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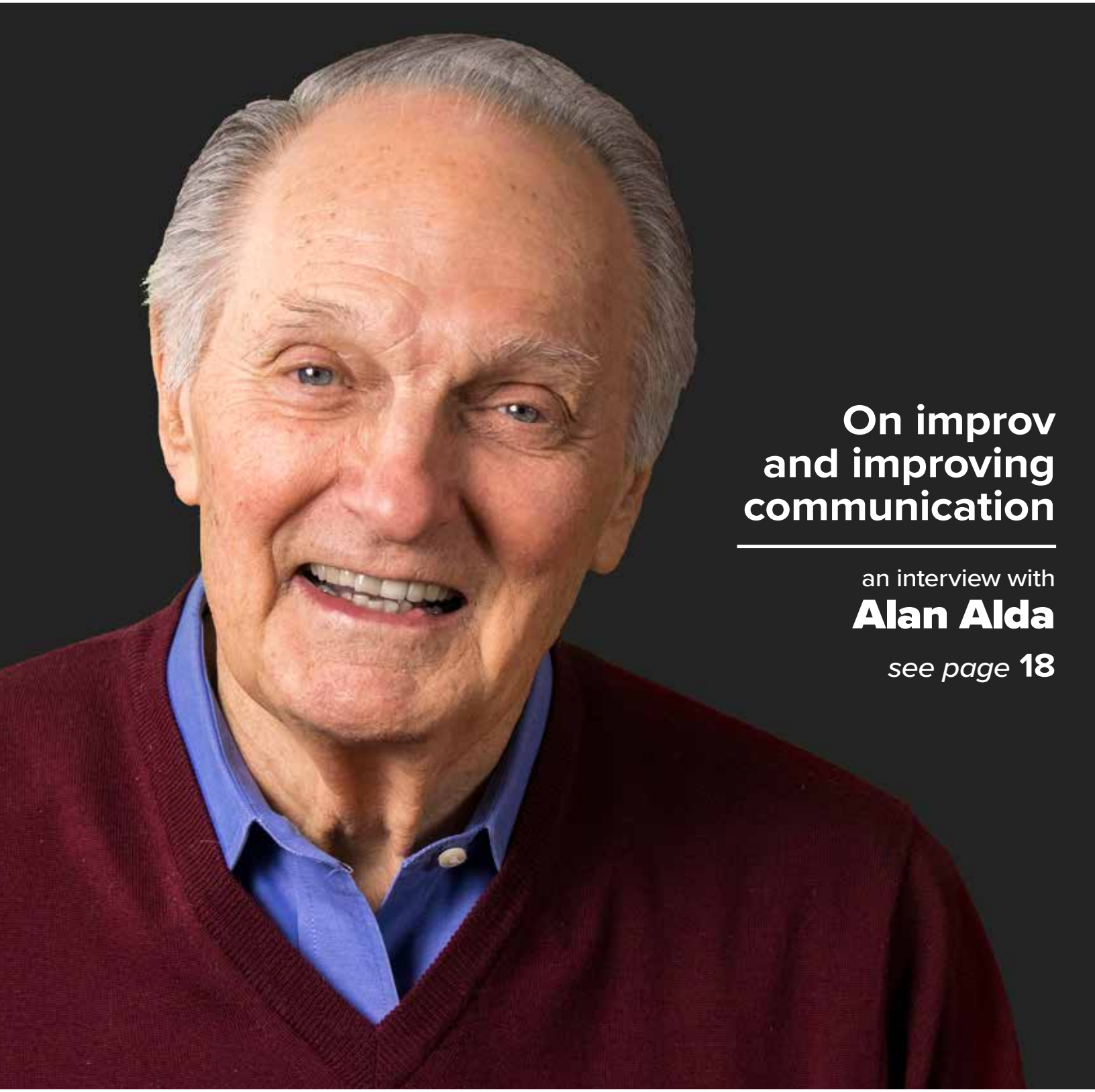
Compliance & Ethics PROFESSIONAL®

A PUBLICATION OF THE SOCIETY OF CORPORATE COMPLIANCE AND ETHICS

MARCH 2018



On improv and improving communication

an interview with
Alan Alda

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by Eike Bicker and Marcus Reischl

German Federal Court of Justice treats compliance management systems as mitigating factor

» German Federal Court of Justice held that the quality and efficiency of a compliance management system has to be taken into account as a mitigating factor when calculating a fine and/or a profit disgorgement against the company.

» The legal situation in Germany is drawing closer to the U.S. and the UK.

» Wherever compliance management systems serve to prevent breaches of the law, the implementation of such a system shall be taken into account in setting the fine.

» Antitrust authorities in Germany and other European countries are still reluctant to accept the investments in compliance systems as a mitigating factor.

» The ruling provides a great incentive to implement effective compliance programs.

Eike Ricker *(eike.bicker@gleisslutz.com) is Partner at Gleiss Lutz in Frankfurt, Germany, and* ***Marcus Reischl*** *(marcus.reischl@gleisslutz.com) is Associated Partner at Gleiss Lutz in Frankfurt, Germany.*

With its decision of 9 May 2017, the German Federal Court of Justice, the highest criminal court in Germany, commented for the first time on the significance of compliance management systems. In corruption cases at least, the German Federal Court treats compliance management systems as a mitigating factor when calculating corporate fines. Given repeated past discussions about the role of compliance management systems in reducing liability and fines, the German Federal Court's indication is warmly welcomed among practitioners.

Bicker

Reischl

The case

The defendant was a managerial employee of a German defence company. In 2001, the company sold 24 self-propelled howitzers to Greece for €188 million. To do this, it engaged the services of two sales agents, whose activities were coordinated by the defendant.

Sales agent B was hired specifically for this arms deal on a commission basis of 3%. According to the Court's findings, the arms deal was based on a bribery agreement between the defence company and the Greek minister of defence; sales agent B had personal access to this minister. The commission agreement was concluded to provide the funds required for the bribery agreement.

In 2002, sales agent B issued an invoice for a €1.85 million commission. The defendant, together with his superior, approved the invoice for payment. The invoice was paid and declared in the tax return of the defence company as ordinary business expenses for 2002. The defendant left the company in 2004. After his departure, further payments were made to the sales agents and were treated as business expenses.

The defence company employed another sales agent (P), a personal friend of the defendant, in Greece for the arms deal; this sales agent forwarded bribery payments from commission payments to the deputy armament director in Greece. In addition, between 2002 and 2004, the defendant received kick-back payments in excess of €657,000—paid into his Swiss bank account—from sales agent P. The defendant concealed these payments from the German tax authorities.

Although it could not be established that the defendant definitely knew that sales agent P was involved in bribery, P did start to tell the defendant that the deputy armament director in Greece was demanding part of P's commission. The defendant "stopped" P in mid-sentence, however, by saying that he didn't want to hear about it and that it only concerned P.

In the past, most German authorities have considered the efficiency of a compliance program as a mitigating factor when calculating a corporate fine or profit disgorgements.

Decision of the Federal Court of Justice

The Court of First Instance, the Regional Court of Munich, had sentenced the defendant to a total of 11 months in prison for having aided and abetted multiple instances of tax evasion. Any acts of bribery were barred under German criminal law. The Regional Court of Munich imposed a fine of €175,000 on the defence company for failing to prevent bribery payments as required under German law. Corporations in Germany are not criminally liable. However, German public prosecutors or German courts may impose fines and profit disgorgements against a German corporation for failing to prevent acts of bribery or corruption by (former) employees or management.

The defendant, the defence company, and the public prosecutor filed appeals on points of law against the Regional Court's judgment.

With its decision on 9 May 2017, the German Federal Court of Justice set aside the fine imposed on the defence company because its calculation violated the law. The Court stated that the quality and efficiency of a compliance management system has to be taken into account as a mitigating factor when calculating a fine and/or a profit disgorgement against the defence company. The Court held: "When calculating the fine, it is important to what extent the company fulfilled its obligation to prevent violations of the law within the company's sphere and set up an efficient compliance management system, which must be geared towards avoiding violations."

Practical consequences for compliance

In the past, most German authorities have considered the efficiency of a compliance program as a mitigating factor when calculating a corporate fine or profit disgorgements. Further, some authorities have deducted the costs incurred in connection with optimising the system from the amount of a corporate fine.

Nevertheless, the German Federal Court's ruling brings new clarity and has long been anticipated by compliance practitioners. The Court's decision is a step in the right direction. With it, the legal situation in Germany is drawing closer to the U.S. and the UK.

Moreover, one hopes that the decision of the German Federal Court is applicable beyond anti-corruption/tax-related circumstances. In particular, in antitrust matters, the German Federal Cartel Office (Bundeskartellamt) has been reluctant to accept the investments in compliance systems as a mitigating factor. However, the reasoning of the German Federal Court of Justice is rather general: Wherever compliance management systems serve to prevent breaches of the law, the implementation of such a system shall be taken into account in setting the fine.

It remains unclear what requirements a compliance management system—notwithstanding isolated deficiencies—must meet in order to be regarded as efficient, thus justifying a reduction in the fine.

Other legal systems are already much clearer on this issue. For example, the U.S. Sentencing Guidelines lay down specific requirements to be met by a compliance program in order for it to be regarded as an "effective compliance and ethics program." Another example can be found in the instructive guidelines for the assessment of corporate compliance programs by the DOJ's Fraud Section on 8 February 2017.

German compliance practitioners will continue to look to these standards, among other things, for guidance in future. It should, however, be borne in mind that the assessment of a compliance management system's efficiency depends to a large extent on the company's individual risk profile. Further assistance can be obtained from international standards (e.g., ISO 19600 Compliance, ISO 31000 Risk Management, ISO 37001 Anti-Bribery Management Systems), although these are likely to be insufficient to satisfy the requirements of German law.

It is also worth noting that the German Federal Court of Justice has not only recognised the existence of an effective compliance management system *at the time of the violation* as a mitigating factor when calculating the fine, but also the company's efforts to optimise an existing system *after* a violation has been exposed. Once a violation has been uncovered within a company, be it through internal efforts or an investigation by the authorities, the management of a German company has a fundamental duty under German corporate law to carry out an in-depth internal investigation, to analyse the causes of the violation, and to adjust the compliance management system accordingly so as to prevent similar violations in the future. If the members of management fail to take these measures, they may be held personally liable. Moreover, such self-cleansing measures are important in terms of procurement law and could help a company avoid being excluded from participation in public procurement contracts as a result of a criminal offence (section 125, Act Against Restraints of Competition).

These reactive measures are also relevant when it comes to calculating the fine and, moreover, make it possible to reduce the fine.

The German Federal Court of Justice's decision now means that these reactive measures are also relevant when it comes to calculating the fine and, moreover, make it possible to reduce the fine. The ruling provides a great incentive to implement effective compliance programs. ✳

1. The Federal Court of Justice: 1 StR 265/16, May, 9, 2017. Available at http://bit.ly/2r6TzSt.
2. Ibid