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# Germany's New Supply Chain Act – Part 3 of 4 – Litigation

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On 11 June 2021, the German parliament approved the Federal Act on Corporate Due Diligence Obligations in Supply Chains ("*Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten – Lieferkettensorgfaltspflichtengesetz – LkSG*") – **German Supply Chain Due Diligence Act**.

## Overview

The Supply Chain Due Diligence Act (the "Act") does not create any new civil liability for in-scope companies. The Act does, however, increase the risk to companies of litigation under the existing civil liability regime by allowing for representative actions by trade unions and NGOs on behalf of potential tort victims.

This represents a political compromise. It was reached after long and heated debate between those who wished to expand and those who wished to limit corporate liability for impacts in supply chains. That debate took place against the backdrop of the Jabir v KiK case ("Jabir case"). In that case, a German clothing retail company was sued in Germany by the victims of a fire in a textile factory operated by one of the company's suppliers in Pakistan in 2012.

According to the claimants, the work safety measures enforced by the operator of the factory did not satisfy the minimum labour law standards set out in a code of conduct. The code of conduct was agreed with the German company and was based on "relevant rules of the United Nations". The claimants argued that the non-compliance with the code of conduct caused the severity of the damages.

The German courts considered whether the German company was potentially liable under tort and contract law. Eventually, the German courts dismissed the claim because the tort law claim was time-barred under Pakistani law and that there was

no basis for a contractual claim. The new Act provides for a clarification that it is not intended to change this legal regime.

## What is new: trade unions and NGOs will have standing to bring claims

In the lead up to the adoption of the Act, some argued that the Act should lower the barriers to access to remedy in Germany for foreigners who allege that a German buyer is responsible for harm caused by its own purchasing practices or actions by its foreign suppliers. Without the support of a foundation or an NGO, the costs and difficulties of bringing such claims are strong deterrents to potential claimants.

The Act lowers such barriers by allowing German trade unions and NGOs to litigate on behalf of claimants who assert claims based on the violation of "predominantly important interests". The trade union or NGO must have a permanent presence and its articles of association must demonstrate that its purpose is to advocate for human rights. Trade unions and NGOs can be expected to bring mass claims against companies under this new representative action regime.

## Tort claims: foreign law applies

As a rule, non-contractual liability for extraterritorial human rights violations is governed by foreign law.

Article 4 (1) of the Rome II Regulation points to the law of the state in which the direct damage occurred. For example, the German courts decided the *Jabir* case in accordance with Pakistani tort law. Referring to an expert opinion on Pakistani law, the Court dismissed the tort claim as time-barred.

The new Act does not affect the choice of law rule laid down by the Rome II Regulation. Therefore, German law, in particular the general tort law provision in section 823 of the German Civil Code, will only apply to supply chain liability cases in very exceptional circumstances, *e.g.* in the case of a "manifestly closer connection" within the meaning of Article 4 (3) of the Rome II Regulation. As noted above, the new Act also does not create any new cause of action under German law.

A proposed EU directive may, however, introduce changes to the applicable law. As we reported here, on 10 March 2021, the European Parliament adopted a resolution with recommendations to the European Commission, including a proposal for an EU directive on corporate due diligence and corporate accountability (see Part I of our series)[1]. The European Parliament's proposal is to qualify the relevant due diligence obligations as "overriding mandatory provisions" and thereby ensure that they will apply regardless of the otherwise applicable tort law. Further, the proposal seeks to establish certain standards for national law rules on civil liability. In particular, under the proposed directive, EU Member States must ensure that companies can be held liable under national law for any harm suffered due to human rights violations, failure to comply with good governance principles or environmental damage that they, or companies under their control, have caused or contributed to. Companies will not be held liable if they can prove that they took all due care in line with the directive, or that the harm would have occurred even if all due care had been taken.

## Contractual liability: maybe

Under German civil law, a contract between the in-scope company operating in Germany and a supplier may be construed in a manner that gives a direct contractual claim to the supplier's employees.

In the *Jabir* case the supplier had agreed to respect a code of conduct. The code of conduct stipulated minimum standards, in particular with regard to the working conditions in the production facilities and the occupational safety and remuneration of the employees. The German courts discussed if this contractual arrangement granted a direct claim to the supplier's employees against the German company. Eventually, the German courts rejected the contractual claim as a result of their interpretation of this specific contractual arrangement.

Under the Act there will be room for similar considerations. Under Section 6, paragraph 4 of the

[1] Part 1 can be found here.

Act, the in-scope company active in Germany (falling under the scope of the Act due to exceeding the relevant number of employees) has to obtain a contractual commitment from the direct supplier that the supplier will adhere to human rights related and environmental standards and will enforce this obligation and the relevant standards adequately throughout the supply chain. The in-scope company operating in Germany has to verify the fulfilment of the undertaking by agreeing upon adequate control mechanisms with the direct supplier.

In the event of a claim by a supplier's employee, the German courts will need to establish if the relevant code of conduct agreed between the in-scope company and its supplier can be interpreted either (i) to grant the supplier's employees a direct entitlement to a contractual claim; or (ii) to oblige the in-scope company to comply with protection duties towards the supplier's employees. As a rule, the question of whether a supplier's employee has a direct entitlement to a contractual claim against a buyer will be governed by the law governing the supply contract (which will often be German law). The question of whether the company operating in Germany is obliged to comply with protection duties towards the supplier's employees will be governed by the tort law of the foreign jurisdiction where the damage occurred.

For both potential causes of action, an obvious counter-argument is that the relevant code of conduct may give the employees' rights against the supplier in the event of a breach of the code of conduct rather than against the company operating in Germany. However, the potential liability of the buyer (as well as the supplier) will depend on the precise wording of the supply agreement and the code of conduct. Supply agreements often contain a clause excluding third-party beneficiary rights.

## Our briefings on the German Supply Chain Due Diligence Act

This briefing is Part 3 of a series of briefings aiming at providing an overview of the key elements of the new German Supply Chain Due Diligence Act.

Our series will consist of the following briefings:

Part 1: Introduction (updated 22 June 2021)[2]

Part 2: Compliance[3]

Part 3: Litigation

Part 4: FAQs

## Key points

The Supply Chain Due Diligence Act is aimed at public law enforcement as discussed in Part 2 of our series. It does not bring clarification with regard to potential private civil liability of German corporates for violations of human rights and environmental standards in their supply chains. The Act introduces German trade unions and NGOs as potential new claimants in supply chain related litigation. This option may lead to the bundling of a large number of claims, which may in turn result in considerable financial and reputational risks for corporates active in Germany with the relevant number of employees. The merits of such claims will mostly depend on foreign law and on the interpretation of the contractual arrangement with the supplier.

2 Part 1 can be found here.
3 Part 2 can be found here.

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