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Freight forwarders are required to audit carriers for the purpose of spot market dealings

In this interview, Martina Farkas, a partner of the law firm Linklaters, provides reasons why the German Supply Chain Due Diligence Act (*LkSG*) is expected to change procedures in transactions between parties unknown to each other, which have been customary on the spot market.

Q: DVZ: Why does the German Supply Chain Due Diligence Act focus on principals in order to achieve humane employment conditions?

A: Martina Farkas: As the German legislator often has little or no influence on violations of law abroad, it seemed to be the easiest way to place an initial focus on German enterprises. Frequently, these are also last in the supply chain. As a side fact, the act does not only address principals: enterprises are also responsible for their direct suppliers. So in cases where they actually become aware of violations occurring further down the supply chain, they are still under a due diligence obligation and/or are still – indirectly – responsible.

Q: What do these obligations mean?

A: Enterprises are responsible for their value chain with a view to achieving the protective goals of the act. They are required to make continuous appropriate efforts to ensure compliance with these due diligence obligations by analysing the risks they face in this context. This includes seeking to achieve supply chain transparency.

Q: This risk analysis of direct suppliers is one of the key aspects of the German Supply Chain Due Diligence Act. What are the requirements of the act regarding this risk analysis?

A: Risk analysis forms the basis of risk management. Therefore, enterprises need to carry out risk analyses both regarding their own operations and regarding those of their direct suppliers. They must do so now, as the act is entering into force, and they will have to do so subsequently, once a year and if there is reason to do so. For example, the intention to establish a new business relationship within the supply chain is a possible reason to do so.

Q: What is a reasonable approach for enterprises to take to such analyses in order to meet their obligation?

A: That is the essential question. The answer very much depends on the individual enterprise, on the structure of the supply chain and on the risks for the subject matters protected. Enterprises can audit direct suppliers e.g. by carrying out own checks on site, by instructing third parties to conduct audits and by using accredited certification and audit systems. In any event, enterprises are well advised to stipulate their rights to receive information and to monitor in supply contracts.

Q: What is the relevance of self-certifications and undertakings by suppliers?

A: They are very important, if not essential. Self-certifications by suppliers are one of many indicators in a risk analysis. Often, they are the first step to take, in particular, if they address high-risk issues. Seeking contractual undertakings from direct suppliers is actually one of the examples referred to in the act of preventive measures to be taken by an enterprise if the outcome of its risk analysis is such that action is required. However, enterprises must not rely solely on such an undertaking in order to meet their due diligence obligations. In a large number of cases, carrying out on-site checks is an additional measure to be considered.

Q: Does this also apply to the road freight spot market? If you are a party to transport agreements entered into on digital platforms with parties unknown to you, you will likely not carry out a risk analysis of such parties, will you?

A: The German Supply Chain Due Diligence Act does not exclude spot market transactions. It does not differentiate between spot market transactions and established supply relationships though. This is why it is necessary to carry out a risk analysis when establishing a new business relationship within the supply chain. And, given current practice in the market, this is going to be difficult. It is the very nature of a spot market transaction that the parties to it are not known to each other in advance of the transaction. On the other hand, the parties to contracts concluded in spot markets include carriers that regularly work for one and the same logistics provider. It would be possible to enter into framework agreements with these carriers, subjecting them to supply chain due diligence obligations. If these conditions are met, using platforms will continue to be an option.

Q: When it comes to employment conditions and compensation, it is particularly difficult to carry out a risk analysis regarding lorry drivers of third-party carriers. How can freight forwarders still manage to carry out such an analysis?

A: The German Supply Chain Due Diligence Act requires that employees be protected along the entire supply chain. The rights protected by the German Supply Chain Due Diligence Act are based on different international treaties signed and ratified by Germany. These treaties aim to establish a human rights standard that does not necessarily apply to the same extent worldwide. That human rights standard also includes the right to be paid "appropriate compensation", which is to be in line with the provisions applicable at the place of employment. In any case, compensation must not be lower than the minimum wage under applicable law in the country where the transport is carried out.

Therefore, when choosing carriers, freight forwarders should already consider human rights-related risks, address compliance with human rights in contracts and reach binding agreements enabling them to monitor compliance, for example compliance with the provisions on working times and rest times, e.g. by using tachograph data. Moreover, they should ensure that there are contractual provisions to impose sanctions to punish violations.

Q: What happens if there is a breach of duty?

A: If that is the case, a principal needs to take appropriate remedial measures without undue delay (unverzüglich) to prevent, terminate, or minimise the extent of, the breach of duty. A principal that fails to do so will face severe fines and exclusion from public invitations to tender as well as a significant loss of reputation. If an enterprise is unable to remedy a breach of duty within a foreseeable period of time, it must set a timetable within which it will be able to minimise or terminate such breach. It is also possible to temporarily suspend the business relationship. Only in exceptional cases will it be necessary to end the business relationship completely.

Martina Farkas

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