



LkSG

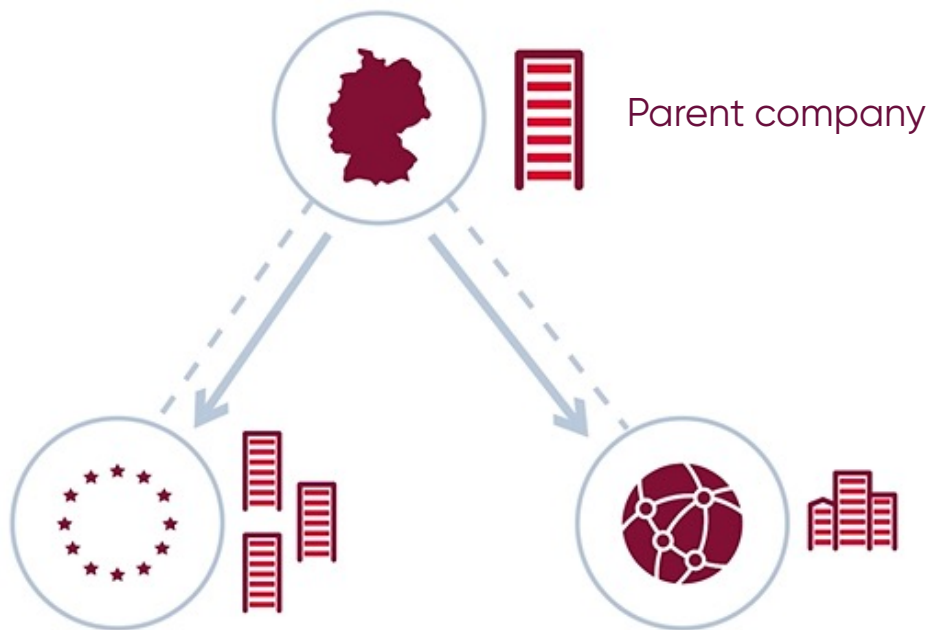
The new Act on Corporate Due Diligence Obligations in Supply Chains (LkSG) in Germany
Impacts on the retail supply chain



1. Introduction

Respecting human rights and basic environmental standards is an important concern for us. With the new Act on Corporate Due Diligence Obligations in Supply Chains (abbreviated to „Supply Chain Act“ or „LkSG“), which entered into force in Germany on 1 January 2023, compliance with such standards in the supply chain is now also standardised by law. The LkSG is only directly aimed at companies above a certain size. However, respecting human rights and fundamental environmental standards along the supply chain is not possible without also involving the suppliers of affected companies. The effects of the LkSG are therefore far greater than the group of companies obligated by the law would initially indicate. The main features of the LkSG and its effects on you as a supplier will be explained below.

2. Who does the German Supply Chain Act affect?



Section 1 LkSG defines the scope of application of the Act. The following parties will be directly obligated as target groups of the Act from the entry into force of the Act on 1 January 2023 will initially be all companies, regardless of their legal form, which

- a) have their head office, principal place of business, administrative headquarters or registered office in Germany and
- b) generally employ at least 3,000 employees (from 1 January 2024: 1,000 employees) in Germany.

In addition, however, foreign companies also fall within the direct scope of application of the Act if they

- a) have a branch office in Germany and
- b) generally employ at least 3,000 employees (from 1 January 2024: 1,000 employees) in Germany.

Note: When calculating the number of employees, jobs that are filled by temporary workers for more than six months in one year must also be taken into account (Section 1(2) LkSG). In the case of affiliated companies, the employees of the subsidiaries employed in Germany must also be added to the employees of the parent company (Section 1(3) LkSG).

The companies directly covered by the scope of application of the LkSG (obligated companies) must observe compliance with human rights and fundamental environmental standards along their supply chains. The supply chain includes all steps at home and abroad that are necessary to manufacture the products and provide the services of the obligated company. Accordingly, it covers the actions of the obligated company in its own business sector, the actions of a direct supplier and the actions of the indirect supplier (Section 2(5) LkSG).

2.1 The company's own business area

In this context, a company's own business area means all activities of a company for the production and use of products and for the provision of services within the scope of achieving the company's objective. Affiliated companies within the meaning of Section 15 AktG are also counted as part of the company's own business area if the parent company exercises a **determining influence** on them (Section 2(6) LkSG). It does not matter whether the affiliated company has its registered office in Germany or abroad – consequently, the Act can also apply to companies in other states if there is a determining influence of a German company to which the Act applies.

Note: Whether a determining influence exists must always be determined on a case-by-case basis. Possible indications could be, for example, a majority shareholding of the parent company in the subsidiary. Agreements in which the possibility of exerting influence is already inherent, overlapping personnel at management level or exertion of influence via the shareholders' meeting can also speak in favour of a determining influence.

2.2 Suppliers

Suppliers are all those companies that supply goods or services that are necessary for the production of the goods of the companies obligated under the LkSG or for the provision or use of its services. Accordingly, only those companies in the supply chain that supply goods or services to the obligated company are covered. The companies downstream of the obligated company in the supply chain, e.g. wholesalers, on the other hand, are not included in the definition of supplier, as they are no longer necessary for the production of the goods (no downstream reference of the due diligence obligations!).

Note: The scope of the Supply Chain Act will be interpreted broadly by the authorities. Accordingly, it makes sense in practice, not only for reasons of simplification, but also for legal protection, to also record the suppliers of mere auxiliary materials. Auxiliary materials are materials that serve general office operations and have no direct relation to the product sold or service offered, such as paper, paper clips, accounting software, etc. The range of potential suppliers is therefore very wide.

Example: Suppliers of raw materials or precursors can be included, but also cleaning or transport companies, warehousing companies, temporary employment agencies, wholesalers, financial service providers such as banks and insurance companies, providers of IT infrastructure and many more.

Depending on whether there are contractual relationships between the obligated company and the supplier, these are either direct (Section 2(7) LkSG) or indirect suppliers (Section 2(8) LkSG). In order to avoid circumventing certain due diligence obligations linked to supplier status, indirect suppliers are also treated as direct suppliers if a (special-purpose) supplier has been improperly involved (Section 5(1) sentence 2 LkSG).

Example: If the company obligated under the LkSG is, for example, a supermarket chain, the manufacturer of chocolate biscuits may be a direct supplier, depending on the structure of the supply chain. The chocolate biscuit manufacturer's suppliers, such as the cocoa farmer, the forwarder or the transport insurer, are in turn indirect suppliers to the supermarket chain.

In this way, beyond the companies directly obligated under the LkSG, a large number of parties along the supply chains at home and abroad are also indirectly covered by the LkSG.

3. What are the obligations of the obligated companies?



The directly obligated companies are subject to various **due diligence obligations** with regard to compliance with human rights and fundamental environmental standards. These have the goal of preventing and minimising corresponding risks and ending the violation of these standards.

The individual due diligence obligations are listed in Section 3(1) LkSG and are further defined in the following provisions of the LkSG. The obligated companies must then:

- a) establish a risk management system,
- b) define an in-house responsibility for monitoring risk management,
- c) carry out regular risk analyses,
- d) issue a policy statement on its human rights strategy,
- e) take preventative measures in your own business area and in dealings with direct suppliers,
- f) take remedial action for violations of the standards that have occurred or are imminent,
- g) establish a complaints procedure
- h) implement due diligence obligations with regard to risks by indirect suppliers and
- i) document the fulfilment of the preceding due diligence obligations and draw up and publish an annual report on this.

Accordingly, the obligated companies must make serious efforts to comply with these standards along the supply chain within the framework of preventive measures. However, they do not have to guarantee compliance with the standards from the outset.

Note: The LkSG stipulates a duty to make an effort, not a duty to succeed! However, there is an obligation to implement due diligence obligations within the company.

The LkSG does not establish any liability on the part of companies for any violations of corresponding standards (cf. Section 3(3) LkSG). It is sufficient but also necessary that they make reasonable efforts to comply with the standards. Which effort is „reasonable“ is always to be determined on an individual basis, taking into account the factors set out in Section 3(2) LkSG, such as

- the nature and scope of the obligated company's business activities,
- its proximity to its suppliers,
- the reversibility and likelihood of violations of protected standards or
- determine the nature of the obligated company's contribution to

causation. Accordingly, not all challenges identified in the risk analysis need to be addressed immediately; instead, it is sufficient to start with the significant risks first. However, if the obligated companies identify a violation of these standards that has already occurred or is imminent, they must take appropriate remedial action.

4. What human rights and environmental standards are affected?

The human rights and environmental standards to be observed are derived from various international conventions listed in an annex to the LkSG (Section 2(1) LkSG). These are conventions ratified by Germany. The LkSG lists the prohibitions to be observed in detail in Section 2(2) and (3) LkSG.

In terms of human rights, the following are prohibited:

- a) Child labour,
- b) Worst forms of child labour (e.g. child trafficking, child prostitution),
- c) Forced labour, debt bondage, human trafficking,
- d) Slavery, serfdom,
- e) Disregard of the locally applicable occupational health and safety regulations,
- f) Disregard for freedom of association (e.g. right to form and join trade unions, right to strike),
- g) Unequal treatment,
- h) Withholding of an adequate living wage,
- i) Adverse impact on natural resources (soil, water, air, noise),
- j) Unlawful eviction and land acquisition,
- k) Use of security forces that violate the prohibition of torture, harm life or limb or interfere with the freedom of association and union.

In relation to environmental standards, the following are prohibited:

- a) Production, use or treatment of mercury or mercury-added products,
- b) Production and use of persistent organic pollutants and the non-environmentally sound handling of these substances,
- c) Export and import of hazardous waste.

Note: In principle, it does not matter whether the underlying convention has also been ratified by the country in which corresponding risks or violations are based. However, if a country has not ratified such a convention, this poses an additional risk. This circumstance must therefore also be included in the risk analysis.

5. What does the LkSG mean for suppliers in the supply chain?



The obligated companies must not only ensure compliance with the aforementioned human rights and environmental standards in their own business sector, but also work towards this along the supply chain. Accordingly, the LkSG also indirectly affects smaller companies or companies not based in Germany. However, these companies do not have to fear any direct effects from the LkSG, for example in the form of reporting obligations, control measures or sanctions by the competent authority – the Federal Office of Economics and Export Control (BAFA). Depending on whether a supplier is a direct or only an indirect supplier, the obligations of the company obligated by the LkSG differ in this respect.

5.1 Obligations in relation to direct suppliers

The starting point for corresponding measures by the obligated companies with regard to their direct suppliers is first of all a risk analysis. Companies are obligated to conduct such a risk analysis with regard to their direct suppliers (Section 5(1) LkSG). Such a risk analysis must be carried out at least once a year and additionally on an ad hoc basis if the company is confronted with a changed risk situation.

Example: A changed risk situation can result, for example, from a new supplier, the expansion of the range to include new products or services or the takeover of another company. Regulatory changes in a country or increasing social tensions can also change the risk situation.

As part of this risk analysis, the first step is to identify and assess the various human rights and environmental risks in the supply chain. Both publicly available information and internal information, for example from previous inspections, can be used for this purpose. For the risk assessment, the risk events identified in this way are to be evaluated with regard to their probability of occurrence. In a second step, the identified risks are to be weighted and prioritised. The decisive factor here is an assessment taking into account the probability of occurrence on the one hand and the severity of the expected violation on the other. The severity of an expected violation is determined primarily according to

- the possibilities of influence of the obligated company,
- the extent,
- the number of people affected by a (potential) violation and
- the irreversibility of the violation (cf. Section 5(2) LkSG).

Building on the results of this risk analysis, the obligated companies must take appropriate preventive measures with regard to their direct suppliers (Section 6(4) LkSG). In this respect, the LkSG lists various possible preventive measures. However, obligated companies are also free to establish further preventive measures.

5.1.1 Examination before entering into contractual relationships

Even before an obligated company enters into new contractual relationships with a potential supplier, it must examine the supplier. It must determine whether the potential supplier poses a risk of violations of human rights or environmental standards or even whether relevant violations have occurred (Section 6(4) no. 1 LkSG). For this pre-contractual risk analysis, obligated companies can make use of publicly available information on the one hand and self-assessment questionnaires from suppliers on the other. Willingness to cooperate and the scope of the information provided or available are also included in the risk analysis. If an obligated company identifies a risk with a potential supplier, this does not necessarily mean that it cannot establish a business relationship with the supplier. However, the obligated company must adequately address the identified risks and, for example, regularly monitor and control the supplier after entering into contractual relationships.

5.1.2 Obligation to comply with standards



**Contract
clause**



or



**Code of
Conduct**

In all cases where the risk analysis reveals indications of existing risks in the supply chain, it must be contractually agreed with the supplier that the latter will also comply with the human rights and environmental standards (Section 6(4) no. 2 LkSG); often this will also be done regardless of the result of a risk analysis when entering into a new business relationship or on the occasion of contract negotiations. The obligated company may have already defined the obligations to be complied with in a „Code of Conduct“ for itself or may have drafted its own „Supplier Code of Conduct“ specifically for its suppliers. Depending on the individual case, such codes of conduct may also contain obligations that go beyond the prohibitions of the LkSG. These obligations may, for example, be directed towards integrity in business transactions or compliance with tax regulations. Typically, a direct supplier must then contractually agree to comply with this code of conduct. In addition to the abstract obligation to comply with these standards, obligated companies must also agree on concrete behavioural obligations with their direct suppliers. These serve to jointly prevent violations of the standards and minimise the risks thereof. These measures can, for example, consist of an obligation to report regularly or of mandatory certifications.

Within the framework of the risk analysis to be carried out at least once a year by the obligated companies, new risks may also be discovered or the risks may have to be prioritised differently. Accordingly, the obligated company may at a later stage consider other or further preventive measures necessary to avoid or reduce any risks at its direct supplier. To this end, obligated companies will regularly also agree with their direct suppliers that they will also take further preventive measures when new risks are identified. If necessary, the obligated company can also obtain the right from its direct supplier to propose measures to the supplier or even to order the supplier to take individual measures.

The direct supplier must also undertake to pass on the obligation to comply with human rights and environmental standards to its own suppliers – i.e. the indirect suppliers of the obligated company. This ensures that the obligation to comply with the protected standards does not end with the direct supplier. As a rule, the company obligated under the LkSG has no contractual relationship of its own with the indirect suppliers, which means that it is dependent on the cooperation of its direct supplier.

Example: The direct supplier can pass on the corresponding obligations to the indirect supplier with the help of the „Code of Conduct“ of the obligated company. Alternatively, the direct supplier can also enter into its own contractual agreements with the indirect supplier – provided the latter meet the minimum standards set by the LkSG.

The obligated company may also identify potential risks in relation to its indirect suppliers as part of its risk analysis. In such a case, it will ask its direct suppliers to take preventive measures or remedial action in this regard as well.

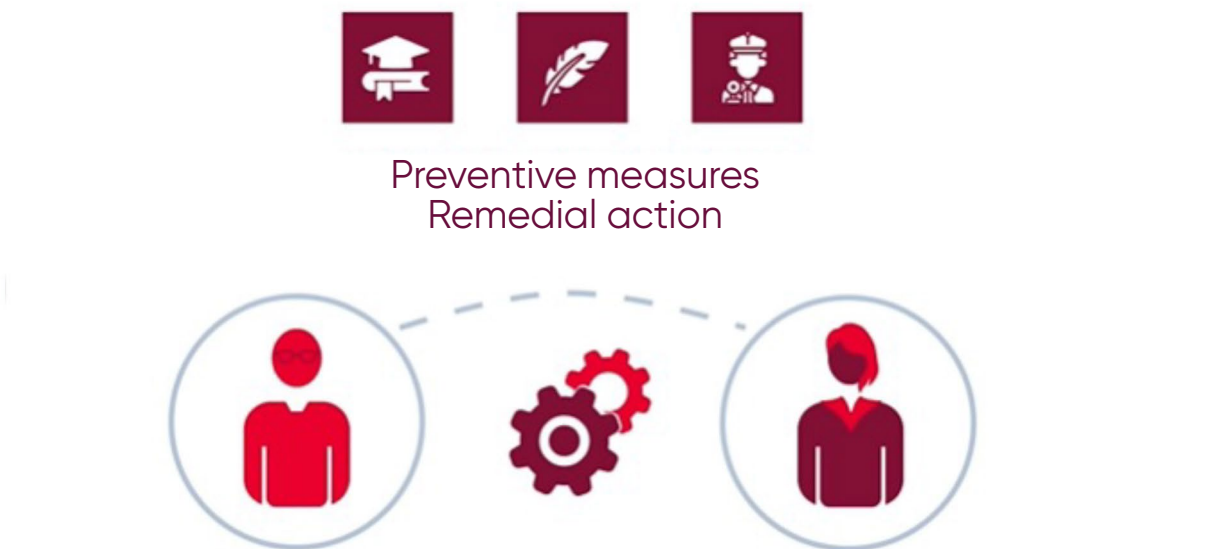
Example: Preventive measures or remedial action taken by the direct supplier may include, among other things, requiring the direct supplier to obtain certificates from its suppliers or only sourcing certain products from certified regions or production sites. The direct supplier may also be obligated to agree with its subcontractors that they also participate in training courses of the obligated company.

5.1.3 Training and further education courses

The obligated companies must also contractually agree with their direct suppliers that the latter participate in training and further education courses (Section 6(4) no. 3 LkSG). The subject of these training courses is compliance with human rights and environmental obligations and appropriately addressing them further down the supply chain. As a rule, the training courses will be aimed at the management of a direct supplier or managers in the departments of a supplier that are particularly exposed to risks. Depending on which risks have been identified in the risk analysis, it may also make sense, for example, to train shift supervisors of a production facility or purchasing staff of the direct supplier separately. These training courses are intended to provide the management and executives of the suppliers with knowledge on the scope and content of the protected legal positions. The focus should be on the risks identified for the supplier, internal company preventive measures to avoid and minimise risks, addressing human rights and environmental risks in the wider supply chain and information and reporting obligations with regard to the identified risks.

Note: Direct suppliers already pay sufficient attention to the human rights and environmental standards to be complied with under the LkSG and conduct their own training courses for their employees, further training by the obligated companies is no longer necessary. In order for the obligated companies to be able to sufficiently fulfil their obligations to provide evidence, they must sufficiently document the supplier's compliance with the standards and the implementation of their own training courses.

5.1.4 Agreement on control measures

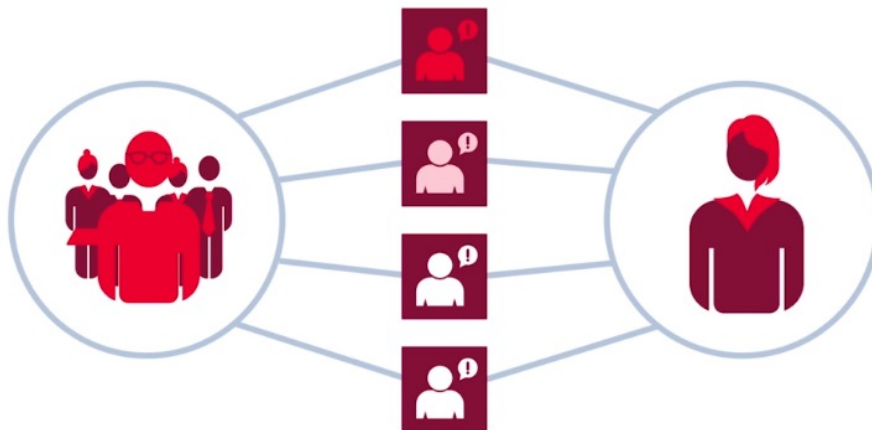


In order for an obligated company to be able to demonstrate compliance with the standards along the supply chain, it regularly also has an interest in being provided with the necessary information and evidence by its suppliers. Accordingly, it will often also contractually agree a corresponding obligation with its direct suppliers. This information can be, for example, self-assessment questionnaires from the direct supplier's suppliers, the results of past audits and inspections or certifications.

In order to be able to verify their suppliers' compliance with human rights and environmental standards even after supplier relationships have been established, obligated companies must agree on appropriate control mechanisms with their direct suppliers (Section 6(4) No. 4 LkSG).

Example: Control mechanisms can, for example, consist of certain information rights. According to these information rights, the direct supplier must, for example, provide information about indirect suppliers or about the implementation of preventive measures. It may also be required to submit certificates or investigation reports. However, it may also be appropriate for an obligated company to grant itself the right to carry out on-site inspections by itself or by third parties in the context of obligated audits or the like.

5.2 Obligations in relation to indirect suppliers



The obligations in relation to indirect suppliers are less comprehensive compared to direct suppliers. With regard to their indirect suppliers, due diligence obligations only apply when companies obtain substantiated knowledge of possible violations of human rights or environmental obligations. For such substantiated knowledge it is sufficient that **there are factual indications** of such a violation on the part of an indirect supplier. Mere opinions or rumours, on the other hand, do not trigger a duty to act; rather, there must at least be a verifiable core of facts.

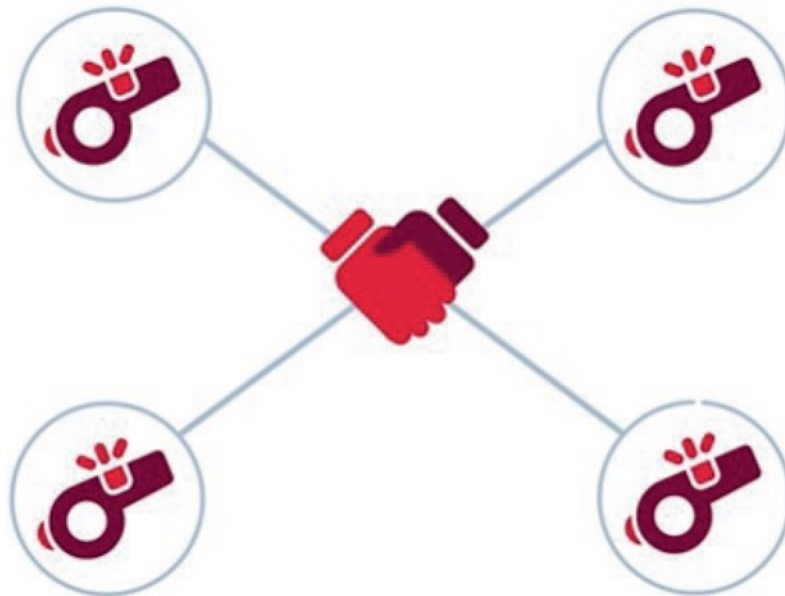
Example: Factual indications can be obtained, among other things, from media reports, complaints, notifications by BAFA or other authorities or the company's own findings during inspections or audits.

Note: Companies are not obligated to actively investigate violations of these standards at their indirect suppliers without cause. At the same time, however, they must not close their eyes to corresponding findings, for example in the context of inspections of their direct suppliers, complaints or handouts from BAFA. BAFA is legally obligated to publish industry information, assistance and recommendations on compliance with the LkSG (Section 20 LkSG). The human rights officers of the obligated companies are expected to take note of these publications.

Secondly, according to these factual indications, the violation of human rights or environmental standards must at least appear possible. It is sufficient if the probability of occurrence is less than 50%.

Only when the obligated company has substantiated knowledge of possible violations at an indirect supplier does it have to take action. In such a case, it must – just as with regard to direct suppliers – conduct a risk analysis in this respect, implement appropriate preventive measures within the scope of its possibilities for the indirect company or update its policy statement on its human rights strategy (Section 9(3) LkSG)

6. What happens in the case of potential violations?



The LkSG aims to eliminate or at least reduce risks with regard to human rights and environmental standards. It also obligates companies to react to violations that have actually occurred or are imminent (Section 7 LkSG).

An important means of uncovering corresponding grievances is the complaints procedure, which must be set up by the obligated companies (Section 8(1) LkSG). This complaints procedure must be designed in such a way that it is accessible to the public. In particular, employees of direct and indirect suppliers must be able to point out potential human rights or environmental risks or violations. Accordingly, the obligated companies will regularly agree with their direct suppliers that they will inform their employees about the complaints procedure, for example, via a notice board or on the intranet. In addition, it is to be expected that direct suppliers will have to contractually undertake to pass on the obligation to inform about the complaints procedure to their suppliers, i.e. the indirect suppliers of the obligated company.

If grievances are discovered in this way or in any other way, the obligated company must take appropriate action. The scope of the required **remedial action** depends on whether the grievances occurred in the company's own business sector or at a supplier. As a rule, grievances in the company's own business sector must be ended (Section 7(1) sentence 3 LkSG); only in the company's own business sector abroad is it sufficient if the remedial action generally leads to the end of the grievance (Section 7(1) sentence 4 LkSG). In this respect, it is therefore a matter of an intensified obligation to make an effort.

With regard to their suppliers, the obligated companies only have to make efforts to end the grievances. For this purpose, the LkSG provides the obligated companies with some possible measures (cf. Section 7(2),(3) LkSG). In principle, the obligated company should first work with its direct supplier in question to develop and implement a temporary plan to end or minimise the violation. In this respect, close cooperation between the companies is required in order to counter the violations. This plan may, for example, allow for the procurement of appropriate protective clothing or the establishment of a new security system within which the prohibition of torture is upheld within a certain period of time. The time limit depends on the individual case and is influenced in particular by the seriousness of the violation or the effort required to remedy the grievance. However, it may also be advisable to join forces with other companies within the framework of industry initiatives and industry standards: in this way, the obligated companies can gain greater influence on the supplier (Section 7(2) No. 2 LkSG). In the event that a supplier does not comply with the jointly developed measures, the suspension of business relations may also be warranted (Section 7(2) No. 3 LkSG). The last ultima ratio to be considered is the complete termination of the business relationship (Section 7(3) LkSG). However, significant requirements apply to this. For example, it must be a particularly serious violation that could not be remedied in a timely manner despite the jointly agreed measures and there must be no milder measures in place to remedy the violation.

With regard to indirect suppliers, the LkSG simply stipulates that the obligated companies must only take action when they have substantiated knowledge of violations (cf. Section 9(3) No. 3 LkSG). In such a case, the LkSG stipulates that the obligated company must create and implement a concept to remedy the grievance. The content of this concept, however, will generally be based on the measures taken with regard to grievances at the direct suppliers.

Overall, the LkSG system is aimed at a constructive expansion of the relevant human rights and environmental standards along the supply chain. Under the LkSG, obligated companies should not primarily withdraw from regions with weak standards. Instead, the LkSG primarily encourages them to work locally with their suppliers or within their industry to improve conditions. Corresponding regions are not additionally weakened by the withdrawal of obligated companies; rather, the conditions on the ground in these regions should improve in the long term as a result of the LkSG.

7. Where can you get support?

Support in relation to the effects of the LkSG is provided by the [BAFA](#) and the [Federal Ministry of Labour and Social Affairs](#).

The contents of this guideline have been legally reviewed by GvW Graf von Westphalen.

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