

## TRANSPORTATION

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### IN THIS ISSUE

*ESG (Environment Social and Governance) concerns are taking on increased attention and importance around the globe, causing governments to pass new legislation designed to drive ESG initiatives forward. The German government recently passed legislation requiring German companies and indirectly, many foreign companies, to adopt due diligence measures related to promoting human rights and environmental protection within their supply chains. Failure to comply can lead to hefty penalties. Any company that supplies German companies or suppliers of German companies may be affected by this new legislation.*

## New German Supply Chain Act – New Challenges and Exposure for Companies Doing Business in Germany

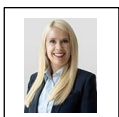
### ABOUT THE AUTHOR



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This IADC Committee was formed to combine practices of aviation, rail, maritime with trucking together to serve all members who are involved in the defense of transportation including aviation companies (including air carriers and aviation manufacturers), maritime companies (including offshore energy exploration and production), railroad litigation (including accidents and employee claims) and motor carriers and trucking insurance companies for personal injury claims, property damage claims and cargo claims. Learn more about the Committee at [www.iadclaw.org](http://www.iadclaw.org).



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*The International Association of Defense Counsel serves a distinguished, invitation-only membership of corporate and insurance defense lawyers. The IADC dedicates itself to enhancing the development of skills, professionalism and camaraderie in the practice of law in order to serve and benefit the civil justice system, the legal profession, society and our members.*

Following the lead of other countries in Europe and around the world, the German Federal Parliament (on 11 June 2021) and the German Federal Council (on 25 June 2021) passed new ESG (Environmental, Social and Governance) legislation called the German Act on Corporate Due Diligence in Supply Chains – commonly referred to as the “Supply Chain Act.” This Act is designed to impose new due diligence obligations on companies, both to protect human rights and to apply environmental standards to companies’ supply chains.

The Act will come into force on January 1, 2023. Beginning at that time, companies with more than 3,000 employees will be required to comply with new due diligence obligations in relation to both their direct and indirect suppliers. This will require them to identify and eliminate or minimize human rights and environmental risks in their supply chains.

Beginning in 2024, the compliance threshold will be reduced, applying to companies with as few as 1,000 employees. For purposes of calculating the number of employees, group companies are included in the calculation of the parent company’s employees. Even temporary workers may be included in the calculation under some circumstances.

Companies and their attorneys located outside of Germany may issue a sigh of relief and conclude from the above that this law does not apply to them. But that conclusion may be wrong! Significantly, this law’s application is not limited just to German companies. Foreign companies that have

subsidiaries, joint ventures and even branch offices in Germany will be required to comply if they meet the requisite employee number thresholds. Moreover, foreign supplier companies and sub-supplier companies also will be impacted by the new law indirectly because of its requirement that certain obligations be extended and/or transferred to those parties as well. This is truly a law with extraterritorial reach.

### **Requirements of the Act**

As mentioned above, the Act is attempting to correct both human rights and environmental problems that are embedded and hidden in global supply chains. Therefore, it imposes comprehensive due diligence obligations on companies in Germany and the companies that supply them to ferret out such problems and eliminate them.

The following are some of the requirements of the Supply Chain Act:

- Establishing a risk management system, beginning with a risk analysis;
- Developing a policy statement for their environmental and human rights strategy;
- Creating a management system to ensure compliance within the company’s entire supply chain, including direct suppliers, indirect suppliers and even some individual suppliers at the end of the supply chain;
- Implementing certain preventive measures, including imposing certain

specified obligations on direct suppliers, such as Code of Conduct obligations, not violating forced labor or child labor laws, avoiding environmental pollutants in operations, etc.;

- Establishing both preventive and remedial measures for their indirect suppliers, in the event the company obtains substantiated knowledge of possible human rights violations or violations of environmental obligations by indirect suppliers'
- Reporting annually on their compliance with the required due diligence obligations;
- Creating or expanding a whistleblower process to report violations when they occur.

### **Penalties Under the Act**

Companies covered by the Supply Chain Act that fail to comply with applicable requirements, including foreign companies, may find themselves to be the recipients of hefty sanctions. Fines for violating the due diligence and reporting obligations, up to €8 million, can be imposed, depending on the nature and seriousness of the violations. Failing to take remedial actions or to implement an appropriate remedial action plan with a direct supplier may result in even greater penalties. For companies with an average worldwide annual turnover of more than €400 million, fines for non-compliance may reach up to 2 per cent of their total worldwide annual group turnover.

### **Impacts on Suppliers**

The Supply Chain Act also will impact direct and indirect suppliers to German companies covered by the Act. These suppliers should expect changes to their supply agreements with German customers who are covered by the Act. Those customers must require their suppliers to comply with the new supply chain obligations, regardless of the suppliers' size.

Among the topics foreign suppliers now will need to discuss and address with their German customers are the following:

- Which human rights and environmental risk due diligence obligations will be transferred and extended to suppliers?
- Among those due diligence obligations, which ones also must now be transferred and extended to the supplier's own sub-suppliers?
- What are the analysis, documentation and reporting obligations that the supplier and its own sub-suppliers now have under the Act?
- What audit and control rights will the customer have against the supplier, and which of those rights will need to be requested from sub-suppliers down the supply chain?

### **Preparation for Compliance**

Given the implementation schedule, companies that will be covered by the Act, their suppliers and their attorneys should begin raising awareness of the Act and its obligations within their company and among their suppliers. They should also begin taking steps now to prepare. After conducting an appropriate risk analysis, other early steps would include developing a policy statement as to their strategy and a preventative system to manage the company's supply chain and implement new processes to ensure compliance throughout their entire supply chain.

A comprehensive review of supply contracts and re-negotiation of terms to account for new obligations imposed by the Act should be initiated. Warranties and representations by suppliers concerning business practices and compliance with human rights and environmental laws will take on added importance, as will indemnification provisions should such representations and warranties be untrue, leading to penalties against the customer that relied on them. Foreign suppliers should anticipate much harder negotiating by their German customers, given the potential exposure flowing to the customers from violation of the Act.

### **Litigation to be Expected**

This new legislative change is likely to lead to litigation (or arbitrations) for many companies. In addition to regulatory litigation over company compliance with the

Act, there also is likely to be contractual litigation and international arbitration among the customer companies, their suppliers and sub-suppliers. Indemnification provisions included in revised supply agreements will be important for sorting liabilities among those parties.

Even beyond such litigation or arbitrations directly related to the Act, attorneys should anticipate other litigation or arbitrations indirectly related to such legislation. Many companies can be expected to not plan ahead and prepare in advance for compliance with the Act. It is likely that this will result in last-minute aborted deliveries of goods and supply chain disruptions. Failed delivery of goods will lead to other breaches of contracts and consequential damage claims. Companies and their attorneys should pay attention to force majeure language in their contracts and analyze whether they will be protected in the event that such supply chain disruptions occur as a result of legislative changes like the Supply Chain Act.

### **Conclusion**

Given the keen global interest and emphasis on expanding ESG initiatives, it is likely that the Supply Chain Act is not the final legislation of its type that companies will need to follow. Companies engaged in global commerce and their attorneys should anticipate further legislation around the globe, with similar extraterritorial application, attempting to address human rights and environmental ills that exist. Therefore, becoming compliant with the



Supply Chain Act now may ease the ability of companies to comply with other legislation that will be coming. Attorneys representing these companies should make an investment now in learning about such legislation so that they can better advise their clients on how to navigate compliance and proactively plan for additional legislation to come.

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