The state of play on the new corporate sanctions law

A CRITICAL ASSESSMENT OF THE IMPACT OF THE DRAFT BILL OF A GERMAN "ASSOCIATION SANCTIONS ACT" ON SMES AND M&A TRANSACTIONS

Executive Summary

- The draft bill of an "*Association Sanctions Act*" has been available since summer 2019 and is currently being discussed by various public associations in Germany.
- In future, corporate sanctions similar to criminal penalties will apply in Germany instead of administrative fines imposed under the Act on Regulatory Offences.
- A company may now be fined up to 10% of the group's worldwide annual turnover.
- The public disclosure of the company's conviction will entail the risk of reputational damage.
- The originally included last resort of "dissolution of the association" should be off the table by now.
- The draft bill contains serious restrictions for M&A transactions. Violations of a smaller acquisition target can pose an existential threat to the corporate buyer, even if they were committed long before the closing.
- The new corporate sanctions law will also apply to foreign offences if the company had its registered office in Germany at the time of the offence.
- The present draft bill provides for a first time codified compliance incentives for companies shedding light on compliance crises through internal investigations. The respective requirements for their admissibility as mitigation or defence are high.
- Departing from the currently applicable opportunity principle of discretionary investigations of white-collar crime under administrative offences law, the principle of legality will entail mandatory investigations according to the draft bill in future. Any initial suspicion of an "*Association Offence*" will suffice so that any competent public prosecutor throughout Germany will have to initiate public investigations against the company. The likelihood of prosecution will hence increase drastically well beyond the currently active public prosecutors´ offices in Munich or Frankfurt.
- Prevention through adequate compliance procedures will significantly gain in importance under future written German law. Yet, as the draft bill does not provide clear expectations towards specific compliance management system modules other than internal investigations, it creates uncertainty - especially for small and medium-sized enterprises (SMEs).

I. Background

In the coalition agreement of 12 March 2018, the grand coalition had already agreed on a reform of the sanctions law for companies for the appropriate and effective punishment of white-collar crime.[1] On 22 August 2019, the Federal Ministry of Justice and Consumer Protection then presented a **draft bill** for a law to combat corporate crime. This "Association Sanctions Act" (*Verbandssanktionengesetz*/VerSanG) is currently being revised by the Federal Ministry of Economics and Energy and is expected to be promulgated as law in the near

[1] Coalition Agreement (*Koalitionsvertrag*) of 12 March 2018, available in German at: https://www.bundesregierung.de/breg-de/themen/koalitionsvertrag-vom-12-maerz-2018-975210 ; see: GSK-Update of 15 August 2018.

future - under any coalition. The term "Association" is to include both typical corporations as well as other legal formats such as associations (i.e. *Verbände*) with and without legal capacity (*nicht rechtsfähige Vereine*). Two years after its pending promulgation, the draft bill is to enter into force.[2] Until then companies will have to make best use of the available time to take the appropriate precautions to prevent and mitigate imminent sanctions.

II. Core Content

The draft bill will create a new **specific corporate criminal law** to sanction associations for the misconduct of their executives. This will move the current German law closer to the legal models of the US, the United Kingdom and also of France while it is still lagging behind in many respects.

1. Wide range of possible sanctions

As sanction mechanisms, the draft bill essentially contains the monetary sanction, the warning with reservation of the monetary sanction, (yet) the dissolution of the association and the public announcement of the conviction. As with the currently available association fine,[3] the new **monetary association sanction** can amount to up to EUR 10 million (Section 9(1) no. 1 VerSanG-E). However, the upper limit for fining companies with annual revenues of more than EUR 100 million was raised significantly: in the case of an intentional association offence, it amounts to at least ten thousand euros and a **maximum of 10% of the average annual turnover**. In case of a negligent association offence, the monetary sanction amounts to no less than five thousand euros and a maximum of 5% of the average annual turnover (Section 9(2)).[4] The practically relevant option of **disgorging excess profits** is to be retained. It thus remains possible to confiscate the amount of money that the association has obtained through the offence which can also exceed the maximum of EUR 10 million.[5]

Alternatively to the monetary sanction the court may issue a **warning with reservation of a monetary association sanction**. The court may also impose conditions (Section 12) and instructions (Section 13) in order to remedy the injustice caused by the association's offence.

As a last resort the court may order the **dissolution of the association** according to the present wording (Section 14). This sanction would go beyond the existing criminal and administrative offence law in Germany. Accordingly, its requirements are stringent: it will have to be a particularly serious case, for example an executive (*Leitungsperson*) is "persistently" committing substantial offences and the violation will likely continue in future. Therefore, the court must apply a strict proportionality test (cf. Section 14(1) no. 3). However, as can be observed in the current discussion regarding the draft bill, this "maximum penalty" should most likely no longer be included in the bill's final version. The court will also obtain the possibility **of a public disclosure of the company's conviction** in case of a large number of injured parties (Section 15). The publication is not supposed to denounce the association, but it should inform the injured parties of the facts relevant to them in order to decide, if necessary, on the assertion of claims. In addition, an **association sanctions registry** will list all legally binding sanctions. Unlimited information from the register can be obtained at the express request of courts, public prosecutors and authorities (Section 61). Information in individual cases should also be provided to scientific institutions, usually in anonymous form (Section 63). However, the additional option of public disclosure entails the risk of reputational damage.

[2] VerSanG-E, Article 15.
[3] See Section 30 Act on Regulatory Offences (*Ordnungswidrigkeitengesetz*/OWiG).
[4] These sanction limits are comparable with regulations in antitrust and data protection law. Cf. the upper limit of 10 % of worldwide group sales in antitrust law, e.g. BGH Decision of 26 February 2013, KRB 20/12, „Grey Cement Cartell Case".
[5] For example, in the so-called "Diesel Scandal" the fine of EUR 1 billion imposed on the VW group already consisted of a small fine of EUR 5 million and disgorged profits of EUR 995 million, see Volkswagen AG's ad hoc announcement of 13 June 2018, available at: https://www.volkswagenag.com/de/news/2018/06/Ad-hoc_VW_Group_Fine_diesel_crisis.html.

2. Threats of prohibitive sanctions for M&A transactions

The present draft bill is expected to have a significant impact on M&A transactions.

First, any sanction imposed on the association, with the exception of the dissolution, may also be imposed on its legal successor in the event of universal succession or partial universal succession (Section 6). It is furthermore particularly noteworthy that the amount of the sanction should be calculated on the basis of the worldwide turnover of all businesses operating as one economic unit over the last three financial years (Section 9). This can lead to considerable risks for the buyer, especially in the case of share deals. According to the draft bill, the combined turnover at the time of the conviction will be relevant for the amount of the sanction and not the possibly significantly lower turnover at the earlier time when the offence was actually committed (Section 9(2)). Thus, if there are sanction proceedings post-closing and the target will be convicted under the Association Sanctions Act, the amount of sanctions may be calculated on the basis of the total turnover of the buyer´s worldwide group. Finally, corporate liability will also increase in the event of a take-over in the shape of an asset deal. The draft bill provides for a contingent liability of the buyer if essential assets of a company are acquired and its business operations are essentially being continued (Section 7(1) no. 2). In this case, liability continues to apply to the buyer even if the company ceases to exist after sanction proceedings have been initiated.

This means that in future a group taking over a German company will have to examine historical compliance risks of the target very closely. Even a very small target can pose an existential threat to the conglomerate buyer. Accordingly, a M&A compliance due diligence will have to be carried out thoroughly in order to identify prohibitive transaction follow-up costs at an early stage and to possibly terminate takeover projects or – well-known from US law[6] – to draft a clearly structured post-closing action plan that could ultimately lead to voluntary disclosure within the context of required cooperation with authorities.

3. The creation of an "Association Offence" with cross-border applicability

As under the Act on Regulatory Offences, a breach of the supervisory duty, i.e. an inadequate organization of the leadership obligation of compliance by an executive, remains the most important offence.[7]

A novelty, however, is the concept of the Association Offence (cf. Section 3(1) no. 1). The draft bill defines this as "a criminal offence by which the duties of the association have been violated or by which the association has been or should be enriched" (Section 2(1) no. 3). This will include conventional offences against property-, tax- and environmental laws as well as competition- and corruption offences.

As a major innovation, offences committed outside of Germany may now also be sanctioned if an executive who is not a German citizen would commit an association offence or if it would merely by committed by any third party acting on behalf of the association (Sections 2 and 3).[8] Such acts will be treated as an association offence, provided that the offence would be regarded as criminal offence under German law and that it is punishable according to the domestic laws of the state where it is being committed (Section 2 (2)). It is of particular importance to foreign companies that according to the draft bill a sanction may be imposed against the association already if it has a registered office in Germany at the time of the offence (Section 2(2) no. 3). However, at this point, the draft bill does not go as far as for instance the UK Bribery Act,[9] according to which any type

[6] US DoJ Opinion Procedure Releases No 08-02 („*Halliburton*") of 13 June 2008 and No 14-02 of 7 November 2014.

[7] Cf. already Sections 30, 130 OWiG.

[8] Up to now, fines could only be imposed on a German association if the association appointed managers with German nationality abroad, making German law applicable according to Section 7(2) no. 1 German Criminal Code (*Strafgesetzbuch*/StGB).

[9] UK Bribery Act 2010, available at: http://www.legislation.gov.uk/ukpga/2010/23/contents.

of business activity in any part of the United Kingdom will suffice for sanctioning foreign companies.[10]

4. Introduction of the legality principle

The draft bill will depart from the currently applicable principle of discretionary investigations under administrative offences law. It will introduce the legality principle thus making investigations mandatory. Until now, the competent enforcement authorities had wide discretionary power to decide whether or not to initiate proceedings.[11] Throughout Germany the prosecution of corporate offences today is varying greatly. Enforcement probability in the northern federal states and cities is significantly lower than in Munich, Frankfurt or Stuttgart.[12] Now, with the introduction of the principle of legality, a **mandatory investigation** must be commenced. Even at the initial suspicion of an Association Offence, any competent public prosecutor throughout Germany must initiate mandatory sanction proceedings against the company. As a result, it can be said that in future it will no longer matter whether a company has its registered office in Bremen or in Bavaria.

5. Mitigating sanctions through internal investigations

The draft bill provides for the mitigation of association sanctions (Section 18) up to the **complete waiver of sanctions** (Section 42) by means of internal investigations. However, the requirements for these are demanding including e.g.:

- Separation of the expert team executing the internal investigations versus counsel defending the association;
- Continuous and full cooperation with the investigating authority;
- Duties to comply with all applicable laws and the fair trial principle.

It should be noted that the strict requirements for internal investigations make the choice of competent advisers increasingly important. The currently prescribed separation between internal investigation and corporate defence is facing a heated debate at present. It remains to be seen whether this topic will survive to the final version as this requirement would take an extra toll on corporate budgets – especially of SME companies – and cause efficiency and effectiveness deficiencies with necessary double team set-ups. It can also not be ruled out that corporate law- and fiduciary duties of executives in Executive- and Supervisory Boards (*Vorständen* und *Aufsichtsräten*) might conflict with the required separation in consequence.

6. Confiscation of documents

The draft bill also contains controversial amendments to the current Code of Criminal Procedure (*Strafprozessordnung*/StPO). In future, it will be possible to confiscate all records and documents resulting from internal investigations that are in the possession or custody of attorneys-at-law.

7. Preventive compliance to mitigate sanctions up to the discontinuation of proceedings

The draft bill explicitly differentiates between preventive compliance measures in the preliminary stages of criminal offences and subsequent compliance measures to optimize the **compliance management system (CMS)** and provides for their cumulative consideration in the assessment (cf. Section 13). Precautions taken prior to the offence to avoid and uncover association offences will have to be taken into account. For the assessment of sanction amounts it is therefore relevant to what extent the association actually fulfilled its duties to prevent violations from the sphere of the company and whether it implemented an effective CMS.[13] It should be emphasized that the court can order the enforcement of such

[10] According to the official guidance on the UK Bribery Act 2010, a company risks criminal charges in the UK for failing to prevent bribes being offered or paid on its behalf, if it "carries on a business or part of a business in the UK (wherever in the world it may be incorporated or formed)"; Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010), p. 9, available at: http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf.

[11] Section 47 OWiG.

[12] In a 2017 study, 18 out of 49 public prosecutors´ offices specialising in white-collar crimes stated that they had not conducted a single administrative offence case against companies during the period 2011-2016; see Henssler, Martin et al., Kölner Entwurf zum Verbandssanktionengesetz, NZWiSt 2018, 1(6).

[13] VerSanG-E, p. 55, citing Federal Supreme Court (Bundesgerichtshof / BGH), Decision of 9 May 2017 – 1 StR 265/16, wistra 2017, 390.

internal precautions and can deploy an external "expert body" (*sachkundige Stelle*) similar to an **independent compliance monitor**. Public auditors, attorneys-at-law and management consultants can be regarded as choices for such an expert body.[14] However, the required measures are still kept very generic. A specific catalogue of necessary CMS modules is lacking. What is more, differentiated yet coherent decisions by courts on the basis of necessarily differing prerequisites of SME companies cannot be expected to develop quickly in future. Well-defined CMS standards as set out in Common Law jurisdictions[15] or even in Brazil[16] in the shape of elaborate compliance management guidance are not visible yet.

III. Conclusion

The draft bill will first of all significantly increase the maximum sanction amount to up to 10% of total turnover for companies with revenues of more than 100 EUR million. At the same time, the prevention of misconduct will become even more important due to the extension of corporate liability also outside of Germany. In future, it will no longer matter whether an offence was committed by a German pass holder or by a foreign company executive – the international standard of liability for third parties will now be become an ingredient of German codified law, too.

Regrettably, the current draft bill misses the opportunity to write forth the internationally proven standards of formulating minimum compliance management requirements as incentives for mitigation and defence beyond the new corporate "must have" internal investigations. Clearly set out expectations of the legislator would certainly be beneficial particularly for SME companies.

That being said two main characteristics of the draft bill should definitively not go unnoticed. First, the departure from the opportunity principle and the introduction of the legality principle will significantly increase the likelihood of enforcement activity in all sorts of white-collar crime cases across Germany. Second, M&A compliance due diligence will become *de rigeur* in all corporate takeover projects in order to weed out prohibitive transaction risks.

High time in essence for companies of all sizes and legal formats to get prepared for this new piece of future legislation.

Eric Mayer
Attorney-at-Law (Germany)
Munich Office
eric.mayer@gsk.de

Thomas Dromgool
Attorney-at-Law (Germany)
Munich Office
thomas.dromgool@gsk.de

Teresa Gaboardi
Legal Assistant
Munich Office
teresa.gaboardi@gsk.de

[14] VerSanG-E, p. 89. Insofar the draft moves German law closer to Anglosaxon jurisdictions where independent compliance monitors can be implemented under dispute settlement agreements such as *Deferred-* or *Non Prosecution Agreements* (D-/NPAs). The French Loi Sapin II 2016 deviates with its *Convention Juridique à l'Interêt Public* (CJIP). This dispute resolution format differs insofar as it provides for a monitor, who is not independent but a member of the central state enforcement authority *Agence française Anti-Corruption* (AfA).

[15] *US FCPA Resource Guide 2012*, available at: https://www.justice.gov/criminal-fraud/fcpa-guidance; *UK Bribery Act 2010 Guidance: The Six Principles,* available at: http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf.

[16] *Programa de Integridade – Diretrizes para Empresas Privadas*, Controladoria Geral da Unio (GRU), September 2015, available at: https://www.cgu.gov.br/Publicacoes/etica-e-integridade/arquivos/programa-de-integridade-diretrizes-para-empresas-privadas.pdf as well as *Guia de Implantação de Programa de Integridade nas Empresas Estatais*, GRU, December 2015.

GSK
STOCKMANN

Disclaimer
This client briefing exclusively contains general information which is not suitable to be used in the specific circumstances of a certain situation. It is not the purpose of the client briefing to serve as the basis of a commercial or other decision of whatever nature. The client briefing does not qualify as advice or a binding offer to provide advice or information and it is not suitable as a substitute for personal advice. Any decision taken on the basis of the content of this client briefing or of parts thereof is at the exclusive risk of the user.

GSK Stockmann as well as the partners and employees mentioned in this client briefing do not give any guarantee nor do GSK Stockmann or any of its partners or employees assume any liability for whatever reason regarding the content of this client briefing. For that reason we recommend you to request personal advice.

www.gsk.de

GSK Stockmann

BERLIN
Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG
Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.
Taunusanlage 21
60325 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH
Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG
Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG
GSK Luxembourg SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com