

## Supply Chain Act (LkSG) – Companies above a certain size now obliged to look carefully at their suppliers

Child labour, exploitative working hours, and chemicals that find their way into rivers and wastewater: reports of human rights abuses in the supply chain are now a major liability for German companies and their suppliers. It is therefore increasingly important to tackle challenges in the supply chain preventively. The following text explains what Swiss companies in particular need to consider with regard to the supply chains of German companies.

### Which companies are affected specifically?

Since 1 January 2023 all companies, including Swiss companies with **headquarters** or a **location in Germany** and **at least 3,000 employees**, must implement human rights and environmental due diligence in their supply chains. **Important:** From 1 January 2024, the law will apply to companies with **at least 1,000 employees** in Germany. **Swiss companies without a location in Germany** must also bear in mind that supplying a company in Germany affected by the act makes them part of the supply chain to be verified by the German company, and therefore subject to the same obligations. In concrete terms, this means that affected German companies will ask their Swiss suppliers to provide assurances they will comply with the requirements of the law.

The act applies primarily to **the direct supplier of the German company affected**. This includes **Swiss companies supplying an affected German company**. The **indirect supplier** – i.e. the supplier of the (Swiss) supplier – is only involved in exceptional cases, and only if **there is real and concrete evidence** of a human rights violation by the indirect supplier (e.g. in media reports, newspaper articles).

**In practice, therefore, it is primarily the Swiss supplier who will have to provide assurances they will comply with the act.** However, it is possible that the German company may nonetheless insist on also involving the indirect suppliers. Swiss companies – including those without a location in Germany – should therefore maintain an up-to-date list of their suppliers outside Switzerland to assure their clients in Germany that these suppliers comply with the requirements of the law. In such cases, relevant enquiries by the German contracting partners would need to be forwarded to the indirect supplier of the Swiss company. In order to be able to provide the German contracting partners with valid information, companies are advised to **prepare their own risk analyses based on the requirements of the LkSG, at least for longer-term supplier partnerships**. Nevertheless, we do not expect German companies to involve indirect suppliers without a concrete reason for doing so, as here too they will likely want to avoid unnecessary bureaucracy.

### What is the scope of the act?

The act covers **due diligence obligations relating to a company's area of business, the actions of contracting partners and – under the circumstances described above – the actions of other suppliers (including indirect suppliers)**. This means that a company is not only responsible for its own actions, but for the entire supply chain.

The LkSG was published in Germany's Federal Law Gazette along with an annex listing eleven internationally recognised human rights conventions. The legal interests protected in these conventions were used to draw up behavioural requirements and prohibitions for corporate behaviour with the aim of preventing the violation of protected legal positions. These include in particular the prohibition of child labour, slavery and forced labour; disregarding occupational safety and health protection; failing to pay an adequate wage; disregarding the right to form trade unions or employee representation bodies; denying access to food and water; and unlawfully seizing land and livelihoods.

### **Which specific measures must companies take to ensure due diligence is applied?**

The following measures are mandatory for all affected companies, and **therefore also apply to all Swiss companies with a location in Germany and staff numbers in line with the above-mentioned figures:**

- establishing or further developing a **risk management system** that also covers sustainability issues in the supply chain;
- allocating responsibilities **within the company**;
- conducting **regular risk analyses**, as well as outlining procedures for identifying adverse human rights impacts;
- issuing a **policy statement** on respect for human rights;
- establishing **preventive measures** within the company's area of business, vis-à-vis direct suppliers and – if there is evidence of a potential violation – indirect suppliers;
- taking **corrective measures** if a protected legal position is violated;
- establishing a **complaints procedure** and a complaints management system;
- carrying out documentation and annual **reporting**.

### **How do companies implement this in practice?**

**Responsibilities within the company:** In order to comply with their due diligence obligations, companies must define **responsibilities** within their organisation, for example by appointing a human rights officer.

**Risk analysis:** All companies that fall under the scope of the act are also required to conduct a **risk analysis**. This means that companies must strive for transparency in the first instance and **identify those parts of their production and supply chains** that pose particularly high human rights and environmental risks. A list of all suppliers, categorised according to the countries in which they are located, must be drawn up and their potential dangers or risks assessed.

**Corrective measures:** If the risk of a human rights violation is identified on the company's own site or in the supply chain, appropriate **measures must be taken to eliminate or mitigate the risk**. This is all the more true if the human rights violation has already taken place. **NB:** As mentioned above, human rights risks at **indirect** suppliers, i.e. at suppliers of suppliers, must also be considered if there is concrete **evidence** of possible human rights violations there.

**Complaints management system:** Companies must also establish a complaints management system that allows people who are aware of or directly affected by an infringement to report risks and violations. The complaints procedure must be **communicated on the homepage** and be easily accessible to affected persons, companies, contracting partners, etc.

**Policy statement:** A **policy statement on the company's human rights strategy** must also be drafted. The statement must mention the environmental and human rights risks identified as priorities for the company in the risk analysis. It should also describe the above-mentioned preventive and corrective measures as well as the established complaints procedure. Further to this, it must address what is expected of the company's employees and the suppliers in its supply chain. The policy statement must be **approved by the company's management**. Again, we strongly advise communicating this policy on the company's website and to long-term contracting partners. The points already identified in the risk analysis can be incorporated and further developed as required.

**Reporting obligation:** The fulfilment of due diligence obligations must be documented within the company on an ongoing basis. The companies concerned must **submit an annual report** to Germany's Federal Office for Economic Affairs and Export Control (BAFA) that clearly explains:

- which human rights and environmental risks the company has identified, if any;
- what the company has done to fulfil its due diligence obligations;
- how the company assesses the impact and effectiveness of the measures;
- and what conclusions it draws from this for future measures.

Swiss companies **without a location in Germany** are **not affected by the reporting obligation! Only Swiss companies with a location in Germany who employ a certain number of employees are affected (until 1 January 2024: 3,000 or more, from 1 January 2024: 1,000 or more).**

**Important:** The report must be submitted to BAFA no later than four months after the end of the business year and published on the company's website, where it must remain available for seven years.

**Trade and business secrets are protected.** BAFA has developed an electronic reporting format to minimise the workload for companies; the form can be downloaded from BAFA's website. You can find details regarding report requirements and information on the online form [here](#).

**An advantage of this procedure** is that the companies concerned can also use this information to fulfil the CSR (Corporate Social Responsibility) reporting obligation.

N.B: On 21 June 2022, the EU institutions agreed on a new Corporate Sustainability Reporting Directive (CSRD). The aim is to provide publicly accessible and comparable information on sustainability-related risks and opportunities for companies, to steer financial flows towards sustainable economic activities, and ultimately encourage the transition to a sustainable and competitive economy in line with the EU Green Deal. The reporting obligation no longer applies only to capital market-oriented companies, but to all large companies that meet two of the following three size criteria: a balance sheet total of at least 20 million euros, net turnover of at least 40 million euros, or at least 250 employees. In addition, small and medium-sized companies with ten or more employees will be obliged to report on sustainability if they are capital market oriented.

#### **What concrete measures must be taken after the risk analysis?**

If the analysis identifies relevant risks within the supply chain, preventive measures must be taken. Based on the act, the following measures are recommended:

- Drawing up a **code of conduct for suppliers** in which the company sets out its expectations for cooperation in a binding and written form. This code of conduct should be incorporated into **all contracts with suppliers**.
- Ensuring the respective supplier provides a written commitment to also adhere to these **compliance standards** in its own downstream supply chain.
- Conducting regular **checks** on existing and future suppliers with regard to their ability to comply with due diligence obligations.
- Introducing **rights of control** and implementing regular, risk-based checks.
- Requesting **evidence from the supplier** of training carried out.
- Implementing necessary **corrective measures** in the event of suspected infringements by direct suppliers of protected legal positions up to and including:
- **terminating business relations** with contracting partners who are unwilling to comply with requirements, sign supplementary contracts and/or who have been found to be in clear violation of the legal requirements.

#### **What happens if there is a violation of the law and which authority reviews these violations?**

As mentioned above, BAFA is responsible for conducting checks of the affected companies and verifying whether the statutory due diligence requirements, including reporting obligations, are being met. Fines of up to 8 million euros can be imposed for very serious violations. If annual turnover exceeds 400 million euros, the fine can be up to 2% of annual **worldwide** turnover. Once again, **Swiss companies without a location in Germany** are not affected in this regard. **NB:** Companies can be excluded from public procurement procedures if a fine above a specified threshold is imposed.

#### **What is the situation in other countries?**

Legal regulations on due diligence already exist in other countries too. In addition, the EU is currently introducing legislation that will require companies within the EU to identify human rights and certain environmental risks in their value chains, implement preventive and corrective measures and report on their work in this area. The European supply chain directive Corporate Sustainability Due Diligence (CSDD) has already been adopted by the EU Parliament, which must now agree on a common position with the Council of Ministers.

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About the VSUD:

The VSUD is a strong cross-sectoral business network that represents political interests and acts as a point of contact for all issues relating to cross-border business. It helps Swiss companies of all sizes and in all sectors to maintain a successful market presence in Germany.

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