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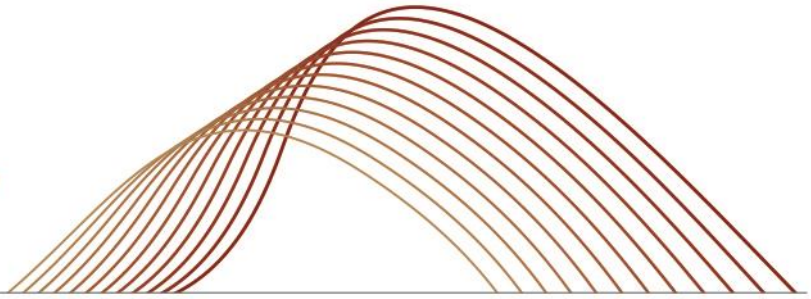

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New German Act to Combat Corporate Crime

By Dr. Regina Engelstaedter, Sebastian Ens, Tara Giunta & Diogo Metz

In the 2018 coalition agreement, the German government outlined its intent to pass a law that would allow for the prosecution of corporate crimes, in response to and consistent with the recommendations of the OECD's Working Group on Bribery that Germany improve its prosecution of legal persons. On 22 August 2019, the German Federal Ministry of Justice ("BMJV") introduced a first draft of the Corporate Sanctions Act (*Verbandssanktionengesetz*, the "VerSanG-E" or the "Act"), representing a significant step towards achieving that goal. Assuming the German Parliament passes the Act as drafted, it will enhance enforcement against corporations for business-related crimes, facilitate punishment of culpable companies, promote internal investigations, and incentivize investment in corporate compliance programs.

The VerSanG-E is in line with the global trend of increasing enforcement efforts. While the U.S. remains the largest single jurisdiction in the fight against corruption, Europe has stepped up enforcement efforts; countries like France, the U.K., and, now, Germany are making different tools available to their prosecutors, including alternative means of resolution in corporate criminal investigations. This alignment of enforcement practices is largely due to closer cooperation between enforcement agencies, coordination through international organizations, and the exchange of lessons learned.

The Act is expected to significantly change the compliance and investigation practice in Germany and beyond. This may also pose major risks on M&A deals, at least where the target is integrated into the buyer's group.

Key Takeaways

If enacted in its current form, the Act will remodel and strengthen the sanctions regime applicable to corporations in Germany. In particular, the Act:

- Introduces a new legal framework for sanctioning offenses committed by corporations (traditionally, individuals rather than corporations have been prosecuted);
- Is also applicable to corporate criminal offenses committed outside of Germany if such offense is attributable to a corporation incorporated, or with its principal place of business, in Germany;
- Eliminates prosecutors' discretion whether to prosecute corporate crimes;
- Grants prosecutors the power to sanction corporations for employee misconduct;
- Significantly increases monetary sanctions up to 10% of the annual global turnover for a willful criminal offense, and up to 5% for negligence, for companies with an average annual turnover above €100 million;

- Allows the upper limit of fines to be reduced by 50% by conducting thorough internal investigations;
- Incentivizes the implementation of effective internal compliance programs; and
- May codify jurisprudence limiting privilege protection to post-indictment documents.

Legal Obligation to Prosecute and Sanction Corporations (Principle of Legality)

The Act removes prosecutorial discretion and mandates that public prosecutors prosecute and sanction corporations whenever there is sufficient reasonable suspicion of a criminal offense under German law attributable to a corporation. Prosecutors or the courts would no longer have the discretion to decide whether to prosecute a corporation.

Applicability to Corporate Criminal Offences Committed Abroad

German prosecutors shall be obliged to investigate alleged or suspected misconduct anywhere around the world if a criminal offence is attributable to a corporation domiciled in Germany, if the misconduct is a criminal offense under German law and under the law of the country where it was committed.

In view of its extraterritorial applicability and the new legal obligation for the authorities to prosecute and sanction corporations, the Act is expected to significantly increase the number of investigations against companies in Germany.

Extended Range of Sanctions

The Act provides for significantly increased monetary sanctions for companies with an annual turnover over €100 million. An intentional corporate criminal offense could receive a penalty of up to 10% of the average annual turnover of the previous three fiscal years (up to 5% in cases of negligence).

It further introduces the option for the authorities to issue a warning and reserve the right to impose monetary sanctions for up to five years, and to impose conditions on the corporation for the duration of such deferral period. For instance, the authorities could order the appointment of an independent monitor to assess the effectiveness of the corporation's compliance program and remediation efforts, aligning Germany to the U.S. where deferred prosecution agreements and independent compliance monitors are commonplace.

For large-scale or widespread violations, the Act confers on the authorities additional tools. For instance, the authorities are entitled to order the dissolution of the offending corporation, but only as a last resort. This measure is meant for extreme violations or where persistent corporate misconduct raises a reasonable fear that the misconduct will continue unless the company is dissolved.

Incentives for the Implementation of Effective Internal Compliance Programs

The Act promotes compliance measures by creating incentives for investments in compliance. The existence of an effective compliance program is a mitigating factor and can lead to a substantial reduction of penalties. In addition, compliance measures to avoid future misconduct can help convince the authorities to only issue a warning. However, conversely, an ineffective compliance system, particularly one meant only to pay lip service to compliance, can be an aggravating factor in determining the penalty.

Mitigating Penalties by Carrying Out Internal Investigations

Under the Act, an independent, internal investigation could reduce the penalty by up to 50% provided the investigation fulfills certain criteria, in particular, that the internal investigation must substantially contribute to clarifying the misconduct. The VerSanG-E also requires that the investigation consider any applicable German laws and principles of a fair trial for credit. Regarding its employees, the company must (i) grant them the right to retain legal counsel; (ii) caution them that any information they provide may be used against them in criminal proceedings, and (iii) grant and inform them about their right to refuse to provide answers to the extent that these could expose them or their close relatives to further prosecution.

Full cooperation with the prosecutor is required. In particular, the results of the internal investigation, including the final report, must be disclosed to the prosecution authorities.

Furthermore, the internal investigation must be "independent", meaning that the corporation's defense counsel may not be involved. However, if an ethical wall is established separating the relevant information of the investigation from defense attorneys within the same firm, then the same law firm may both act as defense counsel and conduct the internal investigation.

Weakened Privilege Protections

If enacted as drafted, the VerSanG-E would codify that documents from an internal investigation in the law firm's possession only become privileged (i) if there is a "relationship of trust" between the law firm and the client with respect to these documents and (ii) once the subject is indicted and the internal investigation is related to the subject of the indictment. Until that point, the authorities would remain able to seize any documents in the law firm's possession. The results of investigations prior to an indictment, or in the context of internal compliance procedures, remain exposed to potential government seizure.

This creates two issues. First, it puts the integrity of the investigation at risk, and it exposes the company, which opts to use the same counsel for the criminal defense and internal investigation. In light of the Act's incentives for a thorough investigation of potential corporate misconduct, the decision to codify the principle that legal privilege only applies once the company is indicted runs against that purpose. It heavily tips the scale in the authorities' favor, and leaves companies with few fair trial protections. This risk is more significant in multi-national investigations. Enforcement authorities could potentially bypass domestic privilege protections because of the German counterpart's seizure of the documents. If a company retains the same counsel for an investigation and the criminal defense, it runs a significant risk that even potentially privileged documents are seized. Companies will likely have to retain independent counsel for each task. This could lead to significant delays in resolutions and unnecessary costs for the company.

Given the substantial negative consequences, this provision may indirectly counter the many incentives the VerSanG-E tries to create for cooperation and thorough internal investigations. The provisions related to privilege will be highly contested between now and the final version of the Act.

Recommendations

The new Corporate Sanctions Act will apply to offenses committed after the Act has entered into force, which will be two years after its promulgation. German companies and German subsidiaries, should use this transitional period to properly prepare for the new regime. They should review their current internal procedures and create a thorough roadmap for the implementation of improvements. In order to ensure an effective compliance regime, they should conduct an appropriately tailored risk assessment, and make adjustments to their compliance program and internal control framework responsive to those findings. In particular, they should assure testing,

monitoring and auditing protocols that can assist in regular review and validation of, or adjustments to, those controls. Further, in order to assure that they are well-positioned to respond promptly when an issue arises, they should implement, and communicate to employees, a mechanism for reporting issues and concerns. Finally, effectiveness of a compliance program depends upon the internal team, so companies are well-advised to assure that they have an internal compliance function that is adequately resourced.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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