

GERMANY

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1. How is “ESG” in Germany defined in a corporate/commercial context, and what are its major elements?

Germany has not adopted a formal definition of this term.

2. What, if any, are the major laws/regulations in Germany specifically related to ESG?

Implementation of EU Law

The Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, as EU regulations, are directly applicable in Germany. Please refer to Question 2 of the EU chapter for more information on these regulations.

The Non-Financial Reporting Directive (NFRD), the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDD), as EU directives, on the other hand, require transposition into German law in order to be legally effective in Germany (summaries of the directives can be found in Question 2 of the EU chapter). In order to implement the NFRD, the German Act to Strengthen Non-Financial Reporting by Companies in their Management Reports and Group Management Reports (CSR-Richtlinie-Umsetzungsgesetz) was ratified by the German parliament (Bundestag) on 9 March 2017. The EU proposal to revise the NFRD (the CSRD) has not yet been adopted and consequently also not yet been implemented in Germany. The draft of the CSDD has a similar aim and scope as the German Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz (Supply Chain Act)), which is already in force (see below, German Law, for more information). However, unlike the Supply Chain Act, the CSDD proposal also provides for duties that support the achievement of the EU’s climate targets. Large EU and large non-EU companies must adopt a plan to ensure that a company’s business model and strategy are consistent with the EU’s goals to transition to a sustainable economy and the EU’s actions to limit global warming to 1.5°C as defined in the Paris Agreement, and set its own emission reduction targets where necessary. As an incentive to implement the aforementioned obligations, which must also be seen in the context of climate action, the proposal stipulates that the fulfilment of these obligations is to be positively reflected in the variable remuneration of the management board. It is expected that the Supply Chain Act will be amended in order to implement the requirements set by CSDD once it has been adopted.

German Law

Supply Chain Act

The German Supply Chain Act obliges companies (with their head office, principal place of business, administrative headquarters, statutory seat or branch office in Germany) to respect human rights by implementing defined due diligence requirements. It will apply to companies with at least 3,000 employees in Germany from 2023 and to companies with at least 1,000 employees from 2024.

The Supply Chain Act contains an exhaustive catalogue of 11 internationally recognized human rights conventions. These include, in particular, the prohibition of child labour, slavery and forced labour, the disregard of occupational health

and safety, the withholding of an appropriate wage, the disregard of the right to form trade unions or employee representatives, the denial of access to food and water and the unlawful deprivation of land and livelihoods.

The law sets out the necessary preventive and remedial measures, and obliges complaint procedures and regular reporting. The core elements of the due diligence obligations include the establishment of risk management to identify, prevent or minimize the risks of human rights violations and damage to the environment. Due diligence obligations will apply to a company's own business operations, to the actions of a contractual partner and to the actions of other (indirect) suppliers. This means that a company's responsibility no longer ends at their own factory gate, but exists along their entire supply chain.

If companies fail to comply with their legal obligations, fines can be imposed. These can amount to up to EUR 8 million or up to 2% of global annual sales. The turnover-based fine framework only applies to companies with annual sales of more than EUR 400 million. In addition, if a fine is imposed above a certain minimum level, it is possible to be excluded from the award of public contracts.

First and Second Leadership Positions Act

On 11 August 2021, the German Second Leadership Positions Act (*Zweites Führungspositionengesetz* (LPA II)) entered into force. As a continuation of the First Leadership Positions Act of 2015 (LPA I), the LPA II introduced a minimum participation requirement for men and women in management boards of companies within its scope. It extends commercial reporting obligations and requires companies to disclose and justify target quotas for their board appointments.

Under the LPA I, listed companies and companies with equal co-determination were subject to a fixed gender quota of 30% for their supervisory boards and had to define a target size for male and female participation on their supervisory and management boards (so-called "flexible quota").

The LPA II does not provide for a fixed quota, but prescribes a minimum participation requirement for management boards of listed and co-determined companies of at least one woman and one man if the board consists of more than three members. One common feature with the LPA I is that appointments made in violation of this requirement are void (so-called "empty chair"). In practice, this means that only a woman can be appointed as a member of the management board if a board has more than three members, but not yet a female member. This obligation applies to new appointments from 1 August 2022. Existing mandates can be held until their scheduled end must then be filled in accordance with the requirements of the LPA II.

In addition, listed companies and companies with equal co-determination must now publicly report their target size for appointments to the management board in their annual accounts (part of the management report). The target of zero women on the board must now be justified. Failure to report or inadequate justification are subject to fines. For companies active in capital markets, sanctions can go up to either EUR 10 Million, 5% of the total annual turnover or twice the economic benefit derived from the violation, depending on which is the highest punishment.

The LPA II also creates the option for members of the management board to take a “sabbatical” in the event of maternity leave, parental leave, illness or care of a family member. This is structured as a right to revoke the appointment for a certain period, combined with a right to reappointment at the end of the period.

3. What other laws/regulations in Germany touch on ESG themes?

EU Conflict Minerals Regulation

The EU Conflict Minerals Regulation is directly applicable in Germany. Please refer to Question 3 of the EU chapter for more information on this regulation.

Act to Improve the Fight against Trafficking in Human Beings

The German Act to Improve the Fight against Trafficking in Human Beings and to Amend the Federal Central Register Act and the Eighth Book of the Social Code (Gesetz zur Verbesserung der Bekämpfung des Menschenhandels und zur Änderung des Bundeszentralregistergesetzes und des Achten Buches Sozialgesetzbuch (Act Against Human Trafficking)), which entered into force on 15 October 2016, implements the EU Directive on preventing and combating trafficking in human beings and protecting its victims. Please refer to Question 3 of the EU chapter for more information on this directive. The combating of human trafficking and the support of its victims are strongly supported by the German Federal Ministry of Justice and Consumer Protection (Bundesministerium der Justiz und für Verbraucherschutz).

In the course of the implementation of the EU directive, the criminal provisions for combating trafficking of human beings in Sections 232 to 233a of the German Criminal Code (Strafgesetzbuch) were fundamentally restructured and expanded.

The actual trafficking of human beings (Section 232 of the German Criminal Code) and the forms of exploitation that follow it (forced prostitution, forced labour and exploitation of labour and exploitation using deprivation of liberty – Sections 232a to 233a of the German Criminal Code) constitute serious criminal offenses. The fundamental reorganization and expansion of the relevant criminal provisions was intended to make them more practicable and, in particular, to improve the fight against labour exploitation.

European Shareholder Rights Directive

Following implementation of the second European Shareholder Rights Directive and the revision of the German Corporate Governance Code (Deutscher Corporate Governance Kodex), German stock corporation law stipulates that in listed companies, the supervisory board must align the management board remuneration structure with the company’s sustainable long-term development.

4. What, if any, litigation or enforcement activity has Germany seen related to ESG?

The increasing density of regulations in the environmental and social sector can give rise to additional costs, but also to fines or liability risks. In recent

years, the lawsuits filed/announced by Deutsche Umwelthilfe e.V., a German environmental, nature and consumer protection organization, against, *inter alia*, automobile manufacturers BMW and Mercedes-Benz and the oil and gas group Wintershall Dea over their CO₂ emissions, have made headlines in Germany.

5. What are the major non-law/regulatory drivers of ESG trends and developments in Germany?

Soft non-binding laws

Germany supports various UN instruments that impact businesses, including:

- the UN Guiding Principles on Business and Human Rights;
- the UN's 2030 Agenda for Sustainable Development; and
- the Sustainable Development Goals.

Other soft non-binding laws include:

- The OECD Guidelines for Multinational Enterprises set out recommendations on responsible business conduct for multinational companies that operate in a global context. The Guidelines contain established principles of responsible business conduct in the areas of information policy, human rights, employment policy, environmental protection, anti-corruption, consumer interests, science and technology, competition and taxation. The Guidelines, which form part of the OECD Declaration on International Investment and Multinational Enterprises, are not legally binding, but reflect the Federal Government's expectations towards the business conduct of German enterprises that operate globally. See www.bmwk.de/Redaktion/DE/Downloads/M-O/oecd-leitsaetze-fuer-multinationale-unternehmen-neufassung-2011-englisch.pdf.
- In 2016, the German government agreed on a so-called National Action Plan on Business and Human Rights, which emphasized the responsibility of German companies to respect human rights. The Supply Chain Act, for example, serves to implement the Action Plan. The action plan in turn is based on the 2011 UN Guiding Principles on Business and Human Rights, which are intended to ensure respect for human rights in business relations.
- The German Sustainability Strategy translates the Sustainable Development Goals (SDGs) of the United Nations, the so-called "Agenda 2030", into a national strategy.
- The German Corporate Governance Code (Deutscher Corporate Governance Kodex, (GCGC)) presents essential statutory regulations for the management and supervision of German listed companies and contains, in the form of recommendations and suggestions, internationally and nationally acknowledged standards for good and responsible corporate governance. In January of 2022, the Government Commission on the German Corporate Governance Code (Regierungskommission Deutscher Corporate Governance Kodex) adopted an updated draft of the GCGC in order to account for the growing importance of ESG aspects and the expansion of reporting requirements as a result of the announced CSRD, as well as the recent amendments to the German Stock Corporation Act (AktG) by the German Financial Market Integrity Strengthening Act (Gesetz zur Stärkung der Integrität der Finanzmärkte) and

the LPA II. Pursuant to a current draft of the new GCGC, the management board shall systematically identify and assess the risks and opportunities for the company associated with social and environmental factors, as well as the environmental and social impacts of the company's activities. Information on the corporate strategy shall provide information on how to implement the economic, ecological and social objectives in a balanced manner.

- The German Federal Financial Supervisory Authority (BaFin) regularly publishes guidelines and Q&As regarding sustainability requirements. In particular, in December 2019, BaFin published its Guidance Notice on Dealing with Sustainability Risks, which BaFin considers as a compendium of non-binding procedures (good practice principles) with respect to the implementation of a proper business organisation and an appropriate risk management system in connection with sustainability risks. In contrast, BaFin put on hold its plan to introduce guidelines for sustainable funds due to the regulatory, energy and geopolitical situation and the concern that the current environment is not sufficiently stable for a permanent regulation.
- The German Sustainability Code (Nachhaltigkeitskodex) was developed in 2010 by the German Council for Sustainable Development (Rat für Nachhaltige Entwicklung (RNE)) in a dialog process with representatives of politics, the financial market, companies and civil society organizations. The German Sustainability Code provides a framework of an internationally applicable reporting standard for topics relating to sustainability pursuant to which users declare their conformity with 20 criteria and the additional non-financial performance indicators taken from the Global Reporting Initiative (GRI) and the European Federation of Financial Analysts Societies (EFFAS).

Stakeholders

Sustainability encompasses all areas of political responsibility. Due to this cross-cutting nature and the particular importance of the topic, responsibility for the German Sustainability Strategy lies with the Federal Chancellery (Bundeskanzleramt). The State Secretary's Committee for Sustainable Development (Staatssekretärsausschuss für nachhaltige Entwicklung) is the most important steering body of the government's sustainability strategy. It is also the government's highest-ranking body and is tasked with ensuring that the guiding principles of sustainability are applied. State secretaries from all federal ministries take part in its meetings, which are held up to four times a year.

The RNE advises the German government on sustainability policy. It is independent in its activities and has been appointed by the German government every three years since 2001. The RNE also carries out its own projects to advance sustainability in practice. In addition, it provides impetus for political and social dialog.

In 2004, the German government decided to establish the Parliamentary Advisory Council for Sustainable Development (Parlamentarische Beirat für nachhaltige Entwicklung). Since then, it has been newly appointed and constituted at the beginning of each legislative period and is to provide parliamentary support and recommendations for the German sustainability strategy of the federal government, the European sustainability strategy and the sustainability policy of the German government at the international level.

Deutsche Umwelthilfe e. V. (DUH), a German environmental, nature and consumer protection organization, made headlines in Germany in recent years. DUH is committed to climate protection, the preservation of biodiversity, an energy supply based on efficiency and renewable sources, resource conservation and recycling management, clean air, sustainable mobility and consumer protection. Since 2009, DUH has received grants from the U.S. Climate Works Foundation, the EU Commission and the German federal government as part of an EU-wide campaign to reduce soot emissions.

National Contact Points (NCPs)

The German Federal Ministry for Economic Affairs and Climate Action (Bundesministerium für Wirtschaft und Klimaschutz) acts as the National Contact Point for the OECD Guidelines in Germany.

6. Are the laws, regulations and obligations highlighted in Question 2 primarily related to corporate disclosure?

EU legislation

Reporting and corporate disclosure make up the focus of much of the EU legislation outlined in Question 2. Please refer to Question 6 of the EU chapter for more information on the EU instruments applicable in Germany.

Supply Chain Act

Under the Supply Chain Act, companies must submit an annual report to the Federal Office of Economics and Export Control (Bundesamt für Wirtschaft und Ausfuhrkontrolle) on the implementation of due diligence obligations and publish it online.

The report must provide comprehensible information on:

- whether and which human rights and environmental risks the company has identified;
- what the company has done to fulfil its due diligence obligations;
- how the company assesses the impact and effectiveness of the measures; and
- what conclusions it draws from the assessment for future action.

The report must be made publicly available online no later than four months after the end of the fiscal year and must be available for seven years. Company and business secrets must be duly protected. The reports are submitted to the Federal Office of Economics and Export Control. Work is underway on an electronic procedure to minimize the burden on companies.

First and Second Leadership Positions Act

As outlined in Question 2 above, the LLP I and the LLP II require disclosure and, in case of a zero target, justification of the targeted participation quota as part of the management report in the annual accounts.

A zero target must be justified in a clear and comprehensible manner; the justification must set out in detail the considerations on which the decision is based. The statement of reasons should take account of the exceptional nature of the zero target. Accordingly, the German government believes that the statement

of reasons must make a conscientious decision plausible to the public. As a guideline for the level of detail, the explanatory memorandum states a length of 100 to 150 words.

7. Which sectors are most impacted by ESG in Germany? How significant is ESG investment in Germany?

EU legislation

Please refer to Question 7 of the EU chapter for more information on impact of the EU instruments applicable in Germany.

Supply Chain Act and CSDD

The Supply Chain Act holds companies responsible for breaches in their supply chain, directly and indirectly (e.g., by sub-contractors), in Germany and abroad. It is difficult to imagine a sector that will not be influenced by the new diligence requirements. The “high-impact sectors” include textiles, food, agriculture, fisheries, forestry, the extraction of mineral resources, the manufacture of base metal products and other non-metallic mineral products and the wholesale of mineral raw materials, base and intermediate minerals.

First and Second Leadership Positions Act

A minimum participation requirement of one woman applies to management boards with more than three members of listed companies and companies with equal co-determination. Pursuant to information published by the competent German Federal Ministry for Family Affairs, Senior Citizens, Women and Youth (Bundesministerium für Familie, Senioren, Frauen und Jugend) in August of 2021, this law affected 66 companies in total (no indication of sector given), of which 21 currently had no women on their boards.

8. What are the trends in Germany regarding ESG governance?

Last May, the new German government presented a new strategy for sustainable financing and a tightening of the climate protection law. For example, Germany is to become climate-neutral as early as 2045 (instead of 2050), and emissions are to fall by 65% by 2030 (compared with 1990). To achieve this goal, the government has adopted 26 measures to mobilize trillions in investment for more climate protection. These include, among other things, an (EU-wide) sustainability traffic light for financial products, an extended sustainability reporting obligation and the reallocation of investment funds from the federal government to sustainable investments.

9. To what extent are ESG ratings or ESG benchmarks relied upon in Germany?

ESG rating agencies

The German government has developed a sustainability action program and provides an annual account of implementation in a monitoring report. The Federal

Statistical Office's (Statistisches Bundesamtes) indicator report, published every two years, forms the basis for the federal government to adjust its measures.

In their 2021 coalition agreement, the German ruling parties agreed to promote European minimum requirements for ESG ratings.

Please refer to Question 9 of the EU chapter for more information from a European perspective.

ESG benchmarks

Please refer to Question 9 of the EU chapter for more information on European ESG benchmarks which are relied upon in Germany.

10. What is the role of the private markets versus public markets in driving ESG developments in Germany?

Consumer demands play a major role in driving ESG developments in Germany. Recent events (the COVID-19 pandemic, floods in western Germany, historical temperature highs, the Me Too and Black Lives Matter movements, Friday for Future demonstrations, war in Ukraine) have increased awareness for social and environmental matters for the everyday consumer. The pressure on politicians and companies to implement meaningful ESG measures will likely increase further and bring additional regulations for all aspects of the economy and society.

11. What are the major challenges in terms of compliance for companies under ESG obligations?

As in other jurisdictions, the major challenges are:

- the collection of reliable ESG data;
- the difficulties in the application of ESG laws by lack of clarification; and
- the varying timelines for the implementation of relevant ESG regulations.

12. What information sources are most relevant for ESG considerations in Germany?

With respect to EU instruments and their interpretation, the EU Commission is the primary source of information.

With respect to corporate ESG requirements and measures, the GCGC provides valuable guidance.

13. Has Germany developed a Taxonomy related to ESG?

Yes. The EU Taxonomy Regulation is directly applicable in Germany. Please refer to Question 2 of the EU chapter for an outline of the regulation.

14. What does the future hold for ESG in Germany?

It is likely that, as ESG capital flows grow, so will greenwashing. The amount of misleading information about the actual environmental, social and governance performance of companies and their products will likely increase. As a result, the importance of consistent and comparable sustainability reporting based on a single global standard for measuring and communicating ESG performance will increase. For future developments, please see Question 14 of the EU chapter, as the European Union with its Green Deal initiative is a key driver of ESG development.

AUTHOR BIOGRAPHIES



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Patricia Volhard is a co-leader of Debevoise & Plimpton's ESG practice and a member of the firm's European Corporate and Investment Management Groups. Her practice focuses on advising banks, insurance companies and private fund managers on a range of European regulatory issues including on the new European ESG regulatory and disclosure requirements. Ms. Volhard is one of Europe's leading regulatory lawyers and has played a prominent role in the ongoing development of private funds regulation and SFDR, in part through involvement in Invest Europe (formerly the European Private Equity & Venture Capital Association).



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