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# *Entered into Force on 1 January 2023*
# *What Is the German Act on Corporate Due Diligence in Supply Chains (LkSG)?*
# *What Does It Mean for Turkish Suppliers?*

The Act on Corporate Due Diligence to Prevent Human Rights Violations in Supply Chains (LkSG and SCDDA) (the Act) was adopted by the German Federal Parliament on 11 June 2021. The Act regulates corporate responsibility in order to prevent violations related to environmental and human rights issues within supply chains and to ensure sustainable trade and production. While the Act initially applied to companies with at least 3,000 employees as of 1 January 2023, its scope was expanded in 2024 by lowering the threshold to companies with at least 1,000 employees.

With globalization, large-scale companies in particular have expanded their supply chains by relocating production abroad due to lower costs. However, it has been identified that they have not assumed responsibility or complied with national legal rules in matters such as respect for human rights, including child labour, harsh working conditions, unfair wage practices, deficiencies in occupational health and safety, and restrictions on trade union rights. The Covid-19 pandemic is a recent example illustrating these violations. During the pandemic, adverse effects experienced by workers, mass layoffs, insufficient support from companies, and the absence of work–life balance gave rise to the "Great Resignation" and, similarly, the more recent trend of "quiet quitting," which can be seen as feedback from the business world. In this context, the Act aims to establish sustainable trade by requiring companies to respect environmental and human rights throughout their entire supply chains and to fulfil due diligence obligations in order to create corporate responsibility.

## *Background*

The German Federal Government did not make the implementation of the UN Guiding Principles on Business and Human Rights, published in 2011, mandatory. Instead, in 2016, it prepared the National Action Plan on Business and Human Rights (NAP), initiating voluntary implementation. However, due to very low participation rates observed in subsequent surveys, the voluntary approach was abandoned and the matter was moved to a legal framework. In this decision, the influence of 18 civil society organisations, including Germany's largest environmental organisations (Bread for the World and Friends of the Earth Germany – BUND), was significant. The Act obliges companies to fulfil due diligence obligations across their supply chains, including overseas operations.

Criticism of the regulation includes both supportive views advocating for broader coverage and opposing views claiming that it negatively affects competitiveness or may even encourage frequent supplier changes instead of improvement.

EU and non-EU countries that place importance on human rights have also enacted legal regulations by drawing on these guiding principles (UN Guiding Principles on Business and Human Rights, OECD Guidelines, and the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy). Norway, Finland, and Denmark have implemented obligations similar to Germany's, while France has adopted broader employee thresholds. The United States and the Netherlands support legislation aligned with transparent supply chains, and the United Kingdom has similar commitments under the Modern Slavery Act. In addition, with regard to risks arising from the disposal of toxic chemicals and hazardous waste, the Act refers to relevant provisions of international conventions focusing more on environmental risks, such as the Minamata, Stockholm, and Basel Conventions.

The European Commission, although it had previously addressed this issue, adopted the Corporate Sustainability Due Diligence Directive (CSDD) on 23 February 2022, which is expected to enter into force in 2024. However, once the CSDD enters into force, the German Supply Chain Due Diligence Act will need to be adapted to EU rules. Although the two regulations are similar in terms of general purpose and structure, there are fundamental differences regarding the scope of companies covered, the definition of the value chain, adverse impacts included, and legal liability. If the CSDD is fully implemented, it is estimated that 12,800 companies within the EU will be affected.

## *Companies Covered by the Act and Dates of Entry into Force*

According to the German Act on Corporate Due Diligence in Supply Chains (LkSG or SCDDA), companies will be subject to obligations based on the number of employees specified below, regardless of their legal form. The draft CSDD Directive covers a larger number of companies. However, since updates to the LkSG will be required following the adoption of the CSDD, companies not currently within scope are advised to prepare.

I. Companies domiciled in Germany and companies with a secondary branch pursuant to Article 13d of the German Commercial Code (HGB) are covered, with entry into force dates based on employee numbers as follows:
a) Companies with at least 3,000 employees in Germany – 01 January 2023
b) Companies with at least 1,000 employees in Germany – 01 January 2024

II. Foreign companies with branches in Germany will be included under the same employee thresholds.

In calculating the number of employees:

- Employees working in Germany and those seconded abroad are taken into account.
- In companies employing temporary agency workers, such workers must be included if their employment exceeds six months.
- In group companies, all domestic employees of the companies within the group must be considered when calculating the employee count of the parent company, including workers seconded abroad.
- Temporary relocation of all employees to another EU country is also included.

It is also expected that SMEs currently outside the scope will be affected in the future, as the Act envisages the transfer of due diligence obligations from large companies to their suppliers.

## *What Is the Supply Chain?*

Under the Act, the supply chain refers to all products and services produced by a company. It includes all domestic and international goods and services processes required from the procurement of raw materials to delivery to the final consumer. Accordingly, the company's scope of activities includes:

1. Activities within its own business operations: covering all actions taken to achieve its objectives. In subsidiaries, if the parent company exercises significant influence, such activities are considered part of the parent company's own business operations.
2. Activities of direct suppliers: covering all supplies required for the production of the company's goods or services.
3. Activities of indirect suppliers: covering all procurement of goods and services necessary for the creation of the main activity.

## *What Are the Due Diligence Obligations?*

Companies are obliged to comply with due diligence requirements in order to minimise and prevent environmental risks and human rights violations throughout their supply chains. In its simplest terms, due diligence encompasses all efforts required to identify these risks along the supply chain from raw material or service procurement to the final consumer. Companies must place due diligence at the centre of their business processes in supply chain risk management and periodically monitor and analyse it.

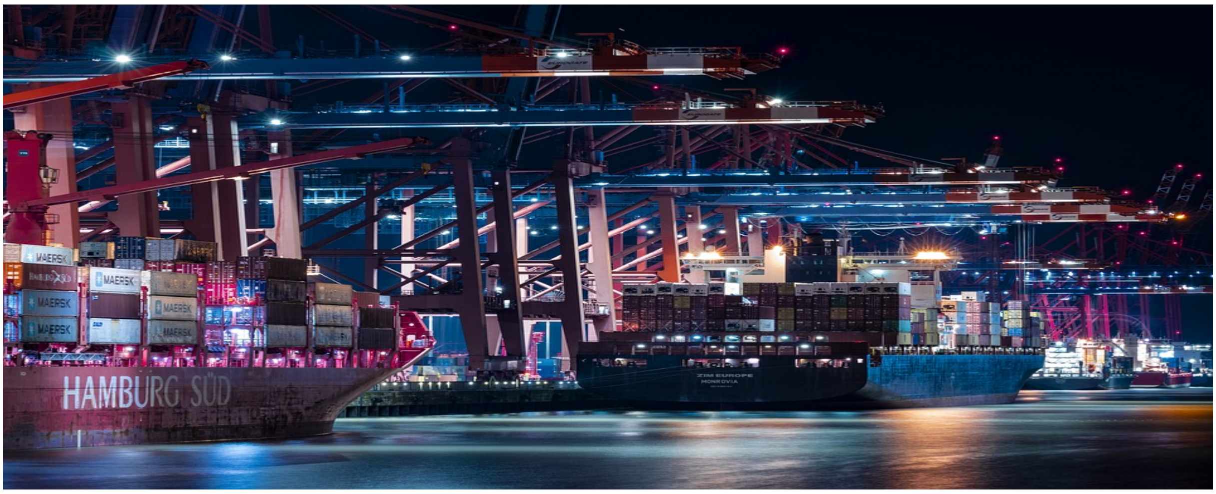
Due diligence includes the following steps:

- Establishment of a risk management system and designation of internal responsibility
- Conducting periodic risk analyses and assessments
- Taking preventive and remedial measures

- Issuing a policy statement on the company's human rights strategy (for itself and its direct suppliers), with the effectiveness of the strategy to be reviewed annually
- Risk-based due diligence practices for indirect suppliers
- Establishment of a complaints mechanism for reporting violations
- Documentation and reporting

## Main Risk Issues to Be Addressed by Companies

- Child labour
- Forced labour
- Violations of freedom of association
- Occupational health and safety
- Unethical employment practices
- Discrimination
- Environmental degradation
    - Soil, water, air, and noise pollution, excessive water consumption
    - Production and use of persistent organic pollutants
    - Use of mercury compounds




## *What Does the LkSG Expect from Companies?*

The LkSG does not require companies to guarantee the elimination of all risks within their supply chains. Instead, it requires them to manage a system that identifies risks along the chain, establishes procedures, takes actions to prevent or mitigate risks, establishes complaint procedures, and fulfils reporting obligations—essentially focusing on the responsibility to make an effort. Primarily, companies are held responsible for themselves and their direct suppliers. However, where complaints are received regarding indirect suppliers or where there is reason to believe that an indirect supplier may violate environmental or human rights, companies are required to conduct risk analyses regarding potential harm and to take corrective actions. In other words, if non-compliance is identified at the level of an indirect supplier, immediate action and corrective measures are required.

## *Which Authorities Are Responsible for Audits and What Are the Sanctions?*

The Federal Office for Economic Affairs and Export Control (BAFA) is responsible for official controls and enforcement. The Federal Ministry for Economic Affairs and Energy is responsible for the legal and technical supervision of this office under the Act and, in cooperation with the Federal Ministry of Labour and Social Affairs, applies these audits based on a risk-based approach. Companies are required to submit reports within four months following the end of the financial year and to publish them on their websites for seven years. To reduce workload, integration with CSR reporting is recommended.

**Monetary fines**

German companies may be subject to monetary fines if preventive measures are not taken. The maximum administrative fine is EUR 50,000. Depending on the severity of violations, fines may reach up to EUR 8 million or up to 2% of annual global turnover. The turnover-based fine system applies only to companies with annual turnover exceeding EUR 400 million.

**Prohibition from public procurement**

German companies may, where necessary, be excluded from public procurement for up to three years.

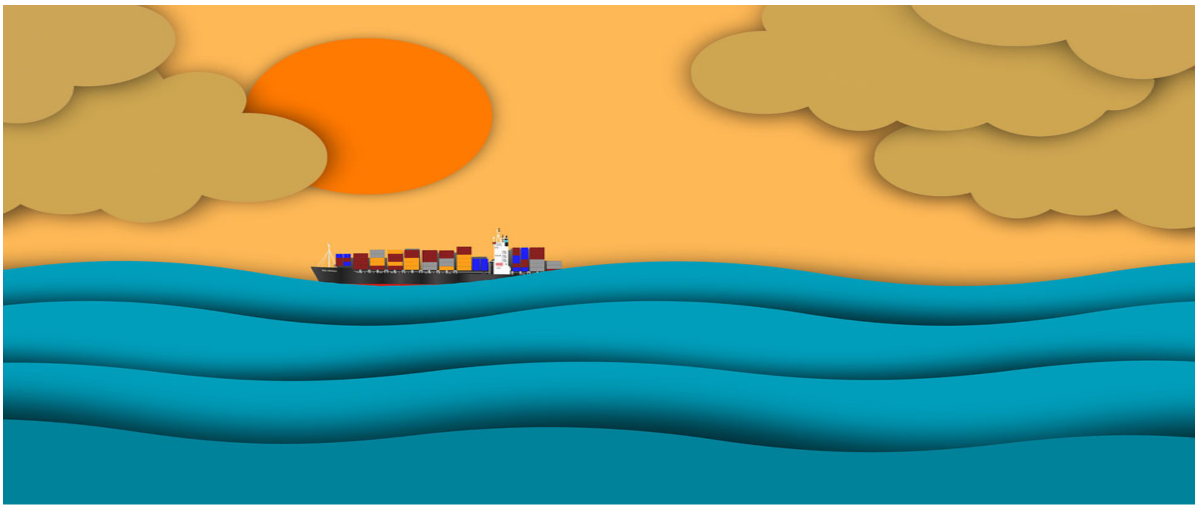
However, losses may not be limited to these sanctions. Where risks are disregarded and made public, reputational risk beyond monetary penalties should not be overlooked (e.g. the use of child labour by Nike in Cambodia and Pakistan in the 1990s).

In addition, as victims of human rights violations may be unable to initiate legal proceedings due to livelihood conditions, trade unions or civil society organisations may now exercise this right on behalf of foreign workers. Where violations are identified in the supply chain and the relevant company demonstrates effort, sanctions should not be expected. Furthermore, companies will not be held responsible for the actions of third parties in overseas supply chains. Although workers employed abroad may have the right to bring claims against German companies for rights violations, the law of the country where they are located will apply. In addition, companies that are suppliers of direct suppliers may be affected; however, if they are not within the scope of the Act, they will not be subject to penal sanctions.

## *What Does It Mean for Turkish Suppliers?*

Although the European Union consists of 27 countries and represents only 6% of the world's population, it is among the world's largest economies. The EU is a key market for Türkiye, ranking first in both exports and imports. According to 2022 data, Türkiye exported USD 103.1 billion (40.6%) to the EU and imported USD 93.28 billion (25.6%). Türkiye ranks 5th and 6th, respectively, in the EU's exports and imports (2022). Germany is Türkiye's most important trade and economic partner, with more than 4,000 German companies operating in Türkiye. In Germany's exports and imports, Türkiye ranks 16th (USD 25.2 billion) and 18th (USD 21.7 billion), respectively (2021).

Accordingly, both for Türkiye and for its suppliers, the Act (LkSG) and the Directive (CSDD) can be considered an opportunity to ensure the sustainability of existing relationships and even to increase market share, provided that both relevant public institutions and Turkish suppliers fulfil their obligations. Under the Act, German companies are required to conduct risk analyses and take preventive and remedial measures with respect to direct suppliers, while such obligations arise for indirect suppliers only where indications of potential environmental or human rights violations are identified. To avoid sanctions, German companies will seek to incorporate these requirements into their contracts. Moreover, where corrective and preventive measures are deemed insufficient following risk assessments, companies may discontinue sourcing. Therefore, to ensure sustainability within the supply chain, Turkish suppliers must first identify their position and take the necessary actions to ensure compliance with the Act. Considering that the CSDD Directive, expected to enter into force as early as 2024, has a broader scope, exporters doing business not only with Germany but with the EU in general are advised to review the Act in light of their own circumstances and begin preparations.



## Conclusion

With global trade, supply chains have become increasingly complex. The LkSG aims to protect human rights and the environment. For this purpose, companies are expected not only to address impacts arising from their own activities but also to take responsibility for the entire supply chain by conducting due diligence and implementing necessary preventive actions to achieve improvements throughout the chain. On the other hand, the view that it is not feasible to conduct due diligence for subsequent suppliers when companies cannot even fully monitor environmental and social impacts within their own operations or first-tier suppliers is not unfounded. In other words, considering data gaps, confidentiality, technical or legal constraints, and complex relationships in global trade, it is widely acknowledged that exercising full control over the entire supply chain is impossible. This is due to the absence of contractual relationships in indirect links, as well as structural issues in third countries and sector- or company-specific challenges. Therefore, cooperation among all stakeholders in the supply chain toward a common objective and joint efforts to address regional and sectoral issues are of critical importance.

For the construction of a sustainable economy, the protection of human rights and the environment is essential. The Act assigns responsibility for the supply chain to companies to ensure global compliance. To succeed, the business world must adopt a sustainability approach and thoroughly understand and internalise the UN Sustainable Development Goals and accepted Guiding Principles. In this way, global awareness can be increased, contributing to sustainable economic development and prosperity.

([1]) *For more information on the CSDD, please refer to the January/2023 issue of our journal.*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