

# The Compliance Officer's Function within a Company – The Federal Supreme Court decides on compliance officers' criminal liability regarding violation of their duties and challenges the compliance organizations within the companies.

## A Compliance Officer's Responsibility after the BGH's Verdict from July 17, 2009

In a current decision (BGH 5 StR 394/08) the Federal Supreme Court (*Bundesgerichtshof, BGH*) has taken a stance regarding a compliance officer's responsibility within a company. Furthermore, it has integrated the still new company function "compliance" into the German legal system. The decision gives reason to summarize the legal requirements for "compliance" within the company and the tasks, authorities and legal obligations arising herefrom for the affected employees. Furthermore, recommendations should be issued on how to accommodate the statutory and practical requirements.



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## The Case

In the case decided by the BGH the defendant held both the position of head of internal audit and legal department within the “Berliner Stadtreinigung” (Berlin’s public cleaning service), a company owned by the State of Berlin, an institution under public law. The defendant discovered a systematic error, which led to excessive notifications of charges. He informed the responsible member of the management board. However, the defendant followed the board member’s subsequent directive not to correct the systematic error. As a result, the persons liable to the fees were excessively called upon and paid. The defendant was convicted of assisted fraud by failure to act (whereby the fraud was committed by the board member).

The BGH based the conviction upon the infringement of contractual duties arising from the employment agreement and having been taken over by the defendant: to protect both his company from damages, as well as – and this is the important aspect – to prevent damages to third parties through acts from within his own company. Thereby the guarantor’s obligations were incumbent upon the defendant to actively and through his own actions prevent fraud, if necessary by informing the chairman of the management board or the chairman of the supervisory board. The BGH used the case to state that a compliance officer in a private commercial enterprise always has the duty to prevent damages to third parties by the own company. Therefore, such an employee is always a guarantor according to criminal statutes.

## Compliance as a Compulsory Corporate Duty

Every management, e.g. the management board of a stock corporation (*Aktiengesellschaft, AG*) or that of a limited liability company (*Gesellschaft mit beschränkter Haftung, GmbH*) – has the duty to organize the company in such a fashion that both within the company and vis-à-vis external relationships (vis-à-vis third parties and the general public) the legal system’s rules are upheld and statutory violations do not occur (*Legalitätsprinzip*, principle of legality). In particular, it is important to effectively prevent crimes and offenses from being committed from within the company. The term “compliance” has become widely used for in-house precautions to warrant the principle of legality to be upheld.

The compliance’s scope, intensity and target depend on the company’s circumstances, in particular, its size and the type of its operation. As such, the observance of statutory pharmaceutical requirements for a producer of pharmaceuticals has a different significance than for a machine manufacturer, while similar requirements regarding prevention of corruption in purchasing and sales, as well as the establishment of slush funds in both companies may exist.

Establishing a compliance organization and defining the employees’ tasks and authorities and providing them with the means necessary to fulfill their tasks within the company is necessary in mid-sized companies, and in particular also in large companies. Typically, compliance organizations will be lead by an executive employee, the compliance officer (CO) and in larger companies the

chief compliance officer (CCO), who reports directly to the responsible member of management; this executive employee is also the supervisor for the employees assigned to the compliance department.

In fact it is not the compliance officer's primary duty to protect the company from attacks and damages, as is the case, for example, with auditing (preventing breach of trust and embezzlement at the company's expense) and measures for the protection of security of the works (preventing unauthorized persons from entering). Rather, compliance's duty – and, therefore, the employees' duty who work in that area – is the prevention of illegal acts having effect within the company (e.g. violation of regulations for the protection of employees) and outside of the company (e.g. cartel agreements or the use of company computers to exchange child pornography). The compliance officer can also take on additional tasks, such as a data security, money laundering or an export control officer. By accepting these duties compliance officers assume a special legal position, which distinguishes them from the other employees within the company.

## Criminal Law

Amongst others, a compliance officer's typical duties include the prevention of crimes according to the Penal Code (*Strafgesetzbuch, StGB*) and the extensive supplementary penal provisions outside the Penal Code from within the company. Therefore, the compliance officer is qualified and obligated to protect legal interests which could potentially be affected by the company. There are many examples for this, such as

- Protecting the competition from cartel agreements
- Protecting business partners – and indirectly the competition – from corruption
- Protecting customers from unfair business practices and dangerous products
- Protecting company employees (safety at work, data protection, co-determination).

These examples have in common that third party legal interests are at stake here, not the company's legal interests. Accordingly, the company cannot dispose of these, rather, it must protect these legal interests and prevent legal injuries. As a result the compliance officer often only indirectly protects the company itself, such as in the prevention of pecuniary fines or damage to the reputation. The compliance officer's main focus is the protection of third parties and the public from the company or from within the company. Therefore, the compliance officer deals with the defense of dangers in favor of third parties and the public.

By assuming the contractual (employment) duties to prevent dangers, which could affect third parties and the public through the company, the compliance officer is a guarantor within the criminal law meaning, Section 13 StGB. This means that compliance officers must actively prevent statutory violations at the expense of third parties which they notice, as they are obliged to do just that. If they neglect the obligatory intervention then criminal and civil liability are impending.

## Position within the Company

In order to recognize and prevent statutory violations from being committed in the future compliance officers must receive the information necessary to fulfill the respective duties and have access to the relevant documents. This information and access right for the compliance department and its employees should be embedded in the company organization, for example in the general organization directives and (company) guidelines.

Detected violations of laws and rules have to be documented, remedied and effectively prevented in the future. The measures necessary must be instructed. However, typically a compliance officer does not generally have authority to give instructions; the necessary instructions shall be initiated by the company's management. As a consequence the compliance officer should have immediate access to the management member in charge of the respective department. The compliance officer may and must report to said member. The consequence hereof is that the management is informed of the compliance officer's knowledge of possibly illegal occurrences in the company. Management boards and managers are then obligated – just as the compliance officer – to adhere to the principle of legality in the company and to terminate breaches of the law which were noticed, in particular criminal and other offenses. Should management not act despite having knowledge thereof then there is a danger of pecuniary fines, other fines and further negative consequences (e.g. loss of reputation) for the company and the person responsible.

## Challenge

In particular unclear facts or uncertain legal situations can lead to difficult situations, in which the compliance officer must decide whether, when and with which recommendation to act the company's management should be informed.

In particular, a delicate issue arises when a management member does not share the compliance officer's opinion regarding the legality of the company's actions (e.g. in a complex foreign commerce issue with possible violations of embargo duties).

If the management member remains passive in this situation and does not eliminate the alleged unlawful condition then there is a danger of criminal liability due to neglect if a criminal offense has in fact been committed. In such a situation the respective management member shall discuss the topic with the entire management board or within the management and effect a resolution regarding this matter, possibly after having received legal advice from a competent third person who is obligated to maintain secrecy. Should the management then make an informed decision based upon this in good faith as to its legality then a criminal allegation will generally not be manifested. What does remain, however, is a possibly strained relation between management and the compliance officer.

## Labor Law

Compliance officers are typically employees; this is also true for most chief compliance officers, so long as they are not members of the management board, which would be an exception. Management, or as the case may be, the member responsible for that department then has authority to issue directives vis-à-vis the compliance officer and the subordinate employees.

In this it is clear that unlawful instructions – e.g. not acting despite knowledge of illegal acts within the company (as hidden accounts) – are legally irrelevant and need not and may not be followed. But how should a compliance officer act in such a stress situation? What if the compliance activities are issues which affect the superior management board member personally and directly, such as cartel agreements which are tolerated or have even been initiated at the highest level? In such cases the compliance officer's or the superior's career is at risk.

The BGH has the effective answer: if a management board member commits a criminal offense from within the company then it is possible and reasonable for the compliance officer to inform the management board's chairperson or the supervisory board's chairperson. However, the BGH had to render a decision on the – downright convenient – rare case in which the defendant already knew everything that was necessary for the correct assessment of the situation at hand. Cases will usually not be that simple: intensive investigations are necessary to show whether irregular or even illegal behavior has occurred. These investigations can be directed or even terminated by the boards.

This will lead to the conclusion that compliance officers must – in the core area of their work, i.e. the ascertainment and prevention of criminal offenses – not be subject to directives, provided that the compliance organization within a company is properly established.

The examples described above show that while performing their duties compliance officers can be caught in certain conflicts with the management – and it is obligatory that they are – when the board of directors tolerate or initiate substantial breaches of the law or even criminal offenses. In such cases not only is there a risk of (mis-)guidance of the compliance officer by management's directives but also personal disadvantages. Therefore, it should be in line with good corporate governance to establish the compliance organization and the compliance officer's employment in such a manner that while performing the obligatory actions there is no threat of repression or disadvantages.

A similar prohibition of discrimination already exists statutorily vis-à-vis members of the works council and its candidates, Section 78 Sentence 2 Works Council Constitution Act (*Betriebsverfassungsgesetz, BetrVG*), as well as the data protection officer, Section 4f Subsection 3 Sentence 3 Federal Data Protection Act (*Bundesdatenschutzgesetz, BDSG*). The minimal requirements for the German Federal Financial Supervisory Authority's (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*) insider law compliance (Minimal Requirements for Compliance [*Mindestanforderung an Compliance, MAComp*]) are also

headed in that direction, albeit only as a draft. In this the compliance officers' independence and assurance of prohibition from discrimination shall be promoted by appointment for a 24 month period and a 12 month notice period for termination of the employment contract.

Compliance officers should have the possibility of attaining advice from a competent third person who is obliged to maintain professional secrecy. This can be achieved by seeking advice from an auditor or an attorney-at-law. As a result this would reduce the tension stemming from the fact that compliance officers are employees, bound by directives, while at the same time they have the duty to maintain legality within the entire company – including the legality of the board of directors' actions. Independent advice cannot be attained within the company as its hierarchy establishes dependencies – probably from the board of directors. If questioned by the compliance officer about a critical issue, no company member would refuse information to the board of directors regarding the conversation's contents and the advice given. Good compliance must account therefor that and make external advice possible.

## Liability

Both the compliance officer's criminal, as well as civil law liabilities go beyond that of the other company employees – even the managerial employees. This is a result of the circumstance that normally an employee is neither punishable nor liable via tort on a civil law basis for intentional criminal offenses committed by colleagues without the employee's knowledge. However, this is different for the compliance officer: due to compliance officers' special duties they are guarantors according to criminal law statutes and are obligated to actively prevent criminal offenses within the company. If this duty is violated then generally the compliance officer is punishable – typically for aiding by omission. Civil law liability follows criminal liability without further ado: everyone who was damaged by the compliance officer's failure to act can put forward claims for damages against the compliance officer personally and without limitation. This civil law liability due to intentional criminal offenses is not insurable, Section 81 Subsection 1 Insurance Contract Act (*Versicherungsvertragsgesetz, VVG*). Instead, it can be avoided by the diligent fulfillment of duties.

In addition to this increased liability risk vis-à-vis third parties, compliance officers typically also have a higher liability risk vis-à-vis their respective employer: this is, for example, the case when the compliance officer culpably does not recognize or did not prevent an illegal situation within the company – such as a permanent violation of data protection regulations – and, therefore, the company was damaged (e.g. pecuniary fine). The company can here take subrogation against the compliance officer acting in breach of duty. In this the compliance officer cannot invoke labor law liability privileges if the prevention of exactly such a damage was part of the respective contractual employment duties.

## Outlook and Recommendation

The current legal situation is characterized by the fact that the legislator naturally assumes the principle of legality – the guaranty of the company’s acts being lawful – but has not consistently standardized its implementation within the company. Rather, the legislator restricts itself to set up rules in many laws for selective individual compliance aspects. Examples for this are: money laundering, data protection, immission control, water pollution control, instrument and product safety, etc. Some of these laws – those which aim at averting dangers in favor of the public – envisage officially appointed officers in companies, others do not. In future there will most likely be an increase in regulations within this area. The legislator will increasingly recognize dangers which companies will either cause (e.g. environmentally damaging immissions) or for which they will offer an adequate starting-point for enforcement actions (e.g. money laundering). The legislator will then prescribe in detail how the companies are required to avert these dangers.

Insofar as there are no statutory regulations the company is obliged to determine on its own how the legality of its actions is ensured. In this it should abide by the following central ideas:

- Compliance is a company’s duty. The company’s management is obligated hereto.
- This duty can be delegated within a company to a compliance organization, which has one or more compliance officers, depending on the individual situation.
- The compliance organization and its members’ tasks and authorities shall be clearly defined, documented and communicated within the company, as in general organizational directives and guidelines.
- Each compliance officers’ tasks and authorities shall be clearly agreed upon in the respective employment agreements and shall be congruent with the organizational directives and guidelines and documented. Exactly the contractually agreed upon tasks and duties shall actually be assumed and fulfilled by the actual compliance officer – not more and not less.
- The particularities of the compliance officer’s task and position regarding right to information, freedom from directives within a certain scope, protection from being disadvantaged, the right to use the chain of command, access to external advisors who are obligated to secrecy – is to be ensured via appropriate organizational and employment contractual regulations.

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