Federal Ministry of Justice presents draft bill on Law to strengthen Integrity in Business

ANALYSIS OF THE MOST RECENT STATE OF THE NEW GERMAN CORPORATE SANCTIONS LAW INCLUDING THE MOST IMPORTANT NEW FEATURES IN COMPARISON WITH THE FORMER DRAFT BILLS

Executive Summary

- The German Federal Ministry of Justice and Consumer Protection (*Ministerium der Justiz und für Verbraucherschutz/BMJV*) presented on Wednesday, 22 April 2020 a new draft bill on a Law to strengthen Integrity in Business (*Gesetz zur Stärkung der Integrität in der Wirtschaft*).
- The now final draft bill of a new „Associations Sanctions Act" (*Verbandssanktionengesetz*) will now be sent into the alignment stage with the federal states (*Bundesländer*) as well as public associations and interest groups until 12 June 2020.
- The initial provision of an extraordinary dissolution of an association was finally abandoned.
- The mitigation of associations sanctions due to internal investigations changed from a „can"- to a „shall"-provision restricting courts´ discretion.
- The disputed separation between internal investigations and corporate- or association defence remains upheld.

I. Background

Already two years ago, the grand coalition had already agreed in the coalition agreement of 12 March 2018 for the 19th legislative period on a reform of the sanctions law for corporations for the appropriate and effective punishment of white-collar crime. On 22 August 2019, the Federal Ministry of Justice then presented an initial draft bill for a **Law to combat Corporate Crime.** The broad term "association" was chosen to include both typical business corporations as well as other legal formats such as associations (i.e. *Verbände*) with and without legal capacity (*nicht rechtsfähige Vereine*). The first draft bill was intensively revised by the Federal Ministry for Economic Affairs and Energy (*Ministerium für Wirtschaft und Energie/BMWi*) and discussed with the legal and economic experts of the ruling parties. On 4 November 2019 a next draft bill version was circulated.[1] Now the Federal Ministry of Justice presented the 147-pages of a final draft bill on 22 April 2020.[2]

While the nomenclature of the actual Associations Sanctions Act remained unchanged the heading of this legislative initiative was significantly altered which is now called the **Law to strengthen Integrity in Business.** This may not coincide with the current COVID-19 pandemic by accident. The Ministry of Justice mentioned in its letter to the public associations dated 21 April 2020 explicitly that Germany is going to face economically harsh times and that hence it could appear doubtful whether such a completely new legal regime for corporate sanctions would be appropriate in these days. But

[1] see GSK Update of 16.12.2019: https://www.gsk.de/en/the-state-of-play-on-the-new-german-corporate-sanctions-law/

[2] published on 22.04.2020 in German on the BMJV homepage https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/DE/Staerkung_Integritaet_Wirtschaft.html .

right now, according to the Ministry of Justice, it would be of importance to strengthen the large majority of corporations which actually is complying with rules and regulations and would not be trying to exploit the emergency of so many for unjust enrichment. US Attorney General William Barr had already announced on 16 March 2020 to make the fight against COVID-19 fraud the highest enforcement priority of the US Department of Justice (DoJ). Pressure was mounting over the previous weeks in the UK on the Serious Fraud Office to intensify investigations against any form of COVID-19 related misconduct. [3]

The 16 German federal states and various public associations now have time until 12 June 2020 to formulate their views on major this legislative initiative.

II. What is new?

The final draft bill displays several changes which indicate that business interests were expressed.

1. No dissolution of associations

The initial draft bill contained the extraordinary **dissolution of associations.** This last resort sanction would have gone beyond the existing criminal and administrative offence law (*Ordnungswidrigkeitenrecht*) in Germany. Now, this provision was striked out reducing the number of sections by exactly one to now altogether 68. Especially legal experts of the conservative parties criticized this "death penalty" as disproportionate in particular for employees, shareholders or customers. The spokesman for legal affairs and consumer protection of the Christian Democratic Union (CDU) Dr Jan-Marco Luczak emphasized the necessity to focus on legal incentives rather than on sanctions. Anyhow the practical relevance might eventually have been limited and only served as a symbolic statement. The coalition agreement had not explicitly mentioned the dissolution of associations beyond the targeted general expansion of corporate sanctions. In any event the dissolution provisions in corporate law will remain.[4]

2. No application for non-profit associations

The final draft bill will apply only for such associations whose purpose is to operate an economic business according to section 1 of the draft Associations Sanctions Act. Non-profit associations are hence no longer in scope. For society, voluntary commitment remains essential and should therefore be protected. The administrative law rules continue to apply for non-profit associations.[5]

[3] see GSK Update of 24.03.2020: https://www.gsk.de/wp-content/uploads/2020/03/GSK-Update-Fight-against-COVID-19-fraud-is-new-investigation-priority-of-US-Department-of-Justice.pdf .

[4] § 396 Stock Corporation Act (*Aktiengesetz*), §§ 61, 62 Act on Limited Liabillity Companies (*GmbH-Gesetz*), § 81 Cooperative Act (*Genossenschaftsgesetz*).

[5] Cf. p. 72 Draft Bill; §§ 130, 131 III. Act on Regulatory Offences (*Ordnungswidrigkeitengesetz*) apply.

3. No associations „offence“

While section 2 I. No. 3 of the draft bill of 15 August 2019 had used the wording “associations offence” (*Verbandsstraftat*), the final bill has altered this legal terminology and is now speaking of an “associations deed” (*Verbandstat*). This exemplifies the special German legislative path. Other than under e. g. the Anglo-Saxon corporate liability principle whereby legal entities such as commercial organizations can become criminally responsible it is apparently not intended to introduce a genuine corporate criminal law. The final draft bill is consistently using the expression sanction and is now strictly avoiding the terms offence or crime. Therefore the final draft bill could either be categorized as an expanded administrative law or as a third special path between administrative- and criminal law.

4. Mitigation of associations sanctions due to internal investigations turns into a „shall“-provision

Already the previous draft bills contained the provision for a mitigation of association’s sanctions by means of appropriately conducted internal investigations up to the complete waiver of sanctions. Section 17 I. of the final draft bill is no longer applying a “can” rule, but is now providing for a “shall” principle. This is an improvement in favour of corporations as it will bind the sentencing court in its discretion. The internationally widely accepted compliance management best practice of internal investigations is now being appreciated in German law even stronger.

5. Omission of general clause on compliance with general laws“ during internal investigations

Whereas the two first draft bills required internal investigations to observe “applicable laws”, this general clause was dropped in the final draft bill. Corporate influence might be felt here, too, as it was feared that thorough and therefore usually costly internal investigations might have been jeopardized by for instance minor violations of data protection law adversely impacting the desired mitigation incentive. The threshold to actually initiate internal investigations – arguably for various German companies a premiere – could thus be lowered.

III. What remains unchanged?

Besides the described changes the original cornerstones of the new sanctions law remained intact in the final draft bill.

1. Legality principle

The pending Associations Sanctions Act will depart from the currently applicable opportunity principle of discretionary investigations under administrative offences law. It will introduce the legality principle thus making investigations against associations mandatory. Until now, the competent enforcement authorities had wide discretionary power to decide whether or not to initiate proceedings against companies. Throughout Germany the actual prosecution of corporate offences today keeps varying. Enforcement probability in the northern federal states and cities is significantly lower than in Munich, Frankfurt or Stuttgart. Together with the introduction of the legality principle, a mandatory investigation must be commenced. Even at the early stage of initial suspicion, any competent public prosecutor throughout Germany must with the final draft bill 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.

2. Drastic rise of fines

As sanction mechanisms, the final draft bill essentially contains monetary sanctions, the warning with reservation of the monetary sanction, and the public announcement of the conviction. Under the currently applicable administrative offences law, monetary fines are capped at EUR 10 million. The new Associations Sanc-

tions Act will drastically raise this threshold according to section 9 II. The upper limit for fining companies with annual revenues of more than EUR 100 million in the case of an intentional association deed can in future sum up to a maximum of 10% of the average annual turnover. For negligence the monetary sanction can still amount up to 5% of the average annual turnover. The practically highly relevant option of additionally disgorging excess profits under administrative offences law will be retained.[6]

3. Separation between internal investigations and associations defence

The final draft bill perpetuates in section 17 I. No. 3 the requirement that external individuals tasked with internal investigations cannot defend the association at the same time. This provision was heavily criticised from the beginning and this will most likely continue. On the one hand side, much speaks in favour of the reasoning of the Federal Ministry of Justice which strives to avoid potential conflicts of interests. Internal investigations must identify all circumstances triggering a violation within- or out of the association. Corporate defence however oftentimes is supposed to protect the overriding interests of the corporation – or here the association operating an economic business - , of the shareholders and of the employees to escape liability. From the ministry´s perspective only a functional separation between investigations and defence can bring about a true self-cleaning of the association in question can start including a genuine cultural change. On the other hand side particularly small- and medium-sized enterprises (SMEs) might have to bear not insignificant additional costs and alignment efforts in retaining and steering two different advisor teams. One of the most active law enforcement agencies of the world, the US DoJ, puts great emphasis since years on "true cooperation"[7] between investigated corporation and law enforcement essentially ruling out any two-pronged strategy with internal investigations here and actual collaboration there. At least the vehemently voiced criticism appears to have led to a change from a strict functional to now personal separation requirement. So associations will no longer need to retain two different law firms, but it remains to be seen how robustly "Chinese walls" will be perceived to actually keep different teams and lawyers of one and the same firm apart in the eyes of German courts.

4. Lacking definitions of compliance measures

The specific meaning of the required "*adequate measures to prevent associations deeds as in particular organization, selection, direction and supervision*" according to section 3 I. No. 2 of the final draft bill remains opaque. There is still no catalogue comprising required modules of a *Compliance Management System* (CMS) as it was for instance already suggested by the Federal Association of Inhouse Lawyers´ (*Bundesverband der Unternehmensjuristen / BuJ*) counter proposal.[8] This can be deemed positively because it opens freedom for flexible interpretation of these measures by the courts. In contrast, it cannot be anticipated that a differentiated judicial practice can evolve across entire Germany in due course on what compliance measures will be adequate for SMEs as opposed to large conglomerates beyond the detailed legal definition of internal investigations. Not only in common law countries legislators and law enforcement keep providing concrete CMS design guidance since long such as in the US or the UK[9]. Even in Brazil legislation is offering since now half a decade CMS guide-

[6] Cf with the „Dieselgate" fines imposed against Volkswagen AG (VW) of EUR 1 billion: EUR 5 million reflected the penalty and the disgorgement EUR 995 million, see VW ad-hoc announcement dated 13. 06.2018.: https://www.volkswagenag.com/de/news/2018/06/Ad-hoc_VW_Group_Fine_diesel_crisis.html.

[7] Cf the US DoJ´s „Yates Memorandum" of 15.09.2015

[8] Beulke/Mossmayer, The reform proposal of the Federal Association of Inhouse Lawyers for sections §§ 30, 130 regulatory Offences Act - OWiG – a plea for a modern corporate sanctions law" (in German), CCZ 2014, 146

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

lines for both private as well as state-owned enterprises.[10]

5. Other

The sentencing court retains the possibility to **publicly disclose an association's conviction** in case of a large number of injured parties. 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's sanctions registry** will be listing all legally binding sanctions.

As another major innovation, **offences committed outside of Germany** remain sanctionable if an executive who is not a German citizen would commit an association's deed or if it would merely by committed by any third party acting on behalf of the association.[11] Such acts will in future be treated as an association deed, 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. It is of particular importance to foreign companies that according to all the draft bills a sanction may be imposed against the association already if it has a **registered office in Germany at the time of the offence.** However, at this point, the final draft bill does – as its predecessors - not go as far as for instance the UK Bribery Act, according to which any type of business activity in any part of the United Kingdom will suffice for sanctioning foreign companies.[12]

Another unchanged feature is that any sanction imposed on the association may also be imposed on its **legal successor** in the event of universal succession or partial universal succession. It remains particularly noteworthy that the amount of the sanction should be calculated on the basis of the worldwide revenues of all businesses operating as one economic unit over the last three financial years. This can lead to considerable risks for a corporate buyer, especially in the case of share deals. According to the draft bill, the combined revenues at the time of the sentencing will be relevant for the amount of the sanction and not the possibly significantly lower revenues at an earlier time when the associations deed was actually committed. Thus, if there are sanction proceedings post-closing and the corporate target will be convicted under the future Associations Sanctions Act, the amount of sanctions may be calculated on the basis of the total revenues of the buyer´s worldwide group. Corporate liability will also increase in the event of a takeover 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. 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 any international group or investor 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 in US law – to draft a clearly structured post-closing action plan that

[10] *Programa de Integridade – Diretrizes para Empresas Privadas* (Compliance Programmes – Guidelines for private companies), September 2015, Controladoria Geral da Unio (GRU): https://www.cgu.gov.br/Publicacoes/etica-e-integridade/arquivos/programa-de-integridade-diretrizes-para-empresas-privadas.pdf and *Guia de Implantação de Programa de Integridade nas Empresas Estatais*, (Guide to implementation of Compliance Programmes in state-oned enterprises) GRU, December 2015.

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

[12] 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*)"

could ultimately lead to voluntary self-disclosure within the context of required cooperation with authorities.

IV. What are the next steps?

The governing coalition made their point. Despite – or rather *because* – of the current pandemic the introduction of the Associations Sanctions Act is going to be seen through. After the alignment with federal states and public associations which was initiated on 22 April 2020 until 12 June 2020 the required legislative process could in fact be concluded before parliamentary summer break. Not only ministries, but also leading individuals of all ruling parties had been intensively discussing this final draft bill. If for instance parliament would pass it on 31 August 2020, it might enter into force on 1 October 2022 according to article 15 of the final draft bill. The pending alignment stage is well structured and should focus on these three topical priorities: the application scope reduced to associations with purely economic business operations, the mandatory separation between internal investigations and associations defence as well as the announcement of sanctions.

V. Conclusion

Also this final draft bill here does *not* make the pending Associations Sanctions Act into a second US Foreign Corrupt Practices Act (US FCPA), UK Bribery Act or even Loi Sapin II.
But in fact the federal government seems to be determined to implement this legislative initiative in a timely manner – despite or because of the lasting COIVID-19 crisis. The new legal framework will definitively produce a genuine *game changer* for Europe´s largest economy and exporting nation - which by the way also remains an attractive investment location.
With these auspices it is high time for all those associations that have not yet put in place any ominous "measures" at all to start designing and implementing an effective Compliance Management System (CMS) comprising dedicated processes for appropriate internal investigations. Until such a CMS can actually mitigate or even completely waive sanctions, many experiences suggest that several quarters can and will pass. Especially because of the lacking definitions of adequate compliance measures only association- or company-specific measures will be deemed as effective – and for this purpose thorough analysis is key. Hence such preventive project work ought to start soon in order to retain all the potential legal incentives once the new law will be set in force.
And for all those associations that have already commenced to design and build their CMS a comprehensive review of the actual compliance robustness and corporate resilience by a specific compliance health check should be put on the agenda.
Based loosely on a title of one of the many novels of the Colombian Nobel Prize laureate Gabriel Garcia Marquez[13] we should get ready for „Compliance in the times of Corona".

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[13] El amor en los tiempos del cólera (Love in the Time of Cholera), 1985

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