the current legal situation. It is possible that this will create a strong incentive for companies to transform more with regard to social responsibility and human rights.

For the design of supply chains, the question will arise in the future as to how the influence on the creation of sustainable and ethical production conditions can be shared among the participants in the supply chain in order to create a consistent control and remedy structure. For example, corresponding requirements could be integrated into performance-based contracts in order to reduce the liability risk across the entire supply chain. This would compensate for gaps in the current law.

Criticism of the enforcement of human rights standards through national compliance laws on international supply chains should not be concealed. Even the existing national compliance laws on supply chains are sometimes seen as an expression of an imbalance of power between industrialised countries and developing countries. One reason for this is the unilateral character of such regulations, in contrast to international agreements, and the possible extraterritorial impact of the regulations [6]. *Seck* calls national supply chain laws an *'illegitimate, if not imperialistic exercise of unilateral jurisdiction'*, unless they are conceptualised *'in the light of democratic inclusion'* [22]. However, international law was obviously not sufficiently effective to enforce global human rights in the past, which is also reflected in the reservations against international regulations of human rights, namely against antidiscrimination rules. The multitude of diverse interests of different states and societies make an effective global protection of human rights difficult [23], especially against the backdrop of economic cost minimisation interests of globally operating companies. Changing the human rights situation in certain economic sectors by creating economic incentives for domestic companies and foreign suppliers as well as national regulation of the offshore behaviour of companies seems more effective here. An important further step will be to strengthen the instrument of private law enforcement.

The introduction of national and supra-national human rights-related compliance rules is also part of the states' interests related to their own markets and thus an area of their own economic policy, the regulation of which has always had a certain extraterritorial effect. It is therefore not only a matter of unilaterally influencing the living conditions of people in the Third World [6], but also of effectively protecting the domestic society from participating in production conditions that violate human rights and therefore concern the own constitutional values of the society. Making use of human rights violating exploitation in other states means violating human rights indirectly. The protection of human rights is a legitimate legislative mandate for national legislators, regardless of the place of violation, which must also be respected by developing countries through the stipulations in international conventions. States can therefore be prevented neither by international law nor by legal policy from creating appropriate rules for the supply chains of their internationally active domestic companies, at least as long as these rules refer to fundamental internationally recognised obligations to protect human rights. This is also part of an internationalised, socially responsible pursuit of interests through the country's own economic law [24]. In addition, the supply chain legislation also has effects on domestic competition and domestic consumers. The distribution of products manufactured with the exploitation of human beings by individual companies can distort domestic competition. Therefore, those legislations are aiming on the mitigation of unfair competitive advantages in the international trade [25] and also within the domestic market. Moreover, domestic consumers have a vested interest in being offered products that are not unethically produced.

The SCDDA and a future European harmonizing Directive could be effective instruments to enforce human rights globally. An EU-Directive will have to be transferred into the law of all member states of the European Union which makes the possible impact of this legislation on international trade significant. The planned strict rules especially on a civil liability together with the reversal of the burden may in the future make it riskier for companies to ignore human rights issues within the supply chain than to adjust their governance processes with respect to the human rights situation in the production countries. This may not lead to a global change of the human rights situation. However, a feasible change in certain areas of the economy seems better than political appeals to respect human rights.

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