ESG in Germany: From the European Green Deal to the Supply Chain Due Diligence Act

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Abstract

This article discusses the trend towards environmental, social and governance (ESG)-related laws in Germany in the context of Germany's membership of the European Union (EU). As an EU member state, Germany is subject to a wave of recent directives and regulations that the EU passed as part of its so-called "European Green Deal". However, Germany also has its own tradition of promoting the goal of sustainability in the law, including company law. The article first distinguishes relevant terminology as some regulations refer to ESG, whereas others to "sustainability". It then traces the historic development of such laws in German law, including the traditional debate about the interest of the company in German law. This discussion is followed by a case study that critically examines the German Supply Chain Due Diligence Act of 2021 that continues to be subject to heated political discussions. The article demonstrates how ESG has, in recent years, become a compliance issue in Germany that is now a matter of consideration for boards.

Keywords: sustainability; supply chain; LkSG; company law; implementation; Germany; corporate governance; compliance; human rights; ESG.

[A] INTRODUCTION

In Germany, discussions about ESG in the legal field tend to be framed through the concept of "sustainability". However, there is an increasing reference to ESG not only in practice, but also in the legal literature. Whilst the terms are not identical, they are often used interchangeably in discussions. At European level, ESG tends to be linked particularly to the concept of "sustainable finance". In accordance with the theme of this

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special section, this article will use a broader understanding of "ESG" unless a regulation or the legal text expressly refers to sustainability. This is particularly true for the recent wave of European directives and regulations related to promoting sustainability.

The article will introduce the political and legal discussions surrounding the increasing regulation of ESG. In terms of relevant regulations, the article will follow a dual approach. First, it will provide an overview of the flurry of recent European regulations which were passed as part of the so-called "European Green Deal" during the previous term of the European Commission and Parliament (2019–2024). Whilst these directives and regulations are not national German inventions, they form the core of what is the developing field of "ESG law" in Germany due to Germany's role as an EU member state. Second, the article will address the German Supply Chain Due Diligence Act (LkSG) of 2021 which introduced mandatory human rights and environment-related due diligence obligations on companies. This Act is a significant step forward for the promotion of greater corporate responsibility in Germany, but it is (still) also subject to intense political discussions. It will soon be superseded by the European Corporate Sustainability Due Diligence Directive (CSDDD), but it is still a national law and a core part of the developing legal framework in the area of business and human rights. The LkSG will then also be the focus of a case study in this article as the Act has both strengths and some potential practical challenges for businesses. The LkSG also provides a useful learning experience for other jurisdictions as it gives first-hand insights into the operation of human rights due diligence laws in business practice.

[B] THE POLITICAL ECONOMY AND HISTORY BEHIND THE EVOLUTION OF ESG RULES IN GERMANY

Germany adopted its first sustainable development strategy in 2002 which established quantifiable goals for 21 topics (von Hauff & Ors 2018). Linked to these goals are indicators that can reliably be measured and for which concrete years for the achievement of the objectives could be allocated (Bundesregierung 2022: 4). An example of these is the goal that the market share of renewable energies as part of the final consumption of energy should be increased to 18% by 2020 and to 60% by 2050 (Bundesregierung 2022: 97). The German sustainable development strategy has been regularly updated since (Bundesregierung 2023). The Government regularly reports about the progress with the implementation of the national sustainability strategy through a progress report that is published every four years (Bornemann: 2014). Moreover, every two years the Federal Statistical Office reports indicators about the 21 quantifiable goals (see Statistisches Bundesamt 2021). Moreover, since 2009, all ministries assess the consequences of every piece of legislation and statutory instrument for sustainability (BMUV 2024). The results of this assessment are then reviewed by the Parliamentary Advisory Council on Sustainable Development (Hausding 2022).

As noted above, references to sustainability are more frequent than references to ESG in legal discussions in Germany. In practice, the term ESG tends to be more widely used by consultancy firms and by enterprises themselves and, indeed, in relation to sustainable finance. The reason why it is particularly linked to finance is due to the inclusion of "governance" and the use of criteria and ratings.

Whilst there is no legal definition of what "sustainable development" means in German law (Schomerus 2014: 290), there are references to it in the letter of the law. A general outline of the concept can be found in the German Spatial Planning Act 2008 (*Raumordnungsgesetz*). It notes in section 1(2) that the aim of "sustainable spatial development" would be to reconcile the social and economic demands on land with its ecological functions. Whereas this statutory provision refers to all three dimensions of sustainable development (ie economic, social and environmental aspects), it might nevertheless slightly prioritize the environmental (ecological) pillar as it defines sustainable development as the reconciling of social and economic issues with ecological matters (Schomerus 2014: 290; Hofmanm 2019: §1, rn 28).

Schomerus notes that there is not yet a clearly distinguishable field of the law for "the law on sustainable development" like environmental law or commercial law (Schomerus 2014: 290). Rather, the law on sustainable development concerns all areas of the law. Also, sustainability is generally considered to be a legal principle (Rehbinder 2002: 657). Principles have to be distinguished from rules. Rules are legal norms that consist of conditions and legal consequences and which are applicable to the particular case (Schomerus 2014: 294). Principles, on the other hand, are not based on conditions, but are of general applicability. They need to be concretized by rules in order to be applicable to individual cases.

However, whilst there is no established "law of sustainability" or "ESG law" like contract law, criminal law or company law, there is still scope to argue that this is an emerging field of law. One of the authors of this article has argued elsewhere that sustainability law (or termed ESG law in line with the theme of this article) is an emerging field of law (Rühmkorf 2025: 379). This view is based, *inter alia*, on the number of recent laws such as the (LkSG) or, indeed, the European regulations that were passed as part of the EU's Green Deal. These different pieces of regulation overlap with the different pillars of ESG such as the social dimension (eg human rights) or the environmental side (eg net zero). Some of them contain the word sustainability expressly in their title such as the Corporate Sustainability Reporting Directive 2022 (CSRD) or the Ecodesign Regulation 2024. Moreover, these regulatory developments are also mirrored in the academic scholarship. For example, there are recent textbooks in this area in Germany (see, eg, Podszun & Rohner 2024).

If one applies criteria from academic literature from the common law world about the question of whether or not a new field of law has been developed, then one finds further support for the argument that there is, indeed, an emerging field of law called ESG law or sustainability law. For example, Hamilton applies two necessary criteria for determining whether a scholarly field exists: (i) academic scholarship and (ii) law school courses (Hamilton 1990). If one applies these two criteria to sustainability in Germany, then one finds an increasing number of hits in legal databases. For example, in online searches conducted on 4 December 2024, the main German legal database Beck-Online comes up with more than 1000 hits for the German term *Nachhaltigkeitsrecht* (in English, sustainability law). Similarly, the search term ESG *Recht* (in English, ESG law) produces more than 4000 hits. If one applies the second criterion—law school courses—then there is also a very recent trend towards creating modules on sustainability law in the law curriculum such as, for example, the module "*Nachhaltigkeitsrecht: Wirtschaft, Klima und Governance*" at Ostfalia Hochschule für angewandte Wissenschaften and the "*Master Nachhaltigkeitsrecht*" at Hochschule Hof.

Building on Hamilton, Linnekin and Broad Leib have developed a total of 10 criteria for this question (Linnekin & Broad Leib 2014). It would go beyond the scope of this article to fully engage with these. One of them is "academic centres". And, indeed, one can find academic centres in this area in Germany, for example, the Research Centre for the Law of Sustainable Development at the Martin-Luther Universität Halle-Wittenberg (which was founded in 2024), or subject-specific legal journals. Related to this, there is even a newly founded legal journal with ESG in its title: *ESG • Zeitschrift für nachhaltige Unternehmensführung* (*ESG—Journal for Sustainable Corporate Governance*). New journals in related areas such as climate change (*KlimaR—Klima und Recht*) add to the observation that, indeed, this is an evolving field of law, no matter whether one refers to it as ESG law or sustainability law.

[C] THE REGULATIONS ON ESG IN GERMANY: A BRIEF OVERVIEW

Whilst the term ESG does not feature in the letter of the law, constituent elements of this concept do, in particular sustainability. The following analysis will therefore trace the use of the terms sustainability and sustainable development in German law as proxies for ESG-related laws in Germany.

First, in addition to the recent trend towards using sustainability in the law, one can already trace older references from a few decades ago such as in the Federal Forest Act (*Bundeswaldgesetz*) of 1975. This reference stipulates that it is the objective of forestry policy in Germany to protect the diverse functions of the forest and its proper management in a sustainable manner (section 1 of the Act). Another long-standing use of the term in the letter of the law can be found in the Federal Act for the Protection of Nature (*Bundesnaturschutzgesetz*) 2010. Section 1(1) of this Act refers to "sustainable usability" of natural resources.

For a complete historic depiction of the significance of ESG matters in German law one needs to look at German company law and corporate governance. For a long time now, German company law has been considered to be a "pluralist" or "stakeholder-oriented" model (see, for example, Wen 2011: 326). The German model has thus been put in opposition to the Anglo-American model of "shareholder value". It would go beyond the scope of this article to fully engage with that debate (see instead Rühmkorf 2020). Rather, some key aspects will be mentioned here to contextualize the analysis in this article. This will also provide a suitable framing of and background to the subsequent analysis of the more recent wave of German laws that are intended to promote sustainability.

The pluralist nature of German company law is not found in the wording of directors' duties. Here, section 76(1) of the German Joint Stock Corporations Act (*Aktiengesetz*) 1965 contains a rather neutral wording and it reads as follows: "The management board is to manage the affairs of the company on its own responsibility." It is generally assumed that the board's discretion in managing the affairs of the company is directed towards the interest of the company (*Unternehmensinteresse*). There is, in fact, a longstanding academic debate as to how this interest of the company is to be understood (see Spindler 2007). In essence, the dominant academic view is that there is no preference to any stakeholder group, neither shareholders nor employees, but that directors must decide, on a case-by-case basis, what is best for the company as a whole (Mertens & Cahn 2010: § 76, paragraph 15; Koch 2016: § 76, paragraph 28). This equal standing of the different stakeholder groups does, at least, one thing: it is clear that shareholders are not given priority. Although not a law, the German Corporate Governance Code 2022 has an important role in the practice of German listed companies through its "comply or explain" approach and through the recommendations it makes. In its "Foreword", the Code states:

> The Code highlights the obligation of Management Boards and Supervisory Boards – in line with the principles of the social market economy – to take into account the interests of the shareholders, the enterprise's workforce and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests). These principles not only require compliance with the law, but also ethically sound and responsible behaviour (the "reputable businessperson" concept, *Leitbild des Ehrbaren Kaufmanns*).

This statement is significant insofar as it highlights the equal standing of the different stakeholder groups in the decision-making process of German listed companies. It also emphasizes the aim of sustainable value creation which is an important point at times when short-termism is often seen as one of the flaws of corporate governance. And, indeed, ESG aims to promote companies taking a more long-term approach to doing business.

Rather than the wording of directors' duties, the stakeholder orientation of German company law and corporate governance can be seen through an institutional perspective. The most widely known distinguishing feature of German company law is the two-tier board structure of German joint stock corporations. Depending on the number of employees, the supervisory board has mandatory employee representation of up to 50% of the board in the largest German companies. This compulsory boardroom representation of employees is known as co-determination (du Plessis & Sandrock 2005: 67; Roth 2010: 53). Equal boardroom participation of employees in the supervisory board was first introduced in 1952 for the industry areas of mining and steel. This was then followed by a compulsory 33% representation of employees in companies with more than 500 employees through the One Third Participation Act (*Drittbeteiligungsgesetz*) of 1957. Finally, the Co-determination Act (*Mitbestimmungsgesetz*) of 1976 introduced the equal representation of employees in supervisory boards of large corporations. The supervisory board is not only responsible for monitoring the running of the business by the executive directors, but it is also responsible for appointing and removing executive directors.

Through this important stake in the running of large, listed German corporations employees have gained a significant say and role. This situation provides the context for a generally more consensual approach between employers and employees and also a comparatively smaller role for shareholders in German company law. The increasing number of institutional investors (particularly foreign institutional investors) tries to enhance their role. Yet, from a legal point of view, it is the supervisory board (with the mandatory employee representation) that is central to German company law and corporate governance as it appoints and removes directors. Employees therefore play an important role in deciding who is in charge of their business (Rühmkorf 2020).

In addition to these important features of German company law and corporate governance, there are further regulations on ESG that are relevant here.

First, more recently, following the 2008 global financial crisis, Germany highlighted the importance of long-term approaches in the remuneration of corporate executives. Section 87 of the German Joint Stock Corporations Act now reads: "The remuneration structure of joint stock corporations is directed towards the sustainable and long-term development of the enterprise." Initially, the wording referred to "sustainable" only, but, following some confusion as to whether sustainable was only understood in this section as meaning "long term" (potentially with no regard to the environmental and social pillar of sustainability), a clarification was added and the amended version of this section now refers to "sustainable and long-term development" (see for an analysis of the original version: Röttgen & Kluge 2013: 900). This emphasizes that all three dimensions of sustainability play an important role in the remuneration structure.

As mentioned above, the German Corporate Governance Code plays an important role in practice although it is not a law. The current version of 2022 includes the term sustainability seven times. First, the already mentioned "Foreword", refers to sustainable value creation as an obligation of the board. Second, Recommendation A1 of the Code notes that "corporate planning shall include corresponding financial and sustainability-related objectives". Moreover, Recommendation A3 of the Code states that "the internal control system and the risk management system shall also cover sustainability-related objectives, unless required by law anyway".

These examples from both the German Joint Stock Corporations Act and the German Corporate Governance Code do not only demonstrate the increasing use of and reference to the term sustainability in the context of company law and corporate governance, but they also mean that this principle increasingly permeates the thinking about the purpose of corporations.

As mentioned above, there has been a recent trend towards regulating issues of sustainability in the European Union (EU) and, consequently, in Germany as an EU member state. The recent wave of EU directives and regulations that are intended to promote ESG matters have all been passed under the umbrella of the so-called European Green Deal (Pieper 2022). As mentioned above, in 2020, the European Commission adopted the Green Deal which pursues the EU's aim to become climate neutral in 2050. The political backdrop to the Green Deal was the EU's commitment towards achieving net zero by 2050. The focus of most of these regulations is therefore on reducing emissions and thus aimed at tackling climate change (Pieper 2022). Part of this plan is the review of existing laws in terms of their climate impact as well as the introduction of new laws that help achieve the aim of net zero (Burgi 2021: 1401; Pieper 2022). It could therefore be argued that the environmental pillar of ESG is currently dominant in the European approach towards ESG. However, there are also recent regulations related to the social side and the governance aspect, thus leading to a more holistic approach.

This section will now briefly outline the EU's recent regulatory framework for ESG as part of its Green Deal—ranging from regulations that cover the circular economy to biodiversity and also to human rights in global supply chains. Examples of the different directives and regulations include: the CSRD which, in turn, introduced the European Sustainability Reporting Standards (ESRS) as the new reporting framework, the Ecodesign Regulation 2024, the CSDDD, the Taxonomy Regulation 2020, the Deforestation Directive 2023, the 2024 Directive on the so-called "right to repair" and the proposed Green Claims Directive that is currently part of the legislative process.

The first regulation of this enumeration, the CSRD, is intended to reform and improve the area of non-financial information disclosure by companies (see CSRD, recital 1). Prior to the Green Deal, the rules on reporting of sustainability issues stem from the Non-Financial Reporting Directive of 2014. This Directive focused on the reporting of large, listed, public-interest entities and was criticized for being too restricted in its personal scope (by covering too few companies) as well as for not requiring reporting that is comparable and detailed. Against this background, the new CSRD was developed with the aim of significantly improving both the quality and quantity of reporting (CSRD, recital 20). It entered into force on 5 January 2023. It significantly expands the number of companies that have to report, including small and medium-sized enterprises. Companies subject to the CSRD will have to report according to ESRS. A key aspect of the new reporting is the so-called "double materiality" (Rogg & Rothenburg 2024: 1439). This concept consists of both impact materiality and financial materiality and constitutes an important step of the mandatory sustainability reporting of companies (Rogg & Rothenburg 2024: 1439). Put simply, it means that companies must not only consider how their own business activities impact on sustainability (eg the environment), but also how sustainability issues can affect the company financially (Rogg & Rothenburg 2024: 1439). Assessing double materiality is thus a critical aspect of the non-financial reporting under the CSRD.

Another recent regulation in the list above is the European Ecodesign Regulation of 2024. It establishes a framework for ecodesign requirements for sustainable products and it repeals the European Ecodesign Directive 2009. As a regulation, the requirements automatically apply to the member states. The Ecodesign Regulation 2024 creates a framework of ecodesign requirements for sustainable products with the goal of expanding their lifecycle (Article 1). The regulation, *inter alia*, introduces a digital product passport and otherwise creates rules on the durability, reusability, upgradability and repairability of products.

The EU also adopted a directive on the so-called "right to repair" in 2024. The aim of this directive is to clarify the obligations for manufacturers to repair goods and also to encourage consumers to expand the lifecycle of a product through repair (Gramlich 2024: 209; Seitz 2024: 194). Manufacturers are under an obligation to inform consumers about their right to repair and they have to provide timely and cost-effective repair services (Augenhofer & Küter 2023: 243).

Another significant part of the EU framework are the different regulations and directives that are part of the EU's Sustainable Finance Strategy and which, as mentioned above, are particularly used in the context of referring to "ESG". The Sustainable Finance Strategy consists of the CSRD, the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR) 2019 (European Commission 2023). The aim of these three pillars of the strategy is to move capital flow towards sustainable investment with green business activities (European Commission 2023).

They all share the ambition of the EU to achieve net zero by 2050. The European Green Finance programme started in earnest only in 2018 with the EU Action Plan on financing sustainable growth. The SFDR came into force in 2021. It requires financial market participants to disclose sustainability information so that investors are able to assess how sustainability risks are integrated in the investment decision (Article 1 SFDR). The Taxonomy Regulation came into force in 2022. It creates a European-wide system of classifying business activities. It is intended to provide investors with information so that they can make decisions to invest in sustainable products (see recital 16 of the Taxonomy Regulation). Under the Taxonomy Regulation, businesses must show how sustainable their business and their investments are by conforming to the taxonomy criteria (Article 1 Taxonomy Regulation). The CSRD came into force in 2023 and it significantly increases both the number of enterprises that have to issue non-financial reports and the quality of those reports (Rogg & Rothenburg 2024: 1439). These three pieces of regulation are therefore central to the concept of ESG law.

At the domestic German level, the LkSG of 2021 is a recent law in Germany that was and still is widely discussed not just in academic circles, but also among politicians, non-government organizations and business (DIHK 2023). The Act imposes mandatory human rights and environment-related due diligence obligations on companies. It will form the case study below so will not be analysed here. It is, however, important to note that the European CSDDD which was passed in 2024 (again, after a long lobbying process) differs in some respects from the LkSG and will thus require some amendments to the German law such as the introduction of civil liability.

And, to complement the overview, the German Government that took office in 2021 (the so-called "traffic light coalition" consisting of the Social Democrats, the Green Party and the Liberal Party) has introduced several laws aimed at significantly cutting the use of energy, for example by introducing new rules on the energy efficiency of buildings in the Building Energy Act 2020 (*Gebäudeenergiegesetz*). However, the coalition broke up in November 2024 and, at the time of writing, the indications are that the new coalition consisting of Christian Democrats and Social Democrats is going to significantly review the Act (FAZ 2025).

At the time of writing, the current economic and geopolitical challenges also impact on the EU's approach towards its Green Deal. Whilst the directives and regulations introduced in this overview have all been passed, there are attempts to scale back some of them (European Commission

2025). In February 2025, the European Commission published the so-called "Omnibus Package" which is intended to particularly affect the reporting duties and the human rights due diligence obligations under both the CSRD and CSDDD. The aim of the proposals is, in the words of the Commission, "to simplify" which, in practice, means to reduce the obligations that companies have under the CSRD and CSDDD as passed.

[D] IMPLEMENTATION OF ESG IN GERMANY: THE SUPPLY CHAIN DUE DILIGENCE ACT

Given that it is the most widely discussed ESG-related piece of law in Germany, the LkSG will be discussed in this section as a case study. It serves as an example of a law that can be considered to be a success, but one that also has limitations.

As indicated above, the Act was passed in June 2021 after years of intensive political discussions about whether or not Germany should pass a law that imposes binding obligations on companies for their supply chains. One example for a similar law in Europe that, like the LkSG, imposes mandatory human rights due diligence obligations on companies is the French *Loi de Vigilance* (Vigilance Law) of 2017. The German LkSG has been in force since 1 January 2023. Due to space constraints, only its key characteristic features will be addressed here.

Since 2024 the LkSG has applied to all enterprises in Germany with over 1000 employees (from 2023, it initially applied to enterprises with over 3000 employees), see section 1. As the Act uses the term "enterprise" rather than company, this term will be used where references are made to the LkSG in this article. The Act imposes nine due diligence obligations whose aim is to prevent or to minimize any risks to the interests protected by the Act or to cease the violation of human rights-related or environment-related obligations (section 3). The legal positions that are protected by the LkSG are human rights and environmental issues that arise from the conventions on the protection of human rights listed in numbers 1 to 11 of the annex such as International Labour Organization Core Conventions (section 2; Weigel 2024: §2, paragraph 3).

The due diligence obligations imposed by the Act are:

1. establishing a risk management system;
2. designating a responsible person or responsible persons within the enterprise;
3. performing regular risk analyses;

4 issuing a policy statement;
5 laying down preventive measures in the business's own area of business and vis-à-vis direct suppliers:
6 taking remedial action;
7 establishing a complaints procedure;
8 implementing due diligence obligations with regard to risks at indirect suppliers;
9 documenting and reporting (for the list, see section 3(1)).

All these obligations are subject to a continuous process (BT-Drucksache 19/28649, 2021: 23).

When undertaking these due diligence obligations the enterprises have to meet the standard of "appropriateness" (section 3(2)); Voland & Lohn 2024: §3). This standard is, *inter alia*, determined by the following criteria: the nature and extent of the enterprise's business activities; its ability to influence the party directly responsible for a risk to human rights or environment-related risk or the violation; and the severity of the violation and its reversibility (see Voland & Lohn 2024: §3). An important point to note is that the obligations are obligations of means and not obligations of result.

As the title of the Act suggests, these obligations span over the supply chain of enterprises. However, the LkSG differentiates between three constituent parts of a supply chain: the actions of an enterprise in its own business area; the actions of direct suppliers and the actions of indirect suppliers (section 2(5)). The obligations relate, first and foremost, to the first two levels of the supply chain: the enterprise's own business area (that is, every activity of the enterprise to achieve the business objective which is every activity for the creation and exploitation of products and services, regardless of whether this is carried out in Germany or abroad) (section 2(6)) and to their direct suppliers (these are, within the meaning of the Act, partners to a contract for the supply of goods or the provision of services whose supplies are necessary for the production of the enterprise's product or for the provision and use of the relevant service) (see section 2(7)).

As noted, the situation is different for indirect suppliers. The Act defines indirect suppliers as enterprises that are not direct suppliers and whose supplies are necessary for the production of the enterprise's product or the provision of the service (see section 2(8)). Under the LkSG, due diligence obligations in regard to indirect suppliers only arise where an enterprise has "substantiated knowledge" (section 9(3)). This term is defined in the LkSG as having "actual indications that suggest that a violation of a human rights-related or an environment-related obligation at indirect suppliers is possible" (section 9(3)). Substantiated knowledge can, for example, be gained through employees of the enterprise who notice such a violation during a visit to an indirect supplier (see, for more examples, Depping 2022: §9, paragraph 11; Voland & Lohn 2024: §9, paragraph 11).

The Act is subject to a public enforcement approach that relies on monitoring and enforcement through a public authority, the Federal Office for Economic Affairs and Export Control (BAFA) (see section 19(1)). Enterprises that fall under the scope of the Act must submit an annual report to BAFA (section 12) which then assesses whether the contents meet the minimum requirements of the Act and, in case they do not, BAFA can then demand that the enterprise amends the report within a reasonable timeframe (section 13(2)). Moreover, BAFA has the power to take action to monitor compliance with the due diligence obligations (section 14). This includes the power to make the appropriate and necessary orders and measures to detect, end and prevent violations of the due diligence obligations under the Act (section 15). Accordingly, BAFA can summon people, order the enterprise to submit a corrective action plan within three months and require the enterprise to take specific action to fulfil its obligations (section 15), and it can also enter and inspect the enterprise's premises, offices and commercial buildings insofar as this is necessary for the performance of its duties (section 16). It is important to note that these powers are discretionary, that is, BAFA can decide whether or not to use any of these powers and, if it does so, it has to comply with the principle of proportionality (Depping 2022: §15, paragraphs 9-13).

The consequence of the public enforcement approach is that BAFA has the power to impose fines on enterprises that do not comply with their due diligence obligations (section 24 (1)). The fines can be up to EUR800,000 (section 24(2)) and, in the case of an enterprise with an annual turnover of more than EUR400 million, be up to 2% of the average annual turnover (section 24(3)). Another possible consequence of non-compliance is that enterprises can be excluded from the award of public contracts for up to three years (section 22).

It is rather unusual for an Act on ESG issues to regularly make it into the news. The German LkSG, however, has managed to continue to be mentioned by politicians and businesses and be discussed publicly since it was passed. The reason is that it is an ambitious law that imposes new obligations on companies not only for their domestic supply chains, but also for their international supply chains. The core aim of the Act should not be controversial: the protection of human rights in the supply chain of companies that are based in Germany (BT-Drucksache 19/28649, 2021: 2). However, the way to achieve this aim is disputed due to the impact it has on business practice. The LkSG can therefore be used here both as an example of a successful implementation and as an example of an implementation that is challenging.

First, in terms of success, a direct impact of the Act is that it has managed to bring human rights in global supply chains to the attention of boards of directors. Boards are now taking notice. Before the introduction of this Act, reports about severe human rights violations in supply chains seemed to repeat themselves with little action by business. Companies pursued voluntary initiatives which did little to change the root causes of the human rights violations and which appeared to hardly have an impact on the activities of German businesses in their purchase practices. With the LkSG, the voluntary nature of ESG practices regarding human rights in global supply chains by companies has now come to an end (Ehmann & Berg 2021: 293). Rather than being a choice, human rights due diligence is now a legal obligation (Gehling & Ors 2021: 231). The effect of this situation is that the law has created a level playing field between enterprises as they can no longer choose to opt in or out of addressing human rights in their supply chains.

Also, in the dualistic (two-tier) board structure of German public limited companies, it is the role of the supervisory board to supervise the management board (section 111 of the Joint Stock Corporations Act, *Aktiengesetz*). Depending on the number of employees of the company, up to 50% of the members of the supervisory board are representatives of the employees. As part of their general supervisory role, they also supervise the compliance of the board with the LkSG, including the risk management in accordance with this Act. The Act expressly stipulates that the result of the risk analysis must be communicated internally to the relevant decision-makers such as the board of directors (see section 5(3)). The supervisory board is also a “relevant decision-maker”.

Moreover, the strength of the Act is that it is backed up by a rather stringent public enforcement approach with the BAFA as a public authority in charge of monitoring and enforcement (Ehmann 2021: 141). The Act includes some powerful tools such as BAFA’s right to enter business premises and to obtain documents. Also, the LkSG provides non-governmental organizations and trade unions with special capacity to sue, meaning that they can bring claims on behalf of victims of human rights violations (section 11). Whilst the absence of civil liability in the Act means that this power is somewhat limited in practice, it nevertheless provides a possibly strong enforcement tool.

Third, the threat of sanctions by the public authority means that human rights in global supply chains are now a compliance issue. The topic has therefore been elevated in the hierarchy of businesses. The legalization of ESG issues as a whole has led to the integration of sustainability departments and compliance departments. Consequently, businesses are taking ESG matters much more seriously than they did before.

On the other hand, the LkSG is also an example of the challenges that a law in this area faces. It was a political compromise, as was the European CSDDD. As such, some features have been criticized by businesses and civil society, yet for different reasons (Thalhammer 2021: 832). First, the absence of civil liability means that victims of human rights abuses at the bottom of global supply chains did not gain a remedy against German enterprises. However, this situation will change with the implementation of the CSDDD as the CSDDD does contain such a liability provision. Second, the focus of the due diligence obligations in the LkSG on the enterprise's own area of business and its direct suppliers means that the automatic reach of the obligations is limited. This stands in contrast to the often long and complex structure of global supply chains in practice (Krajewski & Ors 2021: 556). It remains to be seen to what extent enterprises will have to extend their due diligence obligations to indirect suppliers. Therefore, the danger is that the due diligence obligations might not reach those parts of the chains where human rights violations occur, which is usually at sub-supplier factories in developing countries at the bottom of global supply chains (Initiative Lieferkettengesetz 2021). The key question for the practical impact of the Act is therefore whether or not enterprises will be able to effectively hide away between the different layers of their supply chain or whether they will quickly be assumed to have gained substantiated knowledge about the risk of a violation of due diligence obligations.

Another weakness of the LkSG from an ESG perspective is that the Act primarily focuses on human rights obligations, but includes only some environment-related obligations. These play a minor role compared to human rights, however. A noticeable absence in the LkSG is the lack of an obligation related to climate change. This comes as a surprise in light of the general drive towards net zero. Finally, the role of stakeholders is somewhat limited in the LkSG. There is no requirement for a formal stakeholder engagement process (Stöbener de Mora & Noll

2024: 1396). The CSDDD takes a broader view by including multiple stakeholder initiatives into the due diligence obligations (Hagel & Wiedmann 2024: 190).

Overall, one of the main dangers of the LkSG is that businesses might try to comply with the legal obligations by taking a box-ticking approach. This means that businesses might try to simply comply with the letter of the law, but not with the spirit of the law. Such an approach would mean that businesses run the required processes, but do not fully implement the underlying ideas into their business activities. Enterprises taking such an approach might submit a rather generic report that does not contain specific information about the way they have approached their due diligence obligations. Another example of a box-ticking approach would be enterprises that amend their supplier code of conduct and other policies and offer training for their direct suppliers, but that do not work with their suppliers to change the root causes of human rights violations.

[E] RELEVANCE OF ESG IN GERMANY: PROBLEMS AND SOLUTIONS AS WELL AS GLOBAL LEARNINGS

The analysis and the case study have highlighted the trend towards legally regulating ESG matters in Germany and, indeed, at EU level. Whilst the German LkSG is a particularly well known and contentious piece of law, ESG-related laws are a much broader and bigger phenomenon. These ESG laws do not only address particular issues such as preventing human rights violations in global supply chains, but, on the whole, they try to move the business model of the German economy towards pursuing net zero. Through pursuing a more sustainable long-term approach businesses should take a far-reaching view that integrates environmental, social and governance issues.

The analysis in the preceding parts has shown that the move towards ESG in legal regulation marks a significant shift. About a decade ago, not many expected to see the recent wave of regulations. They are all important contributions towards achieving a more sustainable business model. They are not the solutions on their own, but individually and collectively they are part of the puzzle as to how to integrate ESG aspects in the running of business. The case study of the LkSG provides important insights into both problems and solutions of the existing legal framework for ESG.

In terms of solutions, the German experience offers three main findings: first of all, ESG aspects are no longer voluntary issues that some companies adopt on reputational grounds. Through these laws and regulations, it is no longer optional for companies to reduce their impact on the environment and on human rights. The legal framework creates a set of minimum requirements that all companies covered by the respective laws have to comply with. The laws are creating a level playing field which means that it is now a legal obligation for enterprises to pursue ESG goals. It would go too far to consider those laws the solution, but, at least, they will help to shift businesses towards ESG with the obligations that they impose.

Second, and closely related to the first point, the consequence of this development is that ESG has become a compliance issue. Companies have to fulfil legal obligations such as those required by reporting laws or by the German LkSG and face sanctions if they do not. Consequently, ESG aspects are now matters of concern for boards of directors. Companies not only include them in their compliance work, but also employ new staff with legal backgrounds to implement these laws into the operation of the companies. The reporting requirements of the CSRD and the Taxonomy Regulation as well as the supply chain obligations all require enterprises to have staff that deal with this implementation. Surveys have shown that businesses need at least one full-time member of staff for the German LkSG, often three and in some cases even seven members of staff. In short, this means that the move to ESG also means that enterprises need more staff in legal compliance. This is also a challenge, however, as addressed below.

Thirdly, in the past, ESG issues tended to be a niche field in legal studies due to the lack of binding laws. With the flurry of new regulations this picture has changed. In fact, ESG is now becoming a new and growing field of law in Germany. However, the overview of regulations above has shown how broad the concept of ESG is. This means that the actual focus of ESG has to be understood in the context of the regulation in question.

Nevertheless, such a shift also leads to problems. Whilst civil society applauds that legal regulation on ESG matters is finally coming into force and that it is also designed more stringently than ESG-related laws in the past (ie with clear obligations backed up by sanctions for non-compliance), businesses take a different view. They often complain that these new laws increase their regulatory burden and thus increase the cost of production. This argument is particularly used in these times of political and economic uncertainties. Irrespective of one's view on this debate, it is clear that a range of new laws does lead to an increased need for compliance. The process of the implementation of rules into the operation of a business is a challenge. Here, one needs to distinguish between large, listed enterprises and medium-sized enterprises that have a smaller structure. In Germany, the latter group are often family-owned enterprises. They are the ones that find the new regulatory framework harder to implement because they have a smaller staff base and may lack financial means to build up new teams for dealing with new regulatory requirements.

The recent European Green Deal will provide important global learnings. First, it will lead to a harmonized and comparable standard of ESG-related regulations across EU member states, and those, including Germany, can provide useful learnings globally. Second, as legal requirements are being implemented into the operation of enterprises, the feedback from businesses will show which parts of those regulations work and which are difficult to achieve in practice. Other jurisdictions will be able to monitor those developments, and they can then learn lessons from the European experience and design laws accordingly. Third, probably even more important than feedback from business about the operational side of ESG regulations are the learnings about the impact of those regulations. Do they achieve change in business practice? Are they moving enterprises towards a more sustainable business model? Those insights will only slowly emerge over the course of the coming years as more and more EU directives and regulations are coming into force and being implemented into national laws.

[F] CONCLUSION

The article has shown that ESG has become a significant part of legal regulation in Germany in recent years. This is particularly due to a recent wave of directives and regulations from the EU as part of its Green Deal.

The legal framework for ESG has created a level playing field, namely that all enterprises that are within the scope of a law have to comply with it. The impact of this change remains to be seen and only the future will tell to what extent the different pieces of regulation have moved enterprises towards a more sustainable business model.

Some smaller and small-medium sized enterprises find integrating some of the new regulations harder than do large, listed companies. This is particularly due to their comparatively smaller staff base. After all, new regulatory requirements also require employees to deal with their compliance.

The case study has shown that the LkSG has had a significant impact for ESG in legal and business practice. However, the Act does not reach its full potential—evidenced, for example, by the absence of a mandatory stakeholder engagement process. The CSDDD will require amendments to the LkSG. However, at the time of writing, the political climate both in Germany and the EU is becoming increasingly sceptical of the due diligence obligations and the scale of the obligations could be reduced again. That would send mixed messages to businesses, as the existing rules provide a strong basis to improve the human rights record of enterprises and to create more sustainable and more resilient global supply chains. That, in turn, would be a business advantage of enterprises. What is important for the next stage of the ESG regulations that have either recently become law or are about to be implemented into German law soon is to accompany these with sufficient guidance for enterprises. BAFA has produced several guidance notes for the LkSG and these are quite helpful. In other ESG-related laws, a similar approach would help ensure a smooth practical implementation of the new rules into business practice.

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