

THE SUPPLY CHAIN ACT IS COMING!

On 11 June 2021, the German parliament passed the Act on Corporate Due Diligence in Supply Chains – in short: Supply Chain Act. It will enter into force on 1 January 2023 and establishes extensive due diligence and reporting obligations regarding human, worker's and environmental rights in the supply chain for companies based or operating in Germany.

In globalised trade, value and supply chains take place in the entire world. The procurement markets for intermediate goods or finished products at all stages of production are often located in developing and emerging countries. In these states, standards for social, fair and sustainable economic activities are often less pronounced than in developed industrial nations.

Environmental, Social and Corporate Governance ('ESG') criteria such as labour protection, the fight against exploitation and child labour, or compliance with environmental standards increasingly are in the focus of public attention. After long political discussions, the German parliament on 11 June 2021 passed the Act on Corporate Due Diligence in Supply Chains (the "**Supply Chain Act**").

Particularly the scope of due diligence obligations and their extension to foreign companies operating in Germany as well as the issue of civil law liability in case of non-compliance were subject to controversial discussion.

THE CANON OF OBLIGATIONS UNDER THE SUPPLY CHAIN ACT

As of 1 January 2023, the Supply Chain Act applies to all companies who have their head office (*Hauptverwaltung, oder -niederlassung*), administrative headquarters (*Verwaltungssitz*) or registered seat (*Satzungssitz*) in Germany and employ more than 3,000 people in Germany, irrespective of their legal form. The scope of application also extends to foreign companies that maintain a branch (*Zweigniederlassung*) in Germany. The relevant number of employees is calculated exclusively based on the number of employees in Germany. On 1 January 2024, the scope of application will be extended to companies with at least 1,000 employees. The scope of application will then be evaluated and, if necessary, expanded again.

The Supply Chain Act establishes a canon of due diligence obligations not only extending to the respective companies themselves but also to their respective supply chains. The due diligence obligations *inter alia* relate to

- the prohibition of child labour,
- the prohibition of forced and slave labour as well as slavery,

Key issues

- On 11 June 2021, the German parliament passed the Supply Chain Act.
- The Supply Chain Act establishes comprehensive due diligence obligations for companies regarding the compliance with human rights, the avoidance of forced and child labour as well as occupational health and safety in their respective supply chain.
- The Supply Chain Act will enter into force on 1 January 2023. An extension of the scope of application will take place on 1 January 2024.
- The due diligence canon of the Supply Chain Act must be implemented in the compliance and governance system of the companies within its scope.

- the compliance with workers' rights including occupational health and safety as well as organisational and trade union rights,
- the prohibition of discrimination and unequal treatment, and
- the compliance with environmental standards and rights.

The protected legal positions are defined by referencing an extensive catalogue of international public law treaties. In principle, these – in part only programmatic – public law agreements only address their respective member states, but not companies. Notwithstanding, the Supply Chain Act requires companies to comply with the legal framework of the references public law framework. It is this on the companies to identify the protected legal position and, if necessary, balance conflicting interests as there is not yet sufficient practical guidance on the private law protection of human and environmental rights.

The term 'supply chain' refers to all products and services purchased by a company as well as all steps that are necessary for the manufacturing of its products or the provision of its services. This extends to the company itself and any suppliers, irrespective of their tier. The company's responsibility depends on the degree of knowledge and influence with regard to the respective supplier. Naturally, the influence of a company on an immediate (Tier 1) supplier is greater than on its (Tier 2 to Tier n) sub-suppliers (so-called 'indirect suppliers'). Under the legislation, the obligations are thus more extensive in respect of direct suppliers. Regarding indirect suppliers, due diligence obligations particularly arise if the company receives substantiated knowledge of possible violations. According to the explanatory legislative notes, knowledge is assumed, however, if the respective supplier operates in a region or sector that is prone to human rights or environmental violations.

In any case, a company must implement the canon of obligations of the Supply Chain Act within the scope of its influence. This requires companies, *inter alia*,

- to establish a risk management system and conduct a regular risk analysis and implement appropriate preventive and remedial measures;
- to adopt of a policy statement on its strategy to protect human rights;
- to implement preventive measures in its own business units and towards its suppliers; and
- to document and report transparently on any potential risks identified.

The Federal Office of Economics and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle*) monitors the compliance with due diligence and reporting requirements. Violations and non-compliance incidents are subject to fines of up to 2 percent of the annual global group turnover. Moreover, companies may be excluded from public procurement.

The German Supply Chain Act does not (yet) stipulate for independent civil law claim for damages or a an omission for the benefit of injured parties. A civil liability is possible, however, based on general provisions. In addition, injured parties may authorise domestic trade unions or non-governmental organisations to conduct proceedings by way of a procedural agency (*Prozessstandschaft*).

OUTLOOK ON EUROPEAN INITIATIVES

The EU currently is considering a uniform European legal framework on corporate due diligence obligations with regard to global supply chains. In November 2020, the Legal Affairs Committee of the European Parliament presented a draft directive that was adopted as a proposal by the European Parliament in March 2021. In addition, sector-specific due diligence and transparency requirements on conflict minerals and battery raw materials have recently entered into force or are in the making.

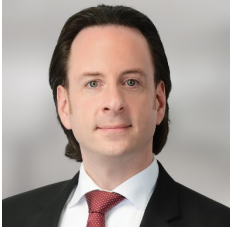
To what extent the proposed directive will ultimately be implemented or whether the Commission will present a significantly different draft yet remains to be seen. It can be expected, however, that a European solution will progress. In the sense of competitive equality, this may be beneficial and German and other national regulations should neither contradict nor go beyond and European approach so as to not undermine a 'level playing field' for enterprises.

CONCLUSION

The Supply Chain Act is a first legislative step towards obliging companies to protect and monitor human and environmental rights in their global supply chains. Due to the legislative initiative at a European level, further (and possibly more far-reaching) regulation is to be expected.

The challenge for executive, supervisory and management boards as well as compliance officers lies in responsibly implementing the canon of due diligence obligations from public law sources into existing compliance and governance systems.

CONTACTS



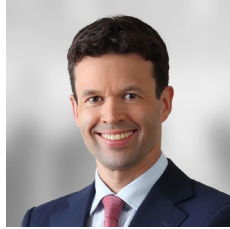
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