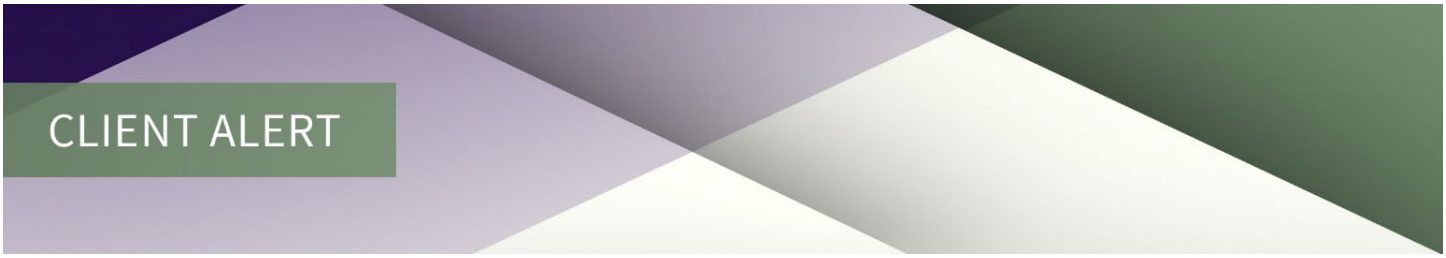

KYS & KYC - (Un-)Intended Interplay Between the German Supply Chain Due Diligence Act and Anti-Money Laundering Laws?

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The German Supply Chain Due Diligence Act (*Lieferkettensorgfaltspflichtengesetz*) ("**LkSG**") requires covered legal persons to implement certain due diligence obligations focused on potential human-rights violations that do not stop at "*its own factory gate*, *but apply along the entire supply chain*."

As a consequence, companies to which the LkSG applies, as well as individuals involved in the LkSG-required due diligence, may obtain information that they previously might not have had access to about human-rights violations committed by suppliers. For example, they might become aware of forced or child labor in a factory of one of their suppliers abroad.

The LkSG then requires, *inter alia*, regular reporting, including of information that needs to be published on the company's website.

According to respective official statements, the LkSG "sets out the necessary preventive and remedial measures, makes complaint procedures mandatory and requires regular reports."

Does it really? Below, we explain why compliance with the requirements of the LkSG is the starting point, but not the finish line, when obtaining information about human-rights violations committed by suppliers.

How Can This Come into Play?

German Anti-Money-Laundering laws, i.e., section 261 para 1 no. 4 of the German Criminal Law Act ("**StGB**"), penalize those natural persons, who, in respect of an object derived from an unlawful act, including, but not limited to human trafficking, keep or use it for themselves or a third party if they were aware or recklessly unaware of its origin at the time of obtaining possession.

Assuming a due diligence / know your supplier ("**KYS**") exercise undertaken due to the LkSG yields results that suggest a supplier has been supplying its product by violating human rights and such violation is a crime at the place of the offense and/or covered by Section 261 para 9 no. 2 StGB the respective customer needs to be alert. If goods were produced under such specific human rights violations and then delivered to a German company, they may be considered objects derived from an unlawful act. Thus, (i) employees who commit any of the acts enumerated in section 261 para. 1 no. 1 through 4 StGB might be prosecuted for money laundering and (ii) companies might be subject to a monetary fine in accordance with sections 30, 130 of the German Administrative Offence Act ("**OWiG**").

LKSG Reporting and Notification Obligations

Section 3 of the LkSG contains a duty of effort for the prevention of human rights violations, while Section 10 contains a documentation obligation. Companies are therefore required to establish a risk management system that is capable of identifying human rights violations and to present an annual report on the findings and actions taken.

Reporting Under German Anti-Money Laundering Laws

German anti-money laundering ("**AML**") legislation provides for two different ways of reporting to the authorities. Companies can either report voluntarily in order to qualify for the associated benefits as part of the self-disclosure process (reporting opportunity under section 261 para. 8 StGB) or they can be obliged to report by law (reporting obligation under section 43 of the German Anti-Money Laundering Act ("**GwG**"). The GwG applies only to companies covered pursuant to section 2 GwG, mostly those active in the financial sector.

According to section 261 para. 8 StGB, a penalty will not be imposed if, after receiving the object from an unlawful predicate offense, the company reports this to the competent authority or voluntarily initiates such a report or causes the object to be seized. However, such a voluntary report is only possible if the offence had not already been discovered in whole or in part at that time and the offender knew or could have reasonably known this.

On the other hand, section 43 of the GwG stipulates a reporting obligation to the relevant authorities (Financial Intelligence Unit). If there is any suspicion of money laundering, the company is legally obligated to proactively inform the authorities that it has been offered money that might originate from illegal sources or, and that is the twist, has already taken it. Although for the most part only credit and financial services institutions, as well as related companies, are obligated to report under

the GwG, the reporting obligation can also affect regular companies themselves, at least indirectly. Banks often pass on their obligation to the companies or, within the framework of their own best practice due diligence, companies want to ensure that the payments or goods obtained do not originate from an illegal predicate offense.

LkSG Reporting Obligations vs. *Nemo Tenetur*?

Notably, the LkSG may ease the evidentiary difficulties that have existed up to now. Where it was previously difficult for authorities to find evidence, companies may now be required or at least have a strong interest in voluntarily handing over incriminating evidence to the authorities. Whether these far-reaching reporting obligations are still compatible with the principle of not having to incriminate oneself (*nemo tenetur*) is disputed and has not yet been conclusively clarified. Moreover, it still needs to be further determined how the legal possibility of a self-disclosure pursuant to section 261 para. 8 StGB relates to both the reporting duty pursuant to the LkSG and the reporting obligation under Section 43 of the GwG.

The Sixth Money Laundering Directive

In Germany, the sixth Money Laundering EU Directive EU/2018/1673 led to a comprehensive modification of section 261 StGB. Previously, foreign offenses only constituted a suitable predicate offense if there were so-called *double criminality*, i.e. the predicate offenses were punishable both in Germany and abroad. However, after the revision by the German legislator, this has changed. According to the newly implemented section 261 para. 9 no. 2 StGB, criminal liability at the place of the offense is no longer required for certain offenses. Of particular interest with regard to the Uyghur case discussed below is section 261 para. 9 no. 2 lit. f StGB, which relates to human trafficking.

Real-Life, not an Academic Exercise:

Already in 2018, a Financial Action Task Force ("**FATF**") and Asia/Pacific Group on Money Laundering ("**APG**") report on financial flows from human trafficking aimed to raise awareness about the type of financial information that can identify human trafficking for sexual exploitation or forced labor.

Following reports on money laundering and the illegal wildlife trade in 2020 and on money laundering from environmental crime in 2021, the increased ESG-related risks in connection with money laundering hence are not surprising news, but have long been expected.

Since there have not yet been any comparable rulings at the German and European level, this topic, as well as its rapidly growing importance and influence, can best be illustrated by the recent UK ruling of the Royal Court of Justice from January 20, 2023.

Legal Action Initiated by NGOs Likely to Increase Scrutiny by Enforcement Agencies:

Recently, in "World Uyghur Congress -v- HMRC and others" **(CO/2931/2021)**, an NGO commenced litigation against various authorities, including the Customs Authority in the UK, for the importation of cotton to the UK, which was allegedly produced in the Xinjiang Uyghur Autonomous Region ("**XUAR**") by the Uyghurs, in violation of their human rights by China.

According to the plaintiff, the Uyghurs were forced to produce cotton in industrial parks. To support the claims, the plaintiff submitted in the proceedings, among other things, leaked documents as well as satellite photos. Allegedly, companies would systematically participate in this oppression, with large British companies having listed these industrial parks as suppliers.

While the lawsuit had no success, the judge expressly emphasized that there is undeniable evidence of forced labor in general in XUAR. He saw this as a "*striking consensus"*. In this case, the task of the court was only to verify whether the defendant could be accused of a breach of duty, which was not proven under the applicable law. According to the judge, there may still be other ways to stop the import of cotton from XUAR.

The court assessed the human rights violation in XUAR to be clearly proven and also signaled the willingness to make such judgments in the future. The ruling is also symbolic of the growing influence of NGOs and the increased attempts to bring the issue to public attention by means of legal action. Thus, it will only be a matter of time before the first public prosecutors proactively investigate, overcome evidentiary difficulties, and achieve selective judicial successes.

Key Takeaways / Lessons Learned

What the FATF and APG report predicted back in 2018 has now finally come to pass. Courts have clearly signaled the willingness to hear claims regarding human rights violation in the supply chain. The influence of NGOs attempting to bring human rights violations to the attention of companies and authorities by means of legal action is already growing significantly. Accordingly, increased interest from law enforcement authorities can be expected. And this interest might go beyond those companies originally tasked to enforce know your customer ("**KYC**") related obligations.

If goods were produced under specific human rights violations and then delivered to a German company, (i) employees might be prosecuted for money laundering, and (ii) companies might be subject to a monetary fine. In this context, the LkSG may ease the evidentiary difficulties that have existed up to now. Where it was previously more challenging to discover and secure evidence, companies may now be required or at least have a strong interest to voluntarily hand over incriminating evidence to the authorities

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

In this context, Willkie Farr & Gallagher LLP and AlixPartners are offering a symposium at the AFC Roundtable on “Anti-Financial Crime Strategies for ESG Compliance” on September 20, 2023 in Munich. The event includes keynotes, a panel discussion and a great opportunity to network and meet with colleagues and industrial experts. Please feel free to register for free on the official event page and have a look at our official post.

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