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# Manager Liability in Germany

von

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are governmental grants with respect to professional development (*berufliche Weiterbildung*), apprenticeship payments (*Ausbildungsvergütung*), as well as winter allowances (*Wintergeld*), the last to be applied for by the company on behalf of its employees.

With respect to all these social benefits, the management will be liable under civil law if such benefits were obtained on the basis of incorrect information. In addition, there may also be a criminal liability pursuant to § 263 StGB for fraud punishable with imprisonment of up to five years or with a fine.

### c. Liability in connection with improper Employment

A liability under criminal law may occur in connection with improper employment of employees. Most widely discussed cases are the employment of a foreign national (generally not including persons from a member state of the European Union, specifics however apply with respect to employees from Bulgaria and Romania until 2014) without authorization, i.e. without the employee having obtained a work permit or a residence title. If the company (i) employs such persons for unfavorable terms compared to German employees or (ii) employs such persons to a large extent (more than five employees at the same time), the management of the company may be punished with imprisonment of up to five years or with a fine.

Another example for a potential liability in this regard is the lending or renting of foreign employees without having the appropriate permissions, which may also be punished with imprisonment of up to five years or with a fine.

## IX. Manager Liability relating to Compliance

### 1. Overview

With the publicity of major corruption cases such as Siemens, to name the most prominent one, compliance has been and still is one of the hot topics of German corporate law. While this may suggest that compliance is something utterly new to German companies, quite the contrary is true. It is more the label than the content that has changed, and general issues now being discussed in Germany in connection with compliance are issues that have applied to German companies for decades. However, and in this regard quite comparable to manager liability in general, the level of detail and sophistication has substantially developed over the years (and in particular as a reaction to the recent corruption cases), resulting in higher standards being applied to managers in their ordinary course of business.

To describe the essence of what is discussed when talking about compliance, it is helpful to take a look at the German Corporate Governance Code (for details see above under B.I.1.f.). The Code defines the term compliance in its article 4.1.3 as follows:

*“The management board ensures that all provisions of law and the enterprise’s internal policies are abided by and works to achieve their compliance by group companies (compliance).”*

Essentially, compliance, therefore, means the abidance of all laws applicable to the company by it and its employees. It is the duty of the management to determine the appropriate means to ensure lawful behavior of the company's employees.

Compliance is first and foremost concerned with organizational structures and risk management. Companies must establish an organizational structure capable of preventing, detecting, and responding to any risk resulting from illegal actions within the company. The aforementioned citation from the German Corporate Governance Code also reminds the members of the management board of a Stock Corporation that it is the top company of a group of companies that has the duty to establish a group-wide compliance organization ("*by group companies*"). The standard features that an internal compliance organization will regularly need to establish are described below in more detail.

The importance of compliance and the high relevance of this topic for managers as it relates to potential liability are due to the potentially high damages that may result from a company that has not established a proper compliance organization. It is not only potential claims for damages asserted by third parties that play a major role in this respect, but, more importantly, potential administrative fines levied upon the company and the managers, in particular resulting from non-compliance with competition laws provisions (for details, see E.VI. above).

In this regard, particular attention should be paid to the Administrative Offenses Act (*Ordnungswidrigkeitengesetz; OWiG*). If a member of the management board or the supervisory board intentionally or negligently failed to take the supervisory actions necessary to prevent illegal behavior within the corporation, § 130 para. 1 OWiG determines that such member may be personally held liable and may be subject to a fine of up to EUR 1 million, provided that the illegal behavior could have been prevented or materially impeded if proper supervision had occurred. This shall explicitly include the due selection, appointment, and supervision of the respective personnel. In addition to the personal liability of the management board and the supervisory board, the company will also be subject to liability.

Moreover, the reputational damages caused by negative publicity should not be underestimated. Potential customers may even abstain from contracting with a company that has had compliance issues if their own compliance organization and guidelines provide that no contracts shall be concluded with companies lacking a state-of-the-art compliance organization.

The management board is primarily responsible for preventing these adverse side effects by implementing adequate measures to ensure that the company and its employees comply with laws and with internal compliance rules. This responsibility is, however, not limited to the management board. The supervisory board also has to deal with the company's compliance organization in the ordinary course of its supervision of the management board. The German Corporate Governance Code can again be cited in this regard. Article 3.4 of the Code provides that

*"The management board informs the supervisory board regularly, without delay and comprehensively, of all issues important to the enterprise with regard to planning, business development, risk situation, risk management, and compliance."*

The supervisory board may, and frequently will, delegate its tasks relating to compliance to a committee (most commonly the audit committee). As already noted above under B.I.2.b.dd., while a delegation of duties is possible, all members of the supervisory board remain jointly responsible for carefully selecting members of the audit committee and for supervising their work on a regular basis. Furthermore, they must ensure, through regular reporting, that all matters of relevance are brought to their attention.

The same is true with respect to the management board. While it is not uncommon in German Stock Corporations that one of the members of the management board is responsible for compliance or even serves as compliance officer, the other members of the Stock Corporation still remain responsible for selecting that person carefully and for that person's continuous supervision, for example by establishing reporting requirements and requesting additional information to the extent necessary.

The concrete actions to be taken by a company with regard to compliance largely depend on the size of the company as well as its business activities. For example, companies having a focus on production may need to focus on compliance with relevant environmental laws. Companies mainly engaging in export activities may need to focus on foreign trade laws. Publicly listed Stock Corporations will need to regularly deal with the compliance of capital markets law provisions applicable to it (for details in this regard, see E.V. above).

While by now compliance organizations have been established in most of the larger companies in Germany, many mid-sized companies still do not give sufficient attention to this topic. Given the potential consequences for the company and the managers personally, this is rather surprising, and management and supervisory board members are well advised to investigate thoroughly, with the help of advisors if necessary, whether and to what extent a compliance organization should be put in place to protect themselves from liability risks.

## 2. Structure of a Compliance Organization

As previously noted, each compliance organization must be tailored to the individual enterprise, and the specifics will therefore differ from case to case. However, the most common compliance measures, which, when taken together, may also serve as a toolkit for the establishment of nearly every compliance organization (for more details see below under E.IX.3.), are the following:

- a clearly documented commitment of the management that compliance has top priority for the company (“tone from the top”);
- a code of conduct applicable to all employees of the company and of its affiliates documenting (i) that the company will not accept any unlawful behavior by its employees, (ii) that any person not observing this principle of legality will be subject not only to the mandatory consequences provided by law (e.g. criminal law sanctions), but also to employment-related sanctions (such as removal), and (iii) a catalogue of “do’s and don’ts” for its employees;
- informational materials explaining the legal obligations regarding selected issues (e.g. insider trading rules, corruption law for the company’s sales force, etc.);

- regular compliance trainings for employees operating compliance risk-related activities;
- reporting chains to provide regular updates on the status of compliance-relevant issues as well as ad hoc reporting for (assumed) infringements of the law (including on a no-names basis); and
- mechanisms to regularly audit the proper functioning of the compliance organization.

Primarily, the management must ensure that these tools are properly implemented within its company and, if applicable, on a group-wide level. However, since compliance affects the day-to-day business of every employee, the management will need additional staff for the implementation and, in particular, for the ongoing operation of the compliance organization. Due attention must therefore be paid to an adequate organizational structure for the compliance organization.

In this respect, many companies have set up compliance committees in which the employees responsible for compliance meet on a regular basis, and that report to the management board or the member of the management board designated as being responsible for compliance. Further, a (chief) compliance officer is often appointed as head of the compliance organization and responsible person for all compliance-related issues. Depending on the size of the company, it may also be useful to appoint several additional compliance officers that are responsible for different group companies or segments within the group. In this case, the compliance officers will regularly report to the chief compliance officer, who is the contact person for the management board.

Setting up a separate compliance unit may be the preferred choice for some companies, while others may decide that compliance issues should be integrated into an existing department (e.g. the legal department). Considering the necessary independence and the human resources available to fulfill compliance requirements, it might be advisable to provide for full-time compliance personnel. There are also arguments in favor of compliance being integrated into the operational departments (rather than the legal department, which is less in touch with operational issues). In particular, it will be more effective with regard to the detection of compliance violations if the personnel responsible for compliance are not completely separated from the rest of the business.

If the company has a works council, it should be noted that although the works council does not need to be involved in the implementation of the compliance organization, it does need to be involved in the determination of binding internal rules of conduct. § 87 para. 1 no. 1 of the Works Constitution Act (*Betriebsverfassungsgesetz*) provides that the works council must approve all rules relating to the conduct of employees of the company.

### 3. Cornerstones of a Compliance Organization

As already noted above, a list of standard items that are regularly used in compliance organizations has been developed over the last several years. These items are frequently divided into three action levels through which a comprehensive monitoring system is created to safeguard that the business is in accordance with all

applicable laws and regulations, as well as with additional internal principles and guidelines established.

The action levels are often characterized as “prevent, detect, and respond”, i.e. (i) providing information and training for all employees of the company depending on the sensitivity of their work from a compliance perspective (below b. to e.), (ii) identifying potential violations of the applicable laws and regulations as well as internal principles and guidelines (below f. to g.), and (iii) reporting and remedying for breaches (below h. to i.).

It should be noted that a member of the management board that has established a compliance organization which does not feature the most common components of what must be considered industry standard for a company of its size and type of business, will have difficulties defending himself in the case of an employee’s breach of duty which could have otherwise been prevented.

### **a. Risk Evaluation**

Prior to the establishment of a compliance organization, the management board must determine the status quo of the company’s business (in terms of risk adversity of the business, past damages of the company due to unlawful behavior of its employees, the current organizational structure of the company, etc.) in order to determine the specific measures necessary for the implementation of a proper compliance organization. In this regard, a “compliance due diligence” of the company should be conducted in which the management and senior professionals should participate. It is also worth considering retaining an external expert advisor experienced in the fields of risk evaluation and the setting up of compliance organizations to expedite the process and safeguard that the compliance organization to be implemented fits the needs of the company but still is “state-of-the-art”.

### **b. “Tone from the Top”**

The starting point for all compliance organizations, although admittedly less important from a liability perspective, is strong and visible commitment by the top management of the company, often labeled as “tone from the top” or a “mission statement”. Managers must communicate and stress that compliance has top priority, and that long-term business success is only possible in a corporate environment that lives up to the standards set forth by the compliance documentation. As one large German company puts it, “We expect our management to walk the talk”. It is, therefore, part of the management’s responsibility to ensure that compliance is taken seriously by the company’s employees, and to provide sufficient backing for all compliance-related matters.

### **c. Guidelines and Policy Statements**

To effectively prevent compliance violations, companies should develop a comprehensive set of rules and regulations applicable to all employees and the management board for their daily business. These compliance rules should provide clear guidance concerning expected behavior.

Quite often, these guidelines and policy statements are divided into a “code of conduct” or “code of ethics”, which sets forth the general principles applicable to all employees of the company, and more specific guidelines that complement these

general principles in certain risk prone areas of the company's business, often called "compliance manuals". Common examples of such specific compliance manuals are manuals relating to capital markets laws (in particular, to insider trading if the company is publicly listed) or to competition laws and anti-bribery provisions (in particular, in companies having a strong focus on exports and companies in which employees frequently have contact and generate business through third-party agents). Guidelines relating to hospitality issues (in particular, provisions on giving and receiving presents to and from business partners, including invitations to events, dinners, etc.) are also quite customary in this regard.

These (generally more detailed) guidelines may be complemented by shorter handouts providing summaries of the most important legal provisions and related internal rules and policies for the employees. Any information provided to employees is helpful. However, regarding acceptance of the compliance organization within a company, employees should not be inundated with too much and too detailed information. The resulting information overload may be counterproductive to achieving an effective compliance organization.

#### **d. Employee Training**

A mission statement from the top management as well as the distribution of compliance guidelines and handouts only serve as the first step to implementing a state-of-the-art compliance organization. In addition, employees working in compliance-sensitive areas should receive compliance trainings in which the applicable guidelines are explained. This is also a good opportunity to have the employees acknowledge that they have received such training, understood the relevant legal provisions and internal rules applicable to their daily business, and declare that they will comply with them. This acknowledgment is of particular importance for the management as documentation that it has taken the appropriate steps to prevent unlawful behavior by the company's employees. In addition to the first-time training sessions, there should be regular "refreshers". Further, the management should make sure that all new employees working in compliance-sensitive areas of the company receive the appropriate trainings in due course after beginning employment with the company.

Trainings may be conducted in-house (e.g. through the compliance officer or members of his team) or also by external experts (most commonly lawyers with special expertise in the respective field of training). In larger companies, especially with regard to "refreshers", it has become common practice to establish web-based e-learning tools to facilitate training and decrease compliance-related costs. In particular, in companies having a multitude of branch offices in different countries, e-learning also helps to mitigate language-barriers, as the e-learning tool may initially be created by an expert and then translated into the different languages.

#### **e. Help Desk (Compliance Hotline)**

For a compliance organization to be an effective risk management tool, employees should have the possibility to contact a person responsible for all compliance-related matters. The contact person may either provide answers or solutions to the employee's questions, or may bring the matter to a more knowledgeable person within the company. Employees should be encouraged by the management to contact the help desk to clarify compliance-related issues before commencing the activities in question. Depending on the size of the company, there may be persons

dedicated to handling inquiries received by the help desk, whereas in smaller companies, it might be sufficient to have the compliance officer also serve as contact person for all compliance-related inquiries by employees.

#### **f. Whistle-blowing**

In addition to the compliance hotline, a separate whistle-blower hotline has become industry standard in Germany over the last several years, especially in large companies. The whistle-blower hotline shall provide employees of the company the ability to report on an anonymous basis any knowledge of potential compliance violations that have come to their attention.

It is of utmost importance that the hotline provides a secure and reliable way of reporting (assumed) compliance violations to the company. Maximum usability of the hotline should guarantee that information can be submitted from anywhere in the world at any time, either online or by telephone, and in all languages that are relevant. Furthermore, it should be ensured that incoming reports are not traced or that reporting parties are not automatically registered; this must be effectively communicated to the employees so that they are confident that the information sharing is truly anonymous and that they will not be subject to any legal consequences.

Quite often, the call center and website used for information sharing are operated by an external provider specializing in the secure and confidential handling of sensitive content. In such cases, the incoming information should be forwarded by the service provider to the company for analysis and further clarification. All decisions regarding subsequent steps will then be made by the company.

#### **g. Compliance Reporting**

The management should set up reporting lines to ensure that all relevant information on (potential) compliance issues is immediately reported to the appropriate persons within the company (e.g. initially the compliance officer, who will then check and verify the information and bring it to the attention of the management, if necessary). Further, the management must ensure that information on compliance issues is brought to its attention on an ad hoc basis, especially if the (potential) compliance issue could result in substantial damages, not only in economic terms, but also from a reputational perspective. Management must also follow up on any additional actions taken regarding a potential compliance issue such as further clarification of the circumstances of the case, an initial risk assessment, as well as subsequent remedies against the employees involved and concrete steps needed to ensure that the issue will not occur again.

In addition to the ad hoc reporting of all compliance-related information to the relevant persons within the company, it has become common practice in quite a number of companies to provide compliance reports on a regular basis (annually, biannually, quarterly). Such compliance reports usually describe the current status of the compliance organization as well as all compliance-related actions taken by the company since the last report including trainings, newly introduced elements within the compliance organization, and compliance violations (if any) and any related remedial actions. As it relates to manager liability, these documents may serve as a starting point for documentation that the management acted in accordance with its duty to implement a sound compliance system, and that even



though a violation of laws by employees has occurred, the management has taken all necessary steps to prevent such violations.

#### **h. Compliance Audit**

The management should ensure that the compliance organization is audited from time to time to thoroughly assess its proper functioning and to uncover potential compliance risks. Such audits should, of course, not be announced in advance to the employees of the department being subject to the audit.

From the management board's point of view, compliance audits are not only important to advance the compliance organization, but also to limit liability risks, in particular concerning potential liability under the OWiG (for details, see E.IX.1. above). There are court rulings in this regard, pursuant to which a member of the management board or the supervisory board must execute, on an ongoing basis, unannounced sample checks of its risk management systems to document that they have not failed to take the supervisory actions necessary to prevent illegal behavior within the corporation.

#### **i. Additional Organizational Measures**

Additional organizational measures may be taken to further the efficiency of the compliance organization. These may include, among others,

- rotation of employees in potentially compliance-sensitive areas of business (for example sales and distribution) to prevent the establishment of ongoing compliance violations between these employees and their third-party contacts;
- implementation of the four-eyes principle in compliance-sensitive areas; and
- use of software-based fraud scans analyzing typically suspicious information, such as irregular account or booking movements within the company.