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Stricter rules on corporate criminal liability in Germany

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THE NEW ASSOCIATION SANCTIONS ACT

The German Federal Ministry of Justice and Consumer Protection recently released a draft of the Association Sanctions Act, which would, for the first time in Germany, provide an independent legal basis for sanctioning corporations and other associations in the context of corporate crimes.

The existence of corporate criminal liability is not new or unique within the EU. Indeed, many EU member states have a corporate criminal law in one form or another. In Germany, there is currently no substantive corporate criminal law. However, there has been an ongoing debate about the need for a change in the legal system for many years. The debate has been ongoing since long before the latest Diesel Emissions Scandal, and many have perceived, rightly or wrongly, that the current legal situation in Germany has not measured up to international standards in this respect. It became clear that this debate is of practical importance, and not just academic, when the parties in the current government coalition for the 19th legislative period formally agreed to put this on their agenda during the years of their government. The current draft law is the result.

Main changes introduced by the draft

The sanctioning of corporations is, of course, not unknown in Germany. Corporations have long been at risk of being subjected to fines and other sanctions in the case of criminal wrongdoing by their officers and employees, and both the legal framework and enforcement have already become stricter. In 2013, the maximum fine for corporate crimes was increased to EUR10 million. In 2017, a new law reformed the disgorgement of profits from criminal wrongdoing, potentially increasing the amounts to be disgorged and making disgorgement possible even for time-barred offences. Also, in specific areas, such as banking supervisory and cartel law, fines have more recently been substantially increased. At the same time, the responsible departments of the public prosecutors' offices in major cities, that are responsible for the prosecution of economic crimes, have visibly increased enforcement pressure and are vigorously prosecuting alleged crimes committed by employees and officers of corporates, also with a view to sanctioning the corporation. Very recent substantial sanctions, reaching three-digit million amounts, have clearly demonstrated this trend both in the corporate world, (such as the Diesel Scandal), and in the banking sector, most importantly in the context of Cum/Ex - trading (trading over the dividend record date with multiple refunds of taxes which were paid only once).

The principle of legality. The Association Sanctions Act (*Verbandssanktionengesetz*) will in future subject the sanctioning of criminal behaviour to the principle of legality (*Legalitätsprinzip*). The principle of legality means that the criminal prosecution authority must open an investigation if a suspicion of a criminal offence arises. As a result, criminal prosecution will in future no longer be left to the discretion of the responsible investigating authorities, as is currently the case. While reliable statistics are not available, it is well known that in the past many potential criminal investigations were not initiated because the authorities exercised their discretion accordingly. This may play a less important role in instances of alleged substantial wrongdoing by large corporates and banks, where as a matter of fact, prosecuting authorities have been investigating rather ambitiously anyway. This was due to their discretion being legally narrowed because of the nature of the wrongdoing and the scope of the ill-gotten gains, or due to public expectation and pressure. The principle of legality may possibly have more of an effect in cases of less obviously substantial wrongdoing, by employees or officers of small to mid-size companies, and outside the districts of the large prosecution offices in Frankfurt, Munich, Cologne and Stuttgart. In any case, from a purely legal point of view, the move from discretion to duty denotes a remarkable change.

Wider jurisdiction. The arm of German jurisdiction will become longer. If the corporation has a registered office in Germany, it may in future also be sanctioned for offences committed abroad even if German criminal law would not apply to the individual's wrongdoing because of an insufficient nexus to Germany. To date, offences committed abroad by non-German nationals usually have not triggered any fines for the corporation. Under the draft law certain conditions must be met for a company to be fined for wrongdoing committed abroad. Perhaps most importantly, the offence must generally also constitute a criminal offence at the scene of crime. The practical implications may be considerable, as this would not only expose the company to now substantially increased fines in Germany, but it may also trigger a proliferation of matters where criminal investigations are conducted simultaneously in different countries. The possibility of suspending prosecution in case of expected sanctions by foreign authorities for the same offence may provide some comfort. However, this would be subject to broad discretion by the German authorities.

Increased fines. The draft law provides for significantly increased maximum fines. Until now, the maximum possible fine against a corporation has been EUR10 million, plus disgorgement of profits. For corporations with consolidated annual turnover of more than EUR100 million, this maximum amount will go up substantially. In future, the following fines can be imposed:

- In case of intentional acts, up to 10% of the corporation's average annual turnover over the last three financial years.
- In case of negligent acts, up to 5% of the average annual turnover.

This dramatic increase is owed to the drafters' view that sanctions should be proportionate to the financial strength of the corporation, which may not be achievable for large multinational corporations if fines are capped at EUR10 million. Although the authors of the draft acknowledge that even under the current law, aggregate sanctions considerably above the EUR10 million limit have been imposed, sometimes even in amounts that measure up to US and international standards, such larger amounts have been attributable to disgorgement requirements. These in effect take away only what was illicitly obtained through corporate crime and the drafters of the new law did not consider them to be real penalties. Under the new law the recently enhanced disgorgement provisions would remain in place alongside the increased fines.

Further sanctions. Besides the significant increases in potential fines, the draft also provides for further sanctions. In particular, it introduces the compliance monitor concept into German law. Instead of imposing an immediate fine on the company, the court could choose to only issue a warning to a company, while specifying a fine to be imposed if either another corporate crime is committed within a probationary period or if the company does not comply with the court's instructions regarding the remediation of a company's compliance system. The company's compliance with these instructions is to be determined by an expert authority, a concept by and large corresponding to a compliance monitor in Anglo-American law. Very likely, this segment in the legal market, and in related areas, will develop substantially. So far, compliance monitors in the German market have practically all resulted from US prosecutions. The concept of naming and shaming is also new (at least specific areas of the law). If a large number of persons have been harmed, the conviction of the corporation may in future be publicised.

Internal investigations. For the first time in German law, the draft formally and explicitly recognises internal investigations as a means to mitigate damages. Although internal investigations on the suspicion of criminal behaviour are well established in Germany and have been a standard instrument for companies for many years now when handling compliance incidents, there have been no explicit provisions that give specific guidance regarding the execution of an internal investigation or its impact on the sanctioning of the company.

The draft law now provides for a 50% reduction of the maximum fine, if a company conducts an internal investigation. However, the internal investigation must meet specific requirements to afford the company the advantage of lowered maximum fines. Two of the most important ones are as follows:

- **Full co-operation.** The company and the firm conduction the investigation must fully co-operate with the prosecution authorities. This essentially requires that the final investigation report, including all material documents on which the report is based, must be shared with the public prosecutor. This also includes a waiver of privilege, even if the investigation is conducted by an external law firm. Although in practice this much resembles the way in which matters were often handled anyway, even under the current law, the formalisation of this approach would mark a noticeable change in the criminal investigation of alleged corporate crime.
- As the draft law also leaves it to the discretion of the prosecution authorities to stay the official prosecution until the internal investigation is finished, this will in effect hand the main part of the criminal investigation, that is, the fact finding, over to the affected companies and their investigation counsel. This is a novelty under German law as the investigation of the facts have always been at the heart of the prosecutor's role, and this change is certainly somewhat at conflict with the right to not have to self-incriminate. Of course, there is no explicit obligation to co-operate. However, if the company wishes to take advantage of the reduced maximum fine, then there is no alternative.
- It may well prove more difficult than before for the company's senior management to risk losing this potential advantage by not fully co-operating, and thereby also taking on the risk of increased personal (civil) liability by failing to mitigate damages for the company.
- **The use of independent investigations counsel**. Closely linked to the concept of full co-operation is the requirement that investigation counsel must be independent. The draft law provides for a clear distinction of roles between investigation counsel and defence counsel. The investigation must be conducted with complete independence from and without any influence by defence counsel. The drafters deem this an essential feature as otherwise the entire investigation may, in their view, lack sufficient credibility.
- This appears to ignore that under current law and practice, experienced investigation counsel have often also taken on the role as the company's defence counsel and have worked co-operatively and in a responsible and transparent manner with the prosecution authorities to support a resolution. Many criminal investigations have been brought to a reasonable resolution by close co-operation between counsel and prosecutor, largely based on the fact finding of the company's advisors and apparently, the prosecutors involved have had sufficient comfort regarding the facts presented.
- One practical implication of this division of roles may be that, in the worst case, the company may have to have the facts investigated twice. Once by investigation counsel and once again by defence counsel, who for obvious reasons cannot provide any sensible guidance without detailed knowledge of the facts which trigger the alleged wrongdoing. That is because the drafters in their explanatory note require defence counsel to not influence the investigation, or even have access to its results. The wording of the explanatory note suggests that this restriction may be confined to cases where investigation and defence counsel are from the same law firm, which according to the note is deemed in line with the draft law as long as Chinese walls are put in place.
- However, as the drafters also stress the importance of the investigation's independence, the right of defence counsel to directly access knowledge derived from the investigation may also become restricted in other cases, where the defence counsel is from a different firm. It remains to be seen whether further discussions about this draft law will lead to a clarification and improvement in this respect.

Privilege. However, the draft law would provide some clarification as to a closely related topic, privilege. The requirements and extent of privilege with respect to investigation results under current law is a much-debated question in Germany, with different views held by various lower courts. The most recent decision by the German Constitutional Court in the Volkswagen matter did not comprehensively decide on all practically important issues in this context. The draft law now makes it clear that privilege exists, for example, with respect to documents in preparation of the company's defence. This certainly is an improvement of the company's position but in effect would not apply to anything produced by the investigation counsel, as long as the company wishes to co-operate to take advantage of the decreased maximum fines.

If the draft law becomes effective in this form, this point will put increased pressure on the consideration at very early stages of an internal investigation as to the appropriate strategy. This may include:

- Full co-operation with all implications, including an effective waiver of privilege, but with the chance to obtain a substantial discount on any future fine.
- A more classical approach, with corporate defence counsel doing the investigation work with the claim to privilege, but with the risk of higher fines.

To be sure, also under the latter approach, co-operation with the authorities may in many, if not most, cases still be the cornerstone of any defence strategy. Nothing in the draft law prohibits such co-operation by the company through its defence counsel from being taken into account positively when it comes to the discussion of an appropriate fine. All in all, the draft seems far from perfect on this question, and it remains to be seen when and to what extent this will become effective.

It is not expected that the German Association Sanctions Act will enter into force this year. The draft of the Federal Ministry of Justice

and Consumer Protection must now first go through the main procedure in the German Bundestag and the German Bundesrat in several readings and may be subject to many changes.

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