

Legal opinion

The Prowave software solution makes it possible to fulfill fundamental due diligence requirements of the German Supply Chain Due Diligence Act (LkSG) in a legally compliant manner and to simplify their fulfillment based on software. The risk analysis stipulated by the LkSG for direct and indirect suppliers, in particular, can be carried out in compliance with the law using Prowave.

The special characteristic of the Prowave system is that it is not only able to identify risks, but also to assess these risks and prioritize them as required by the LkSG. The Prowave system essentially proceeds by evaluating suppliers on the basis of country and commodity risk /industry risks, as well as by means of an AI-supported web screening. This assessment does not require any additional surveying of suppliers – but optionally, supplier self-reports can be included in the Prowave assessment.

Legal requirements of the LkSG and coverage by Prowave in detail:

<u>Legal requirement</u>	<u>Prowave</u>
Risk analysis must be performed and completed annually	Yes , implementation of risk analysis typically possible in 1-3 months
Obtain an overview of all direct suppliers	Yes , by inputting of suppliers from the ERP system (depending on the data delivery of the customer)
Risk identification	Yes , by means of a combination of country risk, commodity risk and web screening (optional: self-reporting, customer information)
Risk assessment and prioritization	Yes , by means of a 360° risk score in combination with ability to influence, contribution to causation and action priority derived from it
Consideration of the type and scope of business activity	Yes , by means of commodity risks
Consideration of ability to influence	Yes , by means of revenue share or customer-specific classification
Consideration of severity, reversibility and probability of injury	Yes , by means of 360° risk score
Consideration of contribution to causation	Yes , by means of customer-specific classification
Derivation / definition of measures	Yes , based on the action priority determined by Prowave ("Action Priority")

Risk Analysis:

The LkSG requires companies to conduct an analysis of human rights (Sec. 2 (2) LkSG) and environmental (Sec. 2 (3) LkSG) risks in their own business unit and at their direct suppliers at least once a year and as necessary (cf. Sec. 5 LkSG). In cases of so-called substantiated knowledge, i.e. there are perceivable signs indicating a violation of human rights or environment-related obligations by indirect suppliers (Sec. 9 (3) LkSG), the risk analysis must also be carried out at the indirect supplier level. The risk analysis carried out serves as the jumping-off point for deciding whether and which preventive and remedial measures would be taken.

→ The Prewave software enables the identification, assessment and prioritization of the human rights and environmental risks at suppliers as stipulated by the LkSG. In order to carry out this risk analysis in compliance with the law, Prewave depends on its user to provide supplier-specific and LkSG-specific information. In addition, the degree of legal compliance also depends on the user not inappropriately changing Prewave's settings. The Prewave software necessitates the user to bear the responsibility of checking whether an appropriate risk analysis requires additional measures beyond the Prewave software and to undertake these.

1. Provide an overview of direct suppliers (see explanatory memorandum to Sec. 5 (1) LkSG)

→ **Law:** Companies should, among other things, obtain an overview of their own procurement processes, as well as their direct suppliers' structures and their contacts at their direct suppliers.

→ **Prewave:** Companies often already have good overviews of direct suppliers, such as stemming from their ERP systems. This supplier data is then inputted into the Prewave software. The user is responsible for the accuracy of the data and to make sure that the data is up-to-date.

2. Risk identification (Sec. 5 (1), p. 1 LkSG)

→ **Law:** The law requires companies to identify human rights and environmental risks and proposes the use of risk-mapping, e.g. by product or country of origin.

→ **Prewave:** Prewave classifies the suppliers inputted by the company into different levels of risk. It classifies suppliers (i) into risk and non-risk countries ("**country risk**") (the geographical location of the supplier is considered) and (ii) into a risk or non-risk commodity/industry category ("**commodity risk**") depending on the goods or services supplied, as well as (iii) on the basis of a web screening for selected suppliers. Optionally, the assessment may also include (iv) self-reporting to be completed by suppliers and (v) information provided by the user on individual risky suppliers.

(i): Country risks are determined on the basis of 11 different publicly accessible indices and divided into no, low, mid, high or critical risks. As far as evident from these indices, they thematically correspond with the human rights and environmental risks specified in the LkSG.

(ii): Prewave uses its own data on over 100,000 suppliers to determine the commodity risks. These suppliers are classified into industries (ISIC standard) and commodity groups. Of the 100,000 suppliers, Prewave maintains a historical record of incidents in the individual industries and for individual commodity groups. Prewave also evaluates the frequency of incidents according to no, low, mid, high and critical risks.

(iii): In addition, an AI-supported web screening is carried out for a certain assortment of suppliers (ideally for the suppliers with the highest risks). This screening involves monitoring social media, the news and other online information based on a supplier keyword and risk keyword search to ascertain whether there are any notifications for each supplier, and if so, their contents. Messages are then forwarded to the user as so-called "risk alerts".

(iv): Optionally, risk identification can also be supplemented by the responses of supplier self-reporting, which risk suppliers have to complete. For this, Prewave has developed its own questionnaires on the topics of "Working Conditions and Human Rights", "Health and Safety" and "Environment".

(v): Optionally, the user can input individual risk suppliers on its own based on, for example, any negative human rights or environmental incidents known to it, to which a certain risk is then also assigned.

→ The results from (i) to (iii) or optionally additionally (iv) and (v) are then combined and together form the so-called 360° risk score of the supplier.

3. Risk assessment and prioritization (Sec. 5 (2) LkSG in connection with Sec. 3 (2) LkSG)

→ **Law:** The risks identified at the direct suppliers are to be evaluated and prioritized. The relevant criteria for prioritization are (i) the nature and scope of the company's business, (ii) the ability of a company to influence the direct causer, (iii) the typically expected severity of the breach, the reversibility of the breach and the likelihood of the breach ("risk potential") and (iv) the nature of the company's contribution to the causation of the risk or breach.

→ **Prewave:** The risk of the individual supplier (result of the 360° risk score) is then considered under the criteria of ability to influence and contribution to the causation. The result of the 360° risk score, together with the determination of the ability to influence and the contribution to the causation, is used to assign a prioritized plan of action for the identified risks. This prioritization can be applied by the user as a basis for deciding when and which preventive and remedial actions to take. The recommendations

made by Prewave do not replace the user's own responsibility to check and decide for itself whether and which prevention and remedial measures it has to take in its own company.

The criterion "ability to influence" is determined by (i) as far as known, the ratio between the company's order volume and the supplier's total sales or (ii) by a classification made by the company itself into critical, high, medium and low ability to influence the respective supplier. A meaningful classification requires the user to deal with the criterion "ability to influence" and the correctness of the data provided.

The contribution to causation is determined by a classification made by the user itself, whether a causation contribution, e.g. due to unilateral contractual requirements on the supplier, exists or not. A meaningful classification requires the user to deal with the criterion "contribution to causation" and the correctness of the data provided.

The criteria "type and scope of business activity" and "risk potential" are taken into account in the prioritization via the result of the 360° risk score. "Type and scope of business activity" are particularly taken into account in the commodity risks described above (industry and commodity risks). "Risk potential" is particularly taken into account (i) in the web screening by the type and frequency of alerts and (ii) in country and commodity risks using the categorization of human rights and environmental risks into different criticalities (see above).

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