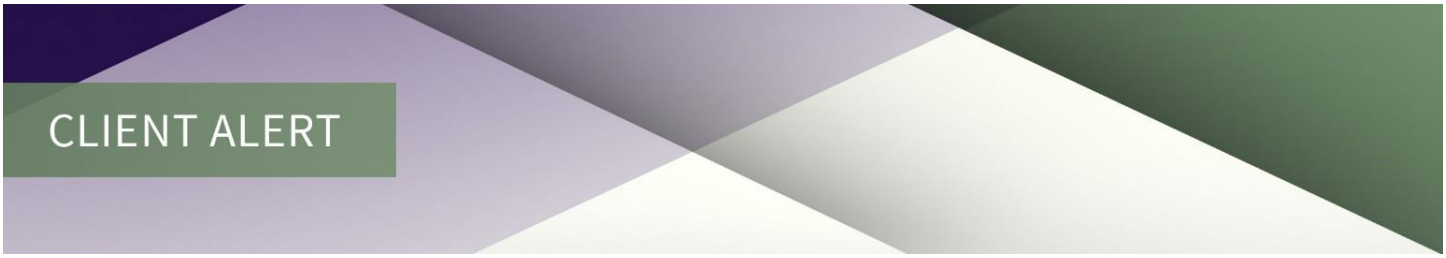

"The Carrot and the Stick" – Germany Modernizes Its Corporate Criminal Law

May 19, 2020

AUTHORS

Matthias Schrader | Johannes Schmidt

I. Background

Traditionally, German laws sanctioning wrongdoing have focused on individuals. Sanctions for offenses committed by companies were the exception rather than the rule. Although companies may be prosecuted under the current legal regime, the existing situation is perceived as an insufficient patchwork of individual rules. A notable exception has always been the enforcement of antitrust law on the basis of European rules which is largely recognized as being an effective deterrent.

The two current ruling parties in Germany had already agreed in their coalition agreement to set a milestone against corporate crime in Germany. In August 2019, a first draft bill was circulated among various stakeholders. After much criticism, primarily from the legal sector, the Ministry of Justice, in April 2020, officially released a modified draft bill for a "Law to Strengthen the Integrity in the Business Sector" (the "Draft Bill").

The Draft Bill centralizes the sanctions law for corporations, obliges prosecutors to take action in case of "corporate offenses," vastly increases the range of fines and other measures and creates more legal certainty in the sentencing process. In particular, the Draft Bill promotes and rewards voluntary cooperation and, for the first time in Germany, provides for guidelines regarding the appropriate consideration by prosecutors and courts of compliance measures and internal investigations of incidents when assessing potential sanctions.

The Draft Bill confirms several German "particularities" that stakeholders should be mindful of, such as the limited availability of legal privilege and the involvement of the courts in settlements.

II. Scope

The Draft Bill extends to all corporations operating a for-profit business. Non-profit organizations are excluded from its scope of application. Their actions remain subject to the existing provisions of the general German administrative offenses laws.

Pursuant to the Draft Bill, corporate offenses are all criminal offenses by which (i) the obligations affecting the corporation (obligations of the corporation) have been violated and/or (ii) by which the corporation has been or was intended to be conferred a benefit. As a result of this broad definition, almost any criminal offense may also be considered a corporate offense. Accordingly, the Draft Bill does not provide for a limitation of the catalogue of corporate offenses to certain categories of offenses most frequently observed in a corporate context, e.g., fraud, bribery or tax offenses. Offenses punishable under the Draft Bill thus include significant, but less frequent offenses, e.g., human rights violations such as slavery and environmental offenses.

An offense will be considered a corporate offense (i) if it has been committed by a member of management, or (ii) if management could have prevented the offense by implementing a reasonable and adequate monitoring and prevention system.

The definition of "management" is sufficiently broad to capture all individuals authorized to represent a company as well as all other individuals in supervising other executive control functions, and includes as a minimum executive board members, supervisory board members, managing directors and other senior officers with the authority to represent the company towards third parties, and potentially other senior personnel tasked with running a business or a division thereof.

Pursuant to the Draft Bill, for a sanction to be imposed, it is sufficient that the existence of a punishable corporate offense has been established by the prosecutor. Conversely, the prosecutor does not need to specify the individuals who were involved in committing the corporate offense.

The Draft Bill is not limited to corporate offenses committed in Germany. If the corporation has its registered or administrative seat in Germany, acts performed for the corporation abroad may constitute corporate offenses; provided that the general requirements of a corporate offense are met and the act is punishable under both German law and the law of the state where it was committed. This rule was adopted in the Draft Bill in order to prevent corporations from evading German sanctions by employing non-German managing staff abroad. Contrary to the global trend, the Draft Bill does not provide for "long-arm jurisdiction" of German authorities over foreign companies committing offenses outside of Germany.

Sanctions may be imposed on legal successors. In case the offender is dissolved, the sanctions may be imposed on entities that have assumed essential assets of the offender or the parent companies that formed a single economic entity with the offender.

III. Prosecutor's Obligation to Investigate

A fundamental novelty is the prosecutor's obligation to pursue every initial suspicion of a corporate offense. Under the current legal regime, prosecutors have wide, albeit not unfettered, discretion whether to pursue and prosecute corporates. For example, public prosecutors may abstain from prosecuting a potential offense if a *prima facie* review shows that the offense, if it occurred, is minor and thus the public interest in prosecuting it is outweighed by the public interest in a sensible allocation of government resources.

German prosecutors may abstain from prosecuting a corporate offense if the corporation has already been subject to comparable sanctions abroad or such sanctioning is expected.

IV. Sanctions

The Draft Bill provides for two types of sanctions: (i) the imposition of a fine, and (ii) the possibility of a "deferred prosecution" in combination with instructions and conditions such as the implementation of an independent compliance monitor. All sanctions are imposed by a court after the indictment by the prosecutor.

The amount of the fine depends on the annual worldwide turnover of the entire corporate group. Corporations with an annual turnover of more than €100 million face a fine of up to 10% of the annual turnover for intentional corporate offenses and up to 5% of the average annual turnover for negligent behavior. The maximum fine for smaller corporations is €10 million for intentional corporate offenses and €5 million for negligent behavior.

The measure for determining the annual turnover used as a basis for calculating the fine is the corporation's average worldwide group turnover during the last three years prior to the sanctioning, not the turnover at the time of the corporate offense. Under the existing legal regime, the maximum fine is €10 million, which was criticized as failing to provide enough of a deterrence. In addition to the fine, a court may order the disgorgement of (gross) profits derived from the corporate offense. Under the current legal regime, a disgorgement of gross profits is not possible if a fine is levied.

In line with international standards, the Draft Bill introduces the possibility of "deferred prosecution" in whole or in part, if the court expects a "warning" to be sufficient to prevent future corporate offenses and/or a fine is not necessary. Whether a company qualifies for deferred prosecution depends on a comprehensive assessment of the overall facts of the case and level of cooperation with the prosecutors. Similar to the practice in other jurisdictions that operate a variety of deferred prosecution regimes, it is likely that German courts will impose certain conditions and/or instructions upon the corporate offender (e.g., compensation for damages or certain measures to prevent further corporate offenses such as

the implementation of an independent compliance monitor). In contrast to other jurisdictions, the deferred prosecution does not rest on a bilateral agreement between the alleged offender and the prosecution. Instead, the court remains involved. In practice, however, in particular in complex cases, it is expected that the key terms of the (deferred) sanctions and additional measures will be the result of negotiations with the prosecutors.

In addition to the imposition of the sanctions, the Draft Bill provides for the possibility of a public announcement of the corporation's conviction, which is at the discretion of the court. This announcement may be made public on the Internet. In addition to being a deterrent, such publication serves to inform potential claimants of the corporation's conviction in order to enable them to assert civil law claims against the corporation resulting from the offense.

Furthermore, the Draft Bill provides for the creation of a register of corporate sanctions. The register will be non-public and only select public authorities (e.g., law enforcement and tax authorities) will have access to it. Records of certain offenses will also be kept in a separate register consulted by public authorities soliciting offers during a public procurement process. An entry may lead to the exclusion from such processes.

V. Mitigation of Sanctions

The sanctions will be imposed on a case-by-case basis taking into account various factors, including, inter alia, the gravity, scope and effects of the offense as well as the existence and/or implementation of an adequate compliance management system.

Sanctions shall be reduced if the corporation cooperates with the prosecutors and significantly contributes to uncovering and investigating the offense. The nature and extent of the reduction depends on the corporation's contribution to the investigation of the corporate offense. The Draft Bill provides, for the first time in Germany, authoritative guidelines as to how internal investigations should be conducted. These guidelines require the corporation to fully and continuously cooperate with the prosecutor, including making available to the prosecutor all findings, essential documents and final investigation reports.

One of the most surprising and controversial aspects of the Draft Bill is the de facto requirement to retain different counsel for the defense and for the purpose of conducting an internal investigation if the corporate offender wants to mitigate sanctions. The stated purpose of this controversial requirement is to avoid conflicts of interest. However, the separation of internal investigation and defense will likely generate considerable additional costs and an additional administrative burden, which may overwhelm small and medium-sized companies.

Full cooperation may result in a reduction of the otherwise applicable fine of up to 50 percent. Another advantage of unfettered cooperation is that there will be no public announcement of any decision. Furthermore, upon written request by the prosecutor, the court may issue a decision by way of a "sanction notice" without a public trial. This provides an

opportunity to resolve the matter without attracting publicity. A sanction notice may be appealed if the company prefers to have its "day in court."

In less severe cases, the prosecutor may decide to drop the charges before or during the trial. Such abandoning of the prosecution – similar to prosecutorial practice in matters of general criminal law – may be tied to certain conditions, such as the voluntary compensation for damages or a payment to the state treasury by the company. If a company reports an internal investigation of potential corporate offenses to the prosecutor, the latter may provisionally refrain from commencing an investigation of its own. Instead, the prosecutor may wait for the internal investigation to conclude and decide upon the further course of action at that point.

VI. "Legal Privilege" Under German Law

In contrast to most common law jurisdictions, there is no comprehensive system of legal privilege in Germany. Indeed, as a general rule, attorney-client correspondence and attorney work product are not protected from search and seizure by public authorities. Instead, the law protects information and documents in the custody of certain protected groups of individuals, such as attorneys, medical doctors, members of the clergy, etc. Consequently, an attorney may have the right (and duty) to refuse to testify and to surrender client-related documents. The same documents are not protected, however, when they are seized at the client's premises. The exact scope of the legal privilege, in particular in the context of internal investigation, remains highly controversial under the current legal regime.

An exception is made in connection with criminal or administrative offenses. Here, correspondence between the client and its criminal defense attorney is fully protected from search and seizure from the moment the prosecutor's investigation against a specific individual has commenced. The same protection exists with respect to the communication between a company and its dedicated defense counsel once investigations into a potential corporate offense have been initiated.

The case law in Germany under the current legal regime has not been entirely clear as to whether this broader approach to legal privilege also extends to documents produced in the context of internal investigations. There have been many instances in the past where prosecutors have successfully seized internal investigation reports and other documents even from law firms on the basis that those law firms were "only" tasked with investigating potential offenses (as opposed to defending against prosecution) and/or their client was not (yet) being investigated by the prosecutors at the time of the creation of internal investigation reports.

The Draft Bill endorses the narrow approach. Communications with and work products of attorneys tasked with the internal investigation will generally not be subject to protection from search and seizure. Conversely, communications with defense counsel are protected. The resulting de facto obligation to retain separate counsel for the investigation, on the one hand, and the defense, on the other hand, is intended to make it impossible to "blur the lines" between investigatory and defense work. Whether this approach will promote or deter internal investigations and cooperation with

prosecutors remains to be seen. It is also not yet certain whether this approach to legal privilege will survive the parliamentary process.

VII. Conclusion

With the Draft Bill for a "Law to Strengthen the Integrity in the Business Sector," Germany is on the right path to modernizing and complementing its traditionally rudimentary corporate sanctions regime. As a result, the sanctioning of corporations in Germany will be brought up to international standards. Companies need to be mindful of the versatile “toolbox” that the legislature is handing to prosecutors and courts to prosecute corporate offenses by virtue of the Draft Bill.

At the same time, companies are given a clear incentive to cooperate with prosecutors. Unfettered cooperation will not only lead to lower fines, it may also avoid the publication of a sanctions decision or help convince the prosecutor to drop the charges before a public trial.

Nevertheless, there are certain German “particularities“ one needs to be aware of, in particular the separation of defense and internal investigations and the limited availability of “legal privilege” which will continue to make coordination with authorities in other jurisdictions challenging.

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

Matthias Schrader
+ 49 69 7930 2244
mschrader@willkie.com

Johannes Schmidt
+49 69 7930 2245
jschmidt@willkie.com