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FAQ on Germany's SUPPLY CHAIN DUE DILIGENCE ACT

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I. THE ACT'S SCOPE OF APPLICATION

1. Whom does the Act apply to and when does it go into effect?

Germany's Supply Chain Due Diligence Act (*Lieferkettensorgfaltspflichtengesetz*, LkSG) goes into effect in 2023 and will initially apply to companies that have more than 3 000 employees. In January 2024, the threshold will sink to 1 000 employees. For purposes of the Act, the following are also counted as employees:

- temporary workers, provided they are employed for more than six months
- all employees of companies belonging to the same consolidated group, regardless of whether they are employed in the same business segment
- all employees temporarily seconded to another country in the EU.

The term company or enterprise is to be interpreted broadly in the context of the LkSG. The Act applies to any enterprise, regardless of its legal form and regardless of the sector or industry in which it operates. Accordingly, the Act also applies to companies such as banks, financial service providers, or accounting firms.

2. Does the Act apply exclusively to German companies?

The LkSG applies not just to German, but to certain foreign companies, as well. The condition is that such companies must have a branch office operating in Germany and, as a rule, employ in Germany more than 3 000 (starting in 2024 more than 1 000) persons. Merely operating and distributing its products in Germany therefore does not bring a foreign company within the scope of the Act. The term branch office is not defined more precisely in the Act. In general, the term is understood to mean a place of business, separate from the corporate seat of the company, which is legally and economically dependent of the parent company, has a specially allocated sphere of responsibilities, and is intended to operate for a significant period of time.

3. How many companies does the Act apply to?

Many large international firms such as Samsung, Google and Zara have subsidiaries in Germany. It is, however, not easy to find out how many persons are employed at these sites. For this reason, it would be useful for the Federal Government of Germany to publish a list of the companies covered by the Act. According to the information currently published by the Federal Government, the Act will apply to over 900 companies, including foreign companies, starting in 2023, and to ca. 4 800 companies starting in 2024.[1] Based on these figures, not more than one percent of the ca. 450 000 German companies that employ more than ten persons will fall within the scope of the Act.

II. THE OBLIGATIONS IMPOSED BY THE ACT

1. What are a company's due diligence obligations?

The Act requires that companies subject to its provisions comply with certain human rights and environmental due diligence obligations. The core elements of these obligations are set forth in § 3 LkSG and are oriented towards the UN Guiding Principles on Business and Human Rights (UNGP) and the National Action Plan for Business and Human Rights (*Nationaler Aktionsplan, Wirtschaft und Menschenrechte*, NAP). In particular, companies are required to:

- set up a risk management system
- determine who shall be responsible for overseeing that system within the company
- carry out risk analyses on a regular basis
- make a statement of principle relative to the company's human rights strategy
- take measures to prevent and remedy abuses
- establish a procedure through which whistleblowers can file complaints and
- document the company's compliance with due diligence obligations and disclose such compliance in an annual report.

With regard to the level of complexity of the measures a company is expected to carry out, the rule is: Such measures must stand in reasonable proportion to the nature and scope of the company's business activities, its ability to influence, the severity of the violation that can typically be expected, and the nature of the company's causal contribution to such violations (§ 3 Para. 2 LkSG). Punctilious compliance with the Act's literal requirements, however, should not be viewed as the ultimate objective in and of itself: pursuant to the objectives defined in § 4 Paras. 1, 2 LkSG, the measures carried out must be effective, i.e., must be adequate for the

[1] https://www.bmz.de/de/entwicklungspolitik/lieferkettengesetz.

purpose of preventing, stopping, and minimizing the effects of violations of human rights and environmental standards.

2. What types of human rights violation does the Act cover?

The LkSG does not apply exclusively to certain classes of human rights violation, such as child labor or forced labor; it serves to establish a general means of protecting human rights. Such rights are defined by § 2 Para. 1 LkSG in connection with the treaties and accords listed in the Act's Annex. These include the International Covenants on Civil and Political Rights and Economic, Social and Cultural Rights, as well as eight Conventions of the International Labour Organisation (ILO), which are referred to as "Core Labor Standards" (*Kernarbeitsnormen*). These accords define fundamental standards relative to the protection of workers, such as the right to collective bargaining.

In order to give clear guidance on the question of what human rights abuses the Act's due diligence obligations are targeting, § 2 Para. 2 Nos. 1-11 LkSG describe the following ten cases of human rights violations, which typically arise along supply chains:

- child labor
- forced labor
- forms of slavery
- disregard of workplace safety standards
- disregard of the right to freedom of association
- discrimination against employees
- denial of a decent wage
- human rights abuses connected with environmental damages
- unlawful displacement of persons
- violence on the part of security forces.

Companies subject to the provisions of § 3 Para. 1 LkSG are obligated to protect against and minimize these risks by carrying out human rights due diligence. The Act's description of the risks that typically arise belies the assertion put forth by trade associations to the effect that respecting human rights is too indefinite a standard for businesses to comply with.

The Initiative Lieferkettengesetz criticizes the Act for setting standards of human rights-based prohibitions that at times fall short of the international standards from which they are derived: In several places, the Act refers to provisions applicable in the jurisdiction of employment. The intent and purpose of enforcing universal human rights, however, is precisely to overcome the shortcomings of local law. With regard to decent wages, for example, the Act stipulates that compensation must conform *at a minimum* to the minimum wage defined under applicable (mostly local) law. National minimum wage standards, however, are very often inadequate to

guarantee protection of workers' internationally recognized right to an income that provides them and their families with an appropriate standard of living.

The term "at a minimum" in the text of the Act—together with the reference in the statement of grounds for the Act to the effect that the local cost of living for workers and their families as well as contributions to social security should be taken into account in calculating what constitutes an adequate wage—should be interpreted as requiring that companies are obligated to pay a wage in excess of the minimum wage to the extent the latter is inadequate, i.e., does not provide workers with what they need to meet their basic living expenses.

In the spirit of the German legal system's principle of respect for international law (Art. 25 Sent. 1 of the Constitution, GG) and in the interest of internationally operating enterprises, the elements defining the scope of other prohibitions in the Act should likewise be interpreted in harmony with the corresponding international standards and the clarifications of United Nations treaty bodies.

In addition, the statement of grounds for the Act makes clear that companies can use its exemplary list of risks as a starting point for their risk management, but that they should not restrict themselves to that list. § 2 Para. 2 No. 12 LkSG prohibits any other conduct not already covered by the prohibitions set forth in Nos. 1-11, which is liable to cause a particularly grave and obviously illegal violation of human rights. As a result, companies should not view themselves as in a safe haven just because no violation of § 2 Para. 2 Nos. 1- 11 LkSG appears. They must also ensure that no other grave violations of law occur. The Act does not explicitly define when a violation should be regarded as particularly grave. Courts will have to decide this on a case-by-case basis.

3. Are companies also obligated to address human rights violations in Germany?

The LkSG also applies to domestic supply chains. That means: Companies must also meet their due diligence obligations with regard to their German business segment and with regard to direct and indirect suppliers operating in Germany. There is a need for application of the LkSG in Germany, too: In the meat-processing industry, workers are being exploited and must work under conditions that endanger their health; in many companies, women are paid less than men for the same work; delivery services pay their couriers less than the minimum wage and violate workplace safety standards.

The LkSG improves the legal framework for prosecuting and forestalling human rights abuses in Germany: The Act provides impacted parties with an additional channel for enforcing their rights. Under § 14 Para. 1 No. 2 LkSG, impacted parties can obligate the German Federal Office of Economics and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle*, BAFA) to take action (see Question 24). This new legal remedy is an important addition, for up to now there has been no agency in Germany responsible on the federal level for persons impacted by the human rights abuses of enterprises and state oversight in this field has been subject to no unified

standards. Thus, for instance, up to now the workplace safety bureaus of the individual states (*Länder*) have been responsible for enforcing workplace safety standards, while the federal customs administration (*Zollverwaltung*) has overseen compliance with the minimum wage. Violations of the equal rights provisions, by contrast, are not reviewed by any agency; and the state investigates disrespect for the freedom of association only to the extent there is evidence of a crime.

4. What obligations do companies have with regard to environmental protection?

The LkSG provides for two kinds of obligation relative to environmental protection. First, the Act recognizes that environmental damages frequently entail human rights abuses. The catalogue of human rights risks set forth in § 2 Para. 2 LkSG includes a special clause addressing this problem. Under § 2 Para. 2 No. 9 LkSG, five kinds of environmental damage (damage to soil, water pollution, air pollution, noise pollution, and excessive water consumption) are to be viewed as a human rights risk within the meaning of the Act, if they cause a deterioration in the natural resources required for sustenance (nourishment), a deterioration in the access to drinking water or sanitary facilities, or a deterioration in health. A typical example would be where chemicals, e.g., from dye works spill into a river and as a result harm the basis for the livelihood (fishing, drinking water) and the health of local inhabitants. Through implementation of the due diligence measures foreseen in the LkSG, companies are in the future obligated to prevent and minimize the effects of such risks.

Secondly, the Act defines independent environmental risks. These are derived from three international accords on environmental protection that Germany has ratified, and which are listed in an annex to the Act. The accords include the Minamata Convention on Limiting Mercury Emissions, the Stockholm Convention on Persistent Organic Pollutants, and the Basel Convention on the Control of Transboundary Movements of Hazardous Waste. This means that violation, e.g., of the prohibition on using mercury in production processes constitutes an environmental risk, which companies are obligated to prevent and minimize the effects of (§ 2 Para. 3 No. 2 LkSG). It is noteworthy that all of the accords referred to also serve, at least indirectly, the protection of health, which is a human right. Other key environmental concerns, such as the climate or biodiversity, are not addressed by the Act.

5. Does the Act apply for the entire supply and value chain? What does the term "graded obligations" mean?

The LkSG applies pursuant to § 3 LkSG in principle to the entire supply and value chain of companies subject to the Act. The supply chain extends to all stages required for the production of products and performance of services—from the mining of raw materials through delivery to the end consumer. In contrast to the position for which trade associations lobbied, the due diligence obligations thus are not limited to direct contractual (level 1) partners. A company's

obligations, however, are "graded." This means the standard of obligations is higher or lower, depending on whether a company's own operations, those of a direct supplier, or those of an indirect supplier are at issue.

A company is subject to the highest standard of obligations relative to its own operations and the operations of direct suppliers. In these cases, remedial measures, for instance, must at least as a general rule put a stop to the violation of duties relative to human rights or environmental protection (§ 7 Para. 1 LkSG). With respect to indirect suppliers, by contrast, it is sufficient for the company to develop and implement a plan for putting a stop to or minimizing violations, without being able to assure that the plan will be successful (§ 9 Para. 3 No. 3 LkSG).

Moreover, the sphere of a company's own operations is to be interpreted broadly: § 2 Para. 6 LkSG provides that own operations shall include not just a parent company's activities with respect to producing and refining products or performing services—such as the export of pesticides or the creation of online platforms. Rather, in the case of consolidated enterprises, the activities of subsidiaries over which the parent corporation exerts a decisive influence are to be counted as "own operations."

In the case of indirect suppliers—that is, the extended supply chain—the LkSG requires that companies take action and for instance carry out a risk analysis only when they have grounds for believing that human rights abuses or environmental damages have occurred ("substantiated knowledge," § 9 Para. 3 LkSG). It is, however, precisely in the extended supply chain that the vast majority of human rights abuses and environmental damages occur. The Initiative Lieferkettengesetz therefore criticizes this provision: It stands in contradiction with the preventive and risk-based approach taken by the UN Guiding Principles on Business and Human Rights (UNGP), according to which companies are to work proactively and with priority to address the gravest human rights abuses and environmental damages in their supply chains—regardless where along the supply chain they occur.

This provision also falls short of the practice already in place at many internationally operating enterprises, which follow the standard set by the UNGP. It is to be hoped that the LkSG provision does not set an example for lowering the bar. We observe that the statement of grounds for the Act does, at least, indicate that the term "substantiated knowledge" is to be interpreted broadly. Thus numerous sources may be deemed to provide companies with grounds for believing that human rights abuses or environmental damages have occurred: reports on the poor human rights conditions in a given region, for example, or the fact that an indirect supplier operates in a sector with high exposure to human rights or environmental risks would suffice. Grounds for determining that a certain sector has high risk exposure in this context may be found, e.g., in the study published by the German Federal Ministry of Labor and Social Affairs *(Bundesministerium für Arbeit und Soziales)*[2] on risk sectors in German industry.

[2] https://www.bmas.de/DE/Service/Publikationen/Forschungsberichte/fb-543-achtung-von-menschenrechten-entlang-globaler-wertschoepfungsketten.html.

Companies therefore should proactively take even indirect suppliers—at least those which operate in risk sectors or at-risk regions—into consideration in performing their risk management. NGOs should, wherever possible, simultaneously communicate new reports on human rights problems in any given region or sector to affected companies as well as to the BAFA.

6. What are a company's obligations with respect to downstream supply chains?

Downstream supply chains are such as are involved, not in the production of a product, but in its distribution. The LkSG is applicable to this kind of supply chain only to a limited extent: the Act's obligations extend only to such stages as are necessary for the production of products and the provision and utilization of services, "from the mining of raw materials through delivery to the end consumer" (§ 2 Para. 5 LkSG). Accordingly, a company must comply with due diligence obligations in the distribution of its products. Such due diligence obligations, however, are limited at the distribution stage to the company's own business operations and direct contractors.

The due diligence obligations applicable at the distribution stage fall into two categories. On the one hand, human rights or environmental risks may arise in the context of the distribution chain itself (e.g., through disregard of fair labor standards in delivery of the product). On the other hand, the product's sale to a client counts as an independent business activity and thus belongs to the supply chain. If the risk analysis determines that the distribution of products such as pesticides, surveillance technologies, or weapons supports the violation of human rights or environmental standards, the company concerned is subject to due diligence obligations with respect to these risks, as well as others. The standard of obligations imposed is determined by reference to the company's access to information and the degree of influence it is in a position to exert, as the statement of grounds for the parliamentary bill which presented the Act demonstrated, using financial service providers as an example.

7. How far do the obligations of (financial) service providers extend?

Although the discussions concerning supply chains have mostly involved the production of material goods, the LkSG also applies to services. Service providers are thus subject to the same obligations along their supply chains as all other enterprises.

The statement of grounds for the parliamentary bill makes special reference to financial service providers, for their services do not easily fit within the framework of the LkSG: on the one hand, they rarely have suppliers, since the granting of loans does not require any upstream production process; on the other hand, loans and financial investments naturally give rise to new production processes.

In order to render the LkSG applicable to these cases, as well, the supply chain here should also be deemed to cover relationships that arise from the granting of loans and financial investments. Where, for instance, a textile producer takes out a loan to finance its production, the supply chain of the financial service provider extends to the buyers of the textiles. The financial service provider is also subject in this case to due diligence obligations at the downstream stage. In the given example, the financial service provider must extend its due diligence obligations to the buyers and confirm, e.g., that the textile buyers process the textiles without using child labor. Financial service providers are subject to due diligence obligations with regard to these downstream stages of the supply chain, however, only where the service provider has a certain ability to access information and play a supervisory role. With regard to particularly large loans, this is the case. The statement of grounds for adopting the legislation refers by way of example to large exposures within the meaning of Art. 392 of EU Regulation 575/2013, where the financial service provider's exposure to one client represents ten percent of its eligible capital. Where a financial service provider does not have such leverage for influence, the statement of grounds in the legislative bill says that it is only subject to due diligence obligations with regard to borrowers, secured parties, and the investment property.

8. Do a company's due diligence obligations also extend to the way in which its products are disposed of or recycled, once their useful life has expired?

There is no one answer to this question valid across the board. If waste management forms a part of the supply chain, companies must perform human rights and environmental due diligence with respect to that process, as well. Whether waste management belongs to the supply chain, however, depends upon the business purpose of the company in question. Thus, the delivery of recycled materials destined for the production of new goods forms a part of the producer's supply chain (e.g., recycled PET bottles for the production of textiles). Where a company's business purpose is the disposal or recycling of waste, its supply chain extends to the sourcing and exploitation of such waste. If a company engages other service providers for the purpose of refining or re-purposing waste, then its supply chain extends downstream to these partners, provided it has sufficient ability to access information and play a supervisory role.

Where, however, a company delivers material goods to its customers, who then dispose of them at a later point in time, any subsequent re-use of the waste no longer forms a part of the supply chain.

9. Under what circumstances are companies obligated to terminate problematic business relationships?

If a company determines that a violation of human rights or environmental obligations has occurred or is imminent in its own field of operations or under the responsibility of a direct

supplier, it is required to take adequate remedial measures immediately. Such measures must be reasonably designed to prevent the violations, put an end to them or to minimize their harmful effects (§ 7 Para. 1 Sent. 1 LkSG). Where any remedial measures taken are inadequate to this purpose, the company risks imposition of a fine. The same is true with regard to indirect suppliers, provided the company has "substantiated knowledge" of a violation of human rights or environmental obligations.

Where the company is unable to put an end to the violations of a direct or indirect supplier in the foreseeable future, it must develop and carry out a plan designed to end or minimize such violations. The precise form of such a plan lies in the company's own discretion. For example, it may seek to reach a solution in cooperation with the supplier, increase its influence over the supplier through sector-wide initiatives, or temporarily cease business dealings with the supplier.

A company is only obligated to terminate its business relationship with a direct supplier when the following conditions are simultaneously met: (1) there has been a grave violation of a protected legal interest; (2) the remedial plan has not rectified the situation within the time frame foreseen; and (3) there are no other, milder means available to the company and increasing its influence over the supplier, e.g., through sector-wide initiatives, would not be effective.

10. How are companies required to act in the event of a conflict between local law and international human rights standards?

The fact that a country has failed to ratify or implement human rights or environmental standards is not per se grounds for requiring that a company terminate its business relationships there (§ 7 Para. 3 Sent. 2 LkSG). Likewise, companies are entitled to commence new operations in such countries.[3] Where, however, a company or one of its suppliers operates in a country that has not ratified or implemented standards referred to in § 2 Paras. 1 and 3 LkSG, the company must take this fact into account in its risk analysis and respond to the special risks this entails, exercising, as necessary, a greater degree of diligence.

In practice, this means that companies operating their own production sites or working with suppliers in countries like China, in which the freedom of association is not recognized, are not required to ensure that such freedom be recognized. They may not, however, take advantage of the situation or aggravate its effects on employees. Rather, they must, in their own business relationships, take special care to prevent violations of the freedom of association, for instance by creating incentives for their suppliers or by allowing the formation of structures representing workers' interests on their own production sites.

[3] Beschlussempfehlung, Ausschuss für Arbeit und Soziales, p. 40, https://dserver.bundestag.de/btd/19/305/1930505.pdf.

11. Are companies also required to change their purchasing conditions and price policies?

Suppliers are often economically dependent on the companies for which they produce. As a result, they must adapt to the purchasing conditions of their customers with regard to delivery times, quantities, and payment. In order to operate profitably, despite these conditions, suppliers often disregard the rights of their workers. For this reason, unrealistic delivery expectations and excessively low prices offered by international buyers frequently lead indirectly to human rights abuses.

As also provided for in the UNGP, companies are obligated in the future, by taking appropriate preventive measures, to avoid contributing to such human rights abuses. The most important measure, in this connection, is to develop and implement sourcing strategies and purchasing practices suitable for ending or minimizing the identified risks (§ 6 Para. 3 No. 1 LkSG). A constant condition must be the payment of wages adequate for workers to meet their daily needs, and such wages often lie above national minimum wage standards (§ 2 Para. 2 No. 8 LkSG). If a risk analysis determines that purchasing practices lead indirectly to human rights abuses, the company is obligated to take adequate remedial measures, for instance by paying prices that are adequate to cover production costs.

12. Does the Act require companies to seek appropriate involvement from the persons whose rights are at stake?

§ 4 Para. 4 LkSG provides that companies, in setting up and carrying out their risk management policies, must take adequately into account the interests of persons who are employed in their supply chains or who may otherwise find their legally protected interests impaired by virtue of the company's economic activities. This is the objective towards which all a company's efforts to meet its due diligence obligations should be directed.

According to the statement of grounds for the Act, the involvement of affected parties serves a key purpose: It should help companies recognize and accurately evaluate their risks, as well as choose suitable preventive and remedial measures that serve the interests of the affected parties. Further, the statement of grounds for the Act emphasizes that the circle of persons to be taken into account should be broadly defined. Companies should, where circumstances require, expand that circle flexibly and pay particular attention to persons who are especially vulnerable (e.g., on the basis of a background of immigration, handicaps, etc.).

The LkSG, however, defines too vaguely, and often less exactingly than the UNGP, just how the involvement of such affected parties is to be structured. Thus, the statement of grounds for the Act leaves to the discretion of each company whether it should consult potentially impacted parties in the context of conducting its risk analysis. This stands in contradiction with UN Guiding Principle 18 b), which states that companies *should* conduct meaningful consultations. Moreover, the LkSG fails to provide impacted parties with the right to seek compensation by

means of the complaint procedure. In the UNGP, this constitutes the primary purpose of such proceedings.

13. What are the reporting requirements imposed on companies by the Act?

Pursuant to § 10 LkSG, companies shall in the future produce a report on the fulfilment of their due diligence obligations once a year. The report must be published on the company's website and remain available for download free of charge for seven years. In this report, companies are required to disclose, at a minimum, what human rights and environmental risks they have identified and what they have done to meet their due diligence obligations. In this connection, companies must report on what measures they have undertaken on the basis of complaints filed against them through the complaint procedure. In accordance with the statement of grounds for the Act, they must also describe the effects of the measures undertaken.

The reporting duty extends to a company's own operations, as well as direct and indirect suppliers—i.e., to the entire supply chain. There is, however, no duty for a company to disclose the identity of its suppliers. The reports must be sufficiently detailed as to allow third parties to follow their reasoning. Besides these public reports, companies also have a duty to document their compliance with the due diligence obligations internally. This documentation must be disclosed to the competent authorities in the event of any investigation, e.g., as a result of the filing of a complaint by impacted parties.

14. What role do sector-wide initiatives and audits play in implementation of the Act?

Sector-wide initiatives can make a significant contribution to implementation of the LkSG, especially in sectors plagued by structural abuses. Audits may help a company supervise human rights compliance by its suppliers. The German inspection company TÜV Rheinland already offers audits of suppliers to support companies in their efforts to comply with the LkSG. The Act explicitly refers to sector-wide initiatives as one of the remedial measures that companies must consider if they are unable to put an end to violations of human rights or environmental duties by their direct suppliers in the near term (§ 7 Para. 2 No. 2 LkSG). In addition, sector-wide initiatives are mentioned, in the statement of grounds for the Act, as an appropriate preventive measure that companies should undertake vis-à-vis indirect suppliers (§ 9 Para. 3 No. 2 LkSG).

Past sector-wide initiatives, however, have been restricted in their substantive scope and often lacking in ambition. Audits are rife with error and corruption; moreover, they generally lack a comprehensive focus on human rights. Neither of these instruments, therefore, can be viewed as proof that due diligence obligations have in fact been fulfilled.

Companies must fulfil their due diligence obligations on an ongoing basis. For this reason alone, a one-off audit can never suffice to relieve a company of its obligations. Likewise, active

involvement in sector-wide initiatives with exacting quality standards should be viewed at most as one indication that a company has made an adequate effort with respect to addressing those substantive problems within the scope of the initiative. This is an area which the regulatory authorities need to focus on in establishing rules that define in greater detail the administrative procedure and the duties of enterprises relative to indirect suppliers.

At the same time, it is important to ensure—by a clear definition of objectives and by external oversight—that audits and sector-wide initiatives meet certain quality standards[4] and thus are in a position to make a meaningful contribution to reducing human rights abuses and environmental damages in global supply chains.

III. ON ENFORCEMENT OF THE ACT

1. What consequences does the Act foresee for companies that fail to comply with its obligations?

The Federal Office of Economics and Export Control (*Bundesamt für Wirtschaft- und Ausfuhrkontrolle*, BAFA) is the German authority responsible for overseeing compliance with the obligations imposed by the LkSG. The BAFA has the power to issue specific injunctions intended to put an end to the violations and, in the event compliance is not forthcoming, to impose periodic penalty payments up to the amount of EUR 50 000 (§ 23 LkSG). Further, the BAFA can assess fines for past violations. The amount of the fine is calculated based on the gravity of the violation and the company's gross revenues (§ 24 LkSG). Where a fine in excess of EUR 175 000 is imposed, the company should also be barred from public procurement contracts for a period of three years (§ 22 LkSG).

2. What is the objective of administrative enforcement?

Germany has the duty as a state to prevent human rights abuses by enterprises that fall under its jurisdiction. The Federal Government has decided to fulfil this duty through the oversight of an administrative authority. To this end, the BAFA verifies that companies publish their due diligence reports and reviews—on its own discretion in accordance with its duties **or upon the request of an impacted party** —companies' compliance with their due diligence obligations (§§ 13, 14 LkSG). Insofar as the BAFA can investigate all enterprises within the scope of the LkSG, the Act has a wider impact than it would if the Act foresaw enforcement exclusively by means of civil liability, which is restricted to specific individual cases. The extensive power of oversight granted to the administrative authorities under the LkSG corresponds to the objective of

[4] On this issue, see two studies recently published by civil society organizations (in German): Positionspapier zu Multistakeholder-Initiativen, available for download at https://www.cora-netz.de/wp-content/uploads/2017/09/2017-09_MSI_Positionspapier_CorA-FMR-FUE-VENRO-vzbv_web.pdf; and Studie von ECCHR, Brot für die Welt und MISEREOR zur Menschenrechtsfitness von Audits, available for download at https://www.ecchr.eu/fileadmin/Fachartikel/ECCHR_AUDITS_DS_WEB.pdf.

prevention at the heart of the UNGP. Nevertheless, the BAFA is an administrative agency under the authority of the German Federal Ministry for Economic Affairs and Energy (*Bundesministerium für Wirtschaft und Energie*, BMWi) and is just beginning to develop its competencies in the field of supervising corporate due diligence obligations. For this reason, it is important that a civil society monitoring body is created as planned and mandated to ensure that the BAFA makes its decisions on an independent basis and exclusively pursuant to the criteria defined by the human rights and environmental due diligence obligations.

3. What is the difference between administrative sanctions and criminal or civil liability?

When someone breaks the law, he or she may be subjected to both state-imposed sanctions and civil liability claims. State sanctions are imposed, depending on the gravity of the offense, by criminal prosecution or administrative enforcement mechanisms. An offender risks criminal prosecution if he or she has committed a crime defined in the penal code. Because crimes involve particularly grave violations of rights, the state prosecutor is obligated to prosecute any crime that is committed. If the defendant is found guilty, the criminal court sentences him or her to pay a fine or serve a term in prison.

Administrative sanctions are imposed in the event that other laws are violated—for instance, the LkSG. Here, the violation is referred to as an administrative offense, which the administrative authorities have the power to sanction by imposing a fine. Since administrative offenses represent a lesser wrong in comparison with crimes, it lies within the discretion of the authorities whether to take action and how high they should set any fine imposed.

Civil liability arises when someone, through a violation of law, infringes on the rights of another person, for instance by damaging his or her property or injuring his or her person. The person suffering damages or injuries can claim compensation from the person who caused them for, e.g., repairing property, covering medical bills, and compensating lost work time. If the person who caused the damages fails to pay such compensation voluntarily, the damaged party must sue him or her in a civil court proceeding.

4. Why does the LkSG not provide for criminal liability?

If a company violates the obligations arising under the LkSG, it commits an administrative offense (§ 24 LkSG). By contrast, there is no provision for criminal liability. This results in part from the fact that in Germany—in contrast to numerous other jurisdictions in Europe—corporations are not subject to criminal liability. Given that the LkSG primarily addresses enterprises, there would be no person to which criminal liability could attach.

Moreover, the LkSG is primarily intended to have a preventive effect—to prevent human rights and environmental violations from happening. For this purpose, administrative oversight and sanctions are the fitting legal instrument, as their principal purpose in the German legal system

is to enforce (security) provisions and prevent damages from arising. Of course it is possible for corporate employees to commit crimes in connection with a company's international business activities and for these crimes to be prosecuted under the general provisions of Germany's criminal code. Proving in court that a particular person within the corporation has committed a crime, however, is exceedingly difficult. For this reason, Germany ought to introduce an independent code of sanctions targeting enterprises.

5. Does the Act provide for civil liability?

The LkSG provides no independent basis for claims of civil liability. This means that where a company has violated its due diligence obligations, for instance by failing to conduct a risk analysis, and as a result the health of one of its supplier's employees is impaired, the LkSG does not provide that the damaged party can claim compensation of damages from the company on the basis of this Act. The legislators made this clear in § 3 Para. 3 LkSG. However, they also specified in this provision that already existing basis for damages under foreign law or the general law of torts in Germany continue to apply.

Thus liability is possible, for example, on the basis of a violation of the so-called duty to ensure the safety of passers-by pursuant to § 823 Para. 1 BGB. This provision addresses cases in which a company is responsible for a source of danger (for instance a factory building) and fails to adequately supervise the danger. If textile workers are burned in a factory building because adequate emergency exits are not available, the factory owner has violated its duty to ensure the safety of passers-by. Just what the responsible party is obligated to do, in order to adequately supervise the danger, depends on its ability to influence the situation, the likelihood of a harm arising, and the expense of any preventive measure. Since the LkSG specifies various due diligence duties intended to prevent human rights abuses, a company's obligations under the duty to ensure the safety of passers-by all along the supply chain gain a degree of clarity. Courts are to take these obligations into consideration even in cases—as is the rule with transnational human rights litigation—the law of the place of damages is otherwise applicable, since rules of safety and conduct within the meaning of Art. 17 Rome II Regulation (EU) are at issue.

Without an independent definition of civil liability for cases involving human rights abuses in the context of business operations, however, it will remain all but impossible for injured parties to hold corporations liable in the German civil courts—the legal hurdles, including the burden of proof and short statutes of limitation—remain too onerous. For this reason, it is crucial that the EU adopt supply chain legislation providing for such a definition of civil liability and that this provision be implemented on the national level.

6. What does the "special representative action" provided for in the Act mean?

The LkSG creates a statutory "special representative action" (§ 11 LkSG). This form of action makes it possible for domestic NGOs or unions to file suit in the German courts in their own name but on behalf of an impacted party.

In German civil procedure, an action must in general be filed by the person whose rights have been infringed upon. In cases involving human rights abuses in the context of international business operations, this is often impossible: The prospective plaintiff's distance from the legal venue, the fear of vindictive harassment, and the high cost of litigation frequently render impacted parties loathe to file suit. The representative action makes it easier for such parties to pursue the remedies available to them in German court.

The only persons eligible to act as representative in such an action are NGOs or unions with seat in Germany. They must moreover be established as non-profits and be engaged in the defense of human rights not merely on a temporary or occasional basis (§ 11 Para. 2 LkSG). They must have a power of attorney from the impacted party authorizing them to pursue that party's rights in court. This distinguishes the "special" representative action from the two "normal" forms of representative action under German law (the statutory and the elective). In statutory representative actions, the representative's standing to sue arises mandatorily and definitively *ex lege*. In the case of elective representative actions, by contrast, the representative has standing only to the extent it has its own legally protected interest in conducting the suit. The power of attorney authorizing a plaintiff representative within the meaning of § 11 LkSG to sue on behalf of an impacted party is valid if such party has suffered infringement of an unusually important legal right. The Act does not specify just what rights are covered, but the statement of grounds for the Act mentions by way of example injury to life or limb.

The provisions of § 11 LkSG have, however, a further significance: In cases involving human rights abuses in the context of international business operations, the (foreign) law of the place of injury generally applies. In this case, the LkSG and the standing it accords to civil society organizations in representative actions would be inapplicable. Since, however, the legislators with the LkSG have introduced a new form of representative action and not limited it to domestic facts and circumstances, there is a solid basis for arguing that special representative actions may also be filed in the context of foreign facts and circumstances. In consequence, it corresponds to the legislative intent to interpret the due diligence obligations imposed by the LkSG as overriding mandatory provisions (*Eingriffsnormen*). The language in § 11 LkSG referring to an "unusually important legal right" would appear to speak in favor of such an interpretation. Overriding mandatory provisions, pursuant to Art. 16 Rome II Regulation (EU), are to be applied by courts even in circumstances where the proceeding would otherwise be adjudicated in application of foreign law.

7. What is the difference between the right to a representative action and the right to file a request for action with the administrative authorities?

The right to file a request for action with the administrative authorities, in contrast to the representative action, does not serve to enforce individual claims arising under civil law. Rather, it serves to compel the BAFA to exercise its duties of oversight relative to companies' due diligence obligations (§ 14 Para. 1 No. 2 LkSG). This remedy is available to any person, domestic or foreign, who can demonstrate an (impending) violation of its legally protected interests. The impacted party need not show that the right infringed upon is of "unusual importance." For example: if a company (or its supplier) unlawfully confiscates grazing land from a Brazilian farmer, the farmer can file a request for action with the BAFA. The BAFA must then review and determine whether the company indicated has undertaken all due diligence measures required to avoid a violation of § 2 Para. 2 No. 10 LkSG.

8. What possibilities does the Act provide to impacted parties from countries harboring production facilities for enforcement of their rights?

Companies, under the LkSG, are required to set up a complaints procedure which is accessible all along the supply chain. Impacted parties from countries harboring production facilities can inform through this procedure about violations of human rights and environmental duties or of the risk of such violations occurring (§§ 8, 9 Para. 1 LkSG).

Companies may face practical hurdles in setting up a complaints procedure that is accessible to impacted parties from indirect suppliers—for instance, where they do not even know the identity of such suppliers. The Act provides no solution to this difficulty. Companies should, however, form as comprehensive an overview as possible concerning their supply chains, in order to insure that all persons potentially impacted by their business activities have access to the complaints procedure. Helpful, in addition, is contributing to the establishment of a collectively operated complaints procedure with more extensive scope within the framework of a sector-wide initiative. In any event, potentially impacted parties should be consulted in connection with designing and setting up the complaints procedure. When a company by way of the complaints procedure obtains "substantiated knowledge" of a possible breach of obligation involving indirect suppliers, this triggers attachment of the due diligence obligations set forth in § 9 Para. 3 LkSG.

Moreover, all impacted parties have the right to file a request for action with the BAFA. Provided the applicant is able to make a credible showing of the (impending) violation of a legally protected interest, the BAFA is obligated to investigate the matter and, as the case may be, to order remedial measures or impose sanctions on the company in question. This is the most important instrument available to impacted parties under the LkSG, since the BAFA is a central

forum and enjoys wide-ranging powers. Finally, impacted parties can empower a domestic German NGO or union to pursue enforcement of its individual claims against the company in court (special representative action).

The LkSG does not establish a claim for compensation. § 24 Para. 4 No. 7 LkSG, however, does create an incentive to furnish compensation insofar as it provides that a company's efforts to furnish compensation should be taken into consideration in calculating the amount of any fine that is assessed.

IV. ON THE ACT'S PLACE IN THE INTERNATIONAL CONTEXT

1. Can the LkSG serve as a model for EU legislation on supply chains?

Various politicians, particularly from the CDU/CSU, have actively touted the LkSG since its adoption as a blueprint for the process of regulating sustainability-based due diligence obligations on the level of the EU. They seek thereby to assure that German enterprises are on an equal competitive footing with other companies in the EU internal market and, at the same time, to forestall any tightening of the obligations.

From the perspective of the Initiative Lieferkettengesetz, the LkSG should not serve as blueprint for the EU process. The LkSG does contain numerous positive elements, which in our view should be incorporated into the EU legislation—these include, in particular, its precise description of the due diligence steps that companies should take, such as reviewing and adapting their own purchasing practices, but also the extensive powers granted to governmental authorities for enforcement. Nevertheless, the LkSG has significant shortcomings: it only applies to very large companies; its due diligence obligations with respect to indirect suppliers and relative to environmental protection are limited; and above all it lacks any provision for civilliability.

In shaping the EU legislation, the EU Commission should not, therefore, reproduce the shortcomings of the LkSG. Instead, it should incorporate the most progressive elements from each of the supply chain due diligence acts hitherto adopted on the national level by EU member states. This would involve combining, e.g., the broader scope of application found in the Dutch Child Labor Due Diligence Act, the civil liability provisions of the French *loi de vigilance*, and the administrative enforcement powers granted under the LkSG.

In the event that EU legislation, in accordance with these proposals, should adopt obligations that go beyond the LkSG, such stricter obligations would need to be incorporated into national law by the German legislature.

2. How does the LkSG stand relative to other international due diligence legislation?

In recent years, a whole series of states have adopted legislation obligating their companies to exercise due diligence with regard to sustainability issues[5]—and the trend is growing. Many of the first-generation due diligence laws apply, however, only with respect to particular abuses along the supply chain, such as modern slavery or child labor, and/or are limited to imposing reporting requirements—and thus just one element of the due diligence obligations provided for under the UNGP. Thus, for instance, the 2015 UK Modern Slavery Act obligates companies to file a statement addressing how they deal with modern slavery in their supply chains. Companies are free, however, to state that they have taken no measures to combat slavery and will incur no legal consequences.

France, in 2017, became the first country to require that companies comply with concrete, comprehensive due diligence obligations with regard to violations of human rights and environmental standards all along their supply chains (and not just report on such violations). Companies in France that disregard these duties will incur consequences: Civil society organizations are entitled to have the reports companies file reviewed by a court, and the Act also provides that, in the event damages arise, companies are subject to civil liability in suits filed by impacted parties.

Like the French due diligence law, the LkSG provides for comprehensive due diligence obligations along the supply chain and consequences in the event of violations of such obligations. To that extent, the LkSG belongs to the younger generation of more advanced due diligence legislation. It is, however—in contrast to the claims put forward by certain legislators—not per se the world's most ambitious act.

3. What is the relationship between the LkSG and the UNGP or the National Action Plans?

Adoption of the UNGP in 2011 in many ways laid the cornerstone for all past and current processes aiming to anchor binding due diligence obligations in law. The concept of human rights due diligence for the supply and value chains was developed there. The UNGP moreover determined that states must prevent human rights abuses on the part of their enterprises and ensure that the rights of impacted parties are effectively upheld.

The subsequently adopted National Action Plans (NAPs) constitute an important instrument in national implementation of the UNGP. They set forth what is required to happen on the national level in order to fulfil the principles of the UNGP – albeit very patchy and with varying quality and clarity. The steps proposed included conditioning the award of public procurement contracts or

[5] See the study by Robert Grabosch, FES (in German), Gesetzliche Verpflichtungen zur Sorgfalt im weltweiten Vergleich, available for download at http://library.fes.de/pdf-files/iez/15675.pdf.

export credits on compliance with human rights standards, as well as measures intended to improve the access of impacted parties to complaint procedures. Nevertheless, the UNGP and NAPs are voluntary instruments. In the intervening years, these have proven inadequate to hold companies to compliance with human rights due diligence, as foreseen in the second pillar of the UNGP.

Only a small fraction of enterprises fulfil due diligence obligations voluntarily. For this reason, statutory provisions are required, and these should apply to as large a number of enterprises as possible. Such legislation will not render the UNGP or NAPs obsolete. The UNGP have today gained international recognition as a "soft law" standard, which must be referred to in interpreting the duties of corporations, particularly where national law makes no provision at all or falls short of the international standards. Governments should continue to use NAPs to reach agreements relevant to the field of business and human rights, for instance to define more clearly the duties of states with regard to upholding human rights.

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