

EUROPEAN EMERGING ISSUES IN GLOBAL COMPLIANCE: THE GERMAN SUPPLY CHAIN ACT & THE E.U. WHISTLEBLOWER DIRECTIVE

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Last year, the German Bundestag and the European Union (“E.U.”) enacted laws and policy directives which will increase the obligations of compliance departments for companies conducting business in Germany and other E.U. nations. The laws are (1) the Lieferkettengesetz, (the “German Supply Chain Act”) and (2) the European Union’s Whistleblower Directive. To prepare for new obligations these initiatives will ultimately require, companies must stay up to date on these enactments and consider innovative solutions to ensure compliance. The implementation challenges may be addressed directly by utilizing digital tools and fostering a corporate culture of transparency.²

This paper will consider the German Supply Chain Act and the obligations which affected companies must anticipate to comply with the law. Additionally, this paper will explain the E.U.’s Whistleblower Directive and explore regional differences that will arise as E.U. Member States transpose the directive into their separate legal systems. Finally, this paper will offer solutions which companies should consider to meet the obligations set forth in the German Supply Chain Act and the Whistleblower Directive.

I. The German Supply Chain Act

a. Scope of the Act

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² *What is the Lieferkettengesetz? – The German Supply Chain Law*, PREWAVE.COM (Mar. 8, 2021), <https://www.prewave.com/blog/what-is-the-lieferkettengesetz/>.

The German Supply Chain Act (“the Act”) was adopted by the German Bundestag in June 2021, and its passage coincides with renewed interest in human rights legislation.³ The Act takes effect in January 2023 and requires corporations with a registered office or branch in Germany to conduct due diligence with respect to third-party suppliers. The Act was passed with the purpose of expanding human rights protections.⁴ It requires affected companies to take responsibility for certain human rights and environmental actions that occur in the entirety of their supply chains. Additionally, the Act requires companies to install grievance mechanisms and to periodically report on their activities. By incorporating policy goals from the UN Guiding Principles on Business and Human Rights, the Act represents a paradigm shift away from voluntary standards and self-regulation principles that previously prevailed.⁵

The Act coincides with greater recognition of human rights violations on the part of third-party suppliers in the developing world. The Rana Plaza in Dhaka, Bangladesh was a textiles manufacturing facility providing fabrics to clothing manufacturers around the world. In 2013, the Rana Plaza collapsed due to poor facility construction and maintenance. The accident resulted in the tragic deaths of approximately 1,132 factory workers.⁶ In the wake of the accident, global leaders called on large companies to take responsibility for their supply chains and protect workers.

In addition to human rights protections, the Act establishes environmental protections to mitigate the risks of illegal logging, the inappropriate use of pesticides, the contamination of water

³ INT’L FED’N FOR HUM. RTS., GERMANY: CALL FOR AN IMPROVEMENT OF THE SUPPLY CHAIN DUE DILIGENCE ACT (2021).

⁴ *Supply Chain Act (Lieferkettengesetz): Greater protection for people and the environment in the global economy*, BUNDESREGIERUNG.DE (Mar. 3, 2021), <https://www.bundesregierung.de/breg-en/news/supply-chain-act-1872076>.

⁵ INT’L FED’N FOR HUM. RTS., *supra* note 2.

⁶ *The Rana Plaza Accident and its aftermath*, INT’L LAB. ORG., https://www.ilo.org/global/topics/geip/WCMS_614394/lang--en/index.htm.

resources, and air pollution.⁷ The Act also addresses competitive disadvantages suffered by companies that previously invested in sustainable supply chain management.

b. Affected Parties

As of January 2023, the obligations set forth in the Act will apply to companies with at least 3,000 employees and a registered office or branch in Germany.⁸ In January 2024, the obligations of the Act will extend to companies with at least 1,000 employees with a registered office or branch in Germany.

Companies with fewer than 1,000 employees are categorized as small and medium enterprises (“SMEs”). The Act will affect SMEs because SMEs must comply with the due diligence obligations of the Act to engage in business dealings with larger companies that are expressly covered by the Act.⁹ By conducting business with larger companies, SMEs are integrated in larger companies’ supply chains. Because the Act requires companies to ensure that third-party suppliers comply with the standards set forth, and because SMEs frequently maintain supplier relations with large companies, SMEs must anticipate compliance obligations set forth in the Act.

c. Due Diligence Obligations

The obligations set forth in the Act require affected companies to establish a risk management system, allocate responsibility to a specific officer of the company, conduct regular

⁷ BUNDESREGIERUNG.DE, *supra* note 3.

⁸ *The new Supply Chain Act in detail: Due diligence obligations and what to do now*, RODL & PARTNERS (Mar. 10, 2021), <https://www.roedl.de/themen/lieferkettengesetz-unternehmen-details-sorgfaltspflichten-was-zu-tun-ist#sorgfalt>.

⁹ *Five myths about the German Supply Chain Act*, CMS LAW-NOW (Jan. 1, 2022), <https://www.cms-lawnow.com/ealerts/2022/01/five-myths-about-the-german-supply-chain-act>.

risk analyses of all elements of the supply chain, establish preventive measures in the company's operations with direct suppliers, implement remedial action, establish grievance mechanisms, and document and report findings.¹⁰ Companies may elect to instate a Human Rights Officer responsible for overseeing the risk management system. The Human Rights Officer need not be a new position, and the responsibilities assigned to the role may be carried out by an existing employee, such as Chief Compliance Officer.¹¹

The duties of the Human Rights Officer include conducting risk analyses. For direct suppliers (i.e. contractual partners), risk analyses must be conducted proactively and systematically on an annual basis.¹² For indirect suppliers (companies that belong to the supply chain of the company but are not its contractual partners), risk analyses may be conducted by the Human Rights Officer on an ad hoc basis when the company gains “substantiated knowledge” of a potential human rights or environmental violation.¹³ “Substantiated knowledge” refers to factual indications “that make the violation of a human rights or environmental obligation at an indirect supplier appear plausible.”¹⁴

Required risk analyses should assess a company's business activity and business relationships to identify potential human rights violations.¹⁵ The Human Rights Officer should

¹⁰ *Frequently Asked Questions on the Due Diligence in Supply Chains Act*, AGENCY FOR BUS. & ECON. DEV., <https://wirtschaft-entwicklung.de/en/> (choose “FAQ Due Diligence Act” from “Topics”).

¹¹ CMS LAW-NOW, *supra* note 9.

¹² *Id.*

¹³ *Id.*

¹⁴ AGENCY FOR BUS. & ECON. DEV., *supra* note 10.

¹⁵ Sebastian Runz, *Guide to the German Supply Chain Due Diligence Act*, TAYLORWESSING (Jul. 28, 2021), <https://www.taylorwessing.com/en/insights-and-events/insights/2021/07/guide-to-the-german-supply-chain-due-diligence-act>.

conduct supplier interviews, conduct on-site inspections, and seek discussions with local trade unions. A risk analysis is adequate if it prioritizes the identified risks and takes some action to mitigate those risks.¹⁶ Companies should prioritize risks according to “(i) the nature and scope of the business, (ii) the company’s ability to influence the immediate violator, (iii) the expected severity of the violation, (iv) the reversibility of the violation, (v) the likelihood of the violation occurring, and (vi) the nature of the contribution to causation.

The grievance mechanism required under the Act should explain the complaint process to employees and provide employees in all steps of the supply chain with access in the form of a website or other direct channels.¹⁷

d. Penalties

Companies that violate the due diligence obligations set forth in the Act may be subject to fines of up to €8 million or more and sanctions which will restrict economic activity in German markets.¹⁸ In addition to fines and sanctions, companies neglecting due diligence obligations may be subject to civil liability because section 11(1) of the Act permits domestic trade unions and non-governmental organizations to assert claims on behalf of persons claiming to be a victim in German courts.¹⁹

II. The E.U. Whistleblower Directive

a. Purpose and Scope

¹⁶ AGENCY FOR BUS. & ECON. DEV., *supra* note 10.

¹⁷ *Implementation by enterprises, CSR*, <https://www.csr-in-deutschland.de/EN/Business-Human-Rights/Supply-Chain-Act/Implementation-by-enterprises/implementation-by-enterprises.html>.

¹⁸ CMS LAW-NOW, *supra* note 9.

¹⁹ *Id.*

The Whistleblower Directive was enacted in December 2019 and reflects public pressure to take whistleblower protections seriously.²⁰ In effect, the directive requires each of the twenty-seven E.U. Member States to transpose the directive into their respective legal systems subject to a two-year deadline (December 2021). Following the Covid-19 pandemic, the E.U. has not yet enforced the two-year deadline, though it is likely that Member States that missed the deadline may incur penalties. As of June 2022, only nine Member States have implemented the directive.²¹

The directive requires a three-tiered model of reporting.²² It specifies that companies subject to the directive will implement internal reporting channels by which persons may file complaints.²³ Additionally, the directive requires Member States to establish external reporting channels at “competent authorities.”²⁴ Finally, whistleblowers making public disclosures may qualify for protections under the directive if they meet the requirements of Article 15.²⁵ The directive protects employees and independent contractors, but also family members of employees, former employees, volunteers, day laborers, and employees of suppliers.²⁶ Importantly, the directive is a first step toward greater whistleblower protections. Many countries may identify the

²⁰ Vigjilencja Abazi, *The European Union Whistleblower Directive: A ‘Game Changer’ for Whistleblowing Protection?*, 49 INDUS. L. J., 640 (2020).

²¹ EU WHISTLEBLOWING MONITOR, <https://www.Whistleblowingmonitor.eu> (last visited Jun. 11, 2022).

²² Abazi, *supra* note 19.

²³ *Id.*

²⁴ Council Directive 2019/1937, art. 10, 2019 O.J. (L 305) 17, 39.

²⁵ Council Directive 2019/1937, art. 15, 2019 O.J. (L 305) 17, 41 (Protections are available for public disclosures when (a) no appropriate action has been taken following an initial report through internal or external channels, or (b) when the person has reasonable grounds to believe that the breach represents a public threat or the possibility of retaliation is high.).

²⁶ *What is the European Whistleblower Directive?*, NATIONAL WHISTLEBLOWER CENTER, <https://www.whistleblowers.org/what-is-the-european-whistleblower-directive/>.

need for greater whistleblower protections, but the directive effectuates change by providing whistleblowers with legal protections.²⁷

At a minimum, laws passed by Member States must require companies to establish internal reporting channels.²⁸ The channels must be secure and confidential. Each country may determine its preferred degree of anonymity, but confidentiality will increase the likelihood of robust reporting.²⁹ The directive sets forth that companies must acknowledge receipt of the report within seven days of filing; additionally, companies must maintain auditable records to enhance transparency. Companies must entrust the responsibility of managing whistleblowing reports with dependable employees and educate their workforces on how to utilize the channels.

Whistleblowers may report violations of E.U. policies in a number of areas, including: (i) public procurement, (ii) financial services, products and markets, and prevention of money laundering and terrorist financing, (iii) product safety and compliance, (iv) transport safety, (v) protection of the environment, (vi) radiation protection and nuclear safety, (vii) food and feed safety, animal health and welfare, (viii) public health, (ix) consumer protection, (x) protection of privacy and personal data, and security of network and information systems, (xi) breaches affecting the financial interest of the E.U., and (xii) breaches relating to the E.U. internal market.³⁰

²⁷ Marie Terracol & Ida Nowers, *Are EU Countries Taking Whistleblower Protection Seriously?*, TRANSPARENCY INTERNATIONAL, (Mar. 24, 2021), <https://www.transparency.org/en/blog/are-eu-countries-taking-whistleblower-protection-seriously>.

²⁸ Jan Stappers, *EU Whistleblower Directive: Addressing Differences in Country Transposition*, JD SUPRA (Apr. 19, 2022), <https://www.jdsupra.com/legalnews/eu-whistleblower-directive-addressing-7232676/>.

²⁹ Abazi, *supra* note 20.

³⁰ Antonio Carino, *EU Whistleblower Directive: Key provisions, SOX comparison and Actions for business*, DLA PIPER (Dec. 2021), <https://www.dlapiper.com/en/europe/insights/publications/2021/06/whistleblowing-guide/key-provisions-sox-comparison-actions-for-business/>.

b. Status Report

As of June 2022, the following nine E.U. Member States have enacted legislation to implement the new directive: Croatia, Cyprus, Denmark, France, Latvia, Lithuania, Malta, Portugal, and Sweden.³¹ For some nations such as France, the directive is implemented as amendment to existing law.³² For other countries such as Sweden and Denmark, the directive is transposed into national law in its entirety.³³

Of the twenty-seven E.U. Member States, seventeen delayed transposing the directive. Those countries are Austria, Belgium, Bulgaria, the Czech Republic, Estonia, Finland, Germany, Greece, Ireland, Italy, Luxembourg, Poland, Romania, Slovakia, Slovenia, Spain, and the Netherlands.³⁴ According to EU Whistleblowing Monitor, Hungary is the only E.U. Member State that has not yet begun transposing the provisions of the directive.³⁵

c. Regional Differences

The open-ended nature of the directive means that companies must structure whistleblowing policies and procedures to accommodate requirements of different countries.

³¹ EU WHISTLEBLOWING MONITOR, <https://www.whistleblowingmonitor.eu/> (last visited Jun. 11, 2022).

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

Substantive differences in laws enacted by E.U. members pose a threat to well-meaning companies that lack the legal sophistication or compliance resources to implement reporting channels.³⁶

The laws enacted by the Latvian and Lithuanian parliaments reflect this challenge. Latvia and Lithuania enacted laws with broad scope. The Latvian whistleblower law covers “any violation which is harmful to the public interest.”³⁷ At this time, Latvia is the only country to extend whistleblower protections to persons reporting crimes related to the environment and climate change.³⁸ The Lithuania law, titled “*Law on Protection of Whistleblowers of the Republic of Lithuania*,” requires public and private sector institutions to ensure employees may safely report possible wrongdoings in the workplace.³⁹ This law uniquely grants Lithuanian courts the authority to award compensation to whistleblowers.⁴⁰ The laws passed by the Lithuanian and Latvian parliaments illustrate the challenges which trans-European companies face. The difficulty is exacerbated by the failure of many Member States to meet the deadline. Companies that implement changes today should anticipate revising whistleblowing policies as more Member States enact versions of the directive.

³⁶ Austin Max Scherer, *The EU Whistleblower Protection Directive in the Context of the Jonathan Taylor Extradition*, 37 INT’L ENF’T L. REP. 210, 211 (2021).

³⁷ Ana Popovich, *Latvia Passes Whistleblower Law in Accordance with EU Whistleblower Directive*, WHISTLEBLOWER NETWORK NEWS (Feb. 3, 2022), <https://whistleblowersblog.org/global-whistleblowers/latvia-passes-whistleblower-law-in-accordance-with-eu-whistleblower-directive/>.

³⁸ Anna Mezale, *New compliance measures in Latvia: Whistleblowing Directive*, BNT ATTORNEYS IN CEE (Mar. 9, 2022), <https://bnt.eu/legal-news/new-compliance-measures-in-latvia-whistleblowing-directive/>.

³⁹ EU WHISTLEBLOWING MONITOR, *supra* note 31.

⁴⁰ Stappers, *supra* note 28.

III. Modern Solutions for Emerging Challenges

a. Digital Tools

With respect to the Supply Chain Act, companies should expect significant reliance on digital tools to acquire information. To comply with the due diligence obligations, companies should consider implementing live trainings and interactive employee sites to increase the flow of information.

Additionally, companies should implement fully-integrated grievance mechanisms that accommodate direct and indirect third-party suppliers. Such complaint systems will be enhanced by employing artificial intelligence to provide real-time answers for employees and free up the capacity of legal personnel. The grievance mechanisms must be available and approachable for employees. Compliance departments have an obligation to ensure that their complaint systems are available in multiple languages. The grievance mechanism should reflect the technology available to persons in the supply chain; for some companies, this may require implementing written and in-person complaint procedures. Companies may also consider outsourcing their complaint systems to reliable specialist vendors in order to provide their employees with more expedient responses.

Remote Investigations are another tool which many companies employed during the Covid-19 pandemic to investigate potential human rights violations. Remote investigations may be a valuable component of a robust compliance strategy, but companies must consider the efficacy of on-site audits to ensure compliance from third-party partners. The best investigative policies will blend remote and on-site investigations to maximize efficiency and demonstrate the importance of supply chain compliance to employees.

b. Transparency & Cooperation

Supply chains should have transparency with sufficient depth of information, from the direct supplier to the raw material needed for the components or materials. With respect to the Whistleblower Directive, companies should log disclosures digitally, conduct prompt investigations, and establish consistent reporting procedures.⁴¹

To respond to the challenges presented by the Supply Chain Act, companies must tailor their approaches based on their specific needs. The Business & Human Rights Initiative from the German Federal Ministry of Labour and Social Affairs offers practical guidance for affected companies.⁴² Implementation must account for the core tenets of the Act while simultaneously individualizing the risk management policy to satisfy the needs of that affected company. To fully appreciate the human rights risks present in a supply chain, the affected company should cooperate with third-party suppliers to identify the particular risks inherent to an industry or practice.⁴³

Companies should also standardize their responses to violations. Standardized sanctions will provide employees with clear expectations. Additionally, standardized responses will yield greater opportunities for data acquisition and may ultimately make it easier for companies to implement artificial intelligence in their compliance programs.⁴⁴ With respect to the Whistleblower Directive, compliance departments should not wait for all Member States to transpose the directive. Instead, companies can implement procedures which meet the minimum

⁴¹ Simon Stephen & Connie Cliff, Article, *Public Interest Disclosures: Workplace Whistleblowing in the UK*, W-018-0959 (2021).

⁴² CSR, *supra* note 17.

⁴³ *Id.*

⁴⁴ Centre for Regulatory Strategy, *AI and Risk Management: Innovating with Confidence*, Deloitte UK (2018), www2.deloitte.com/global/en/pages/financial-services/articles/gx-ai-and-risk-management.html.

requirements set forth under the directive and monitor helpful online resources like EU Whistleblowing Monitor to stay up to date on the legal developments.

Conclusion

The Supply Chain Act requires companies doing business in Germany to make potentially significant changes to their risk management procedures. Companies should prepare to conduct risk analyses of their suppliers, both direct and indirect. These analyses may require appointing a Human Rights Officer, though many companies will elect to assign the duties of this new role to existing members of a compliance department. Additionally, these affected companies must implement grievance mechanisms to provide employees with necessary channels for reporting violations.

The E.U. Whistleblower Directive sets minimum standards for the protection of employees who report violations of some E.U. laws. The direct difficulty presented by the Whistleblower Directive is inconsistent transposition- companies doing business in multiple E.U. States should expect significant variance with respect to the scope of obligations. By utilizing digital tools to standardize policies for prevention, detection, and response, international companies can ensure that they comply with the law in each E.U. Member State.

The Supply Chain Act and the Whistleblower Directive present new challenges for companies seeking to do business around the globe. Companies can prepare by staying up to date with these new laws as they continue to develop.