

The German Supply Chain Act (Lieferkettengesetz¹) aims to protect the rights of people who produce goods for or deliver services to the German market. For this purpose, many obligations to act, due diligence and reporting obligations are imposed on companies. Even though the law will come into force in 2023, it is already necessary for companies to carefully review their compliance management systems to determine whether they must be amended. This Legal Briefing will analyse the legal implications in connection with the German Supply Chain Act in the Gulf region and especially in the UAE.

1. Introduction

Previously existing guidelines and standards in the context of human rights, in particular the UN Guiding Principles on Business and Human Rights, the aim of which is to implement human rights protection worldwide in the form of National Action Plans, were all based on the principle of voluntary self-commitment. However, the German legislator didn't consider this to be efficient enough. Because companies in Germany earn money from items produced and services rendered in other parts of the world, they should also bear responsibility for ensuring that human rights are respected along their supply chains. The legislation on corporate due diligence in supply chains is to obligate German companies to better meet their global responsibility. The law will enter into force on 1 January 2023. Until then companies must ensure compliance with human rights among their entire supply chain. This is the reason why the new law will also affect companies in the Gulf region.

As of 2023, the law will apply to companies with a workforce of at least 3,000 employees in Germany and from 2024 for companies with a workforce of at least 1,000 employees in Germany (affiliated companies in Germany included). The prerequisite is that the company has its registered office or a branch office in Germany. However, it is expected that the law will also have an impact on companies below these thresholds. The companies that are directly obliged by the law will have to oblige their direct suppliers to comply with the compliance standards and sign corresponding contracts with them.

2. What does the Supply Chain Act regulate?

Under the provisions of the new legislation, companies' responsibility is to extend along their entire supply chain, graduated in line with the opportunities they must exert an influence. Companies must realise their obligations in their own field of business and vis à vis their direct suppliers. Indirect suppliers are involved as soon as the company receives substantiated reports of human rights violations at that level.

¹ Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten vom 16. Juli 2021

The legislation translates into concrete provisions the way companies must comply with their due diligence obligations in the field of human rights. This involves analysing human rights-related risks, taking measures to prevent and mitigate human rights violations, setting up grievance mechanisms and reporting on their activities. Furthermore, companies are obliged to adopt a human rights declaration. The law is primarily concerned with abuses at production sites abroad. However, human rights and environmental due diligence obligations are also applicable to construction and infrastructure projects.

Non-compliance may result in penalties, in particular administrative fines and exclusion from public contracts.

3. Impacts of the new law on companies in the Gulf region

The Supply Chain Act will also have a strong impact on businesses in the Middle East. Foreign subsidiaries of German companies which are subject to the law will count as own business area of the German company and thus must comply with the due diligence obligations outlined in the law fully. They must ensure to have a compliance system in place fulfilling all obligations of the law. This must be duly set up and coordinated with the mother company in Germany in time.

In addition, direct suppliers of German companies subject to the law have to ensure compliance with human rights standards and prevent human rights related risks. They will have to implement a respective compliance system and cooperate with their German customer in order to remain its direct supplier.

Countermeasures have to be taken in case of identified deficits or risks. In this respect typical problems can be that the companies

must observe the compliance with minimum labour law standards (like minimum wage or social insurance obligation) and occupational safety at production sites and construction sites, especially by subcontractors. Companies must ensure that no environmental related risks as outlined in the law are violated. This means that German companies as well as their subsidiaries will have to make considerable legal and organisational efforts. In addition to the establishment and coordination of internal company procedures for compliance with human rights standards, contractual adjustments with direct suppliers are required to ensure the necessary flow of information.

In the event of failure to comply with the outlined due diligence obligations, the Supply Chain Act provides for sanctions in the form of fines of up to 800,000 euros, in the case of companies with an annual turnover of more than 400 million euros, fines of up to two per cent of the worldwide turnover and up to three years exclusion from public contracts if a fine of at least 175,000 euros has been imposed.

Therefore, it is important to start taking preventive measures now. Companies can, for example, impose certain duties of care and reporting obligations on their suppliers in general terms and conditions and supply contracts in order to comply with human rights, labour and environmental standards.

4. What measures must be taken by companies?

The Supply Chain Act requires that companies actively manage their risks, even those that will not be directly subjected to the Act.

For this, it is very important to identify human rights risks by due diligence. Business partners must be contractually

obliged to comply with human rights and environmental standards. It is important to define the standards concretely and to provide for specific legal remedies in case of violation (indemnification and compensation, termination for cause). It is recommended to use a code of conduct. The rules and regulations can help the management and employees to navigate in a difficult regulatory environment. The companies are also obliged to document the fulfilment of due diligence obligations on an ongoing basis and to publish a report on this once a year.

In concrete terms, this means that companies must:

- set up a risk management system and conduct a risk analysis in its own business area and with its direct suppliers,
- adopt and publish a policy statement on their human rights strategy and embed it in its relevant business processes,
- establish an internal corporate grievance procedure that indications of human rights and environmental risks can be reported,
- take various preventive and remedial measures.

5. Conclusion

With the Supply Chain Act, German companies will face increased requirements with regard to compliance with human rights and environmental standards in international supply chains.

The core regulation of the law is that German companies must establish a risk management system, define a clear internal responsibility, carry out regular risk analyses and anchor preventive measures both in their own business area and towards their direct suppliers. Furthermore, corrective measures must be taken, and a complaints procedure must be established. Moreover, companies are obliged to continuously document the fulfilment of their due diligence obligations and to prepare an annual report on this.

The Supply Chain Act will not come into force until 2023. However, in view of the comprehensive and very far-reaching due diligence requirements, companies should review their compliance management systems at an early stage to determine whether they need to be adapted to environmental and human rights risks. German companies should prepare as early as possible in order to be able to implement corresponding duties of care in accordance with the German Supply Chain Act in time, especially since implementation requires a lot of time and often new structures. It should also be pointed out that there is a threat of substantial fines if the measures taken under the planned Supply Chain Act are not implemented in time. Finally, non-compliance with the requirements of the law might lead to a considerable reputational damage as compliance with the due diligence obligations as well as any violation will be made public.

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