POHLMANN & COMPANY

International Compliance Update

3/2015

Our "International Compliance Update" portrays current developments and trends in international compliance legislation, jurisdiction and practice with a focus on their relevance for Germany.

Brazil

Legislation amendments for fighting corruption

Eric Mayer

- In the year between two widely acknowledged large-scale sporting events – the football World Cup in 2014 and the Summer Olympics in 2016 – the largest country in Latin America has issued new regulations in March and April 2015 on the **Clean Companies Act** of 2013.
- Additionally, **Guidelines on Compliance Programs** for Private Companies have been published in September 2015 clearly formulating the government´s expectations towards the necessary degree of compliance implementation
- This article deals with their impact on **Compliance Management Systems** of companies operating in Brazil.

>>>

Also in this issue:

A. Hienzsch / N. Willms | **Better safe than sorry – Obligations of the Supervisory Board of a factually insolvent corporation**

M. Erhard | **Enhanced prosecution of individuals by the U.S. Department of Justice – a challenge for companies and executives**

C. Blettgen / C. Salathé | **Internships for relatives of public officials – an "expensive favor"**

Subscribe to the International Compliance Update here.

Overview Clean Companies Act

The new Brazilian anticorruption law – internationally known as Clean Companies Act ("**CCA**")[1] – has already been enacted on August 1, 2013. With the law coming into effect at the beginning of 2014, strict liability of companies and the positive consideration of Compliance Management Systems ("**CMS**") during sanction proceedings have been introduced in Brazil for the very first time. The CCA only applies to companies as legal entities and not to individuals. The latter remain subject to the core of the Brazilian criminal law. According to Article 1 I., the CCA covers companies of all legal forms operating in Brazil. Even temporary "de facto" representations are explicitly mentioned. According to Article 4 CCA, the legal entity's liability continues to exist for the actions of the legal predecessors even in the event of corporate transformation. Under Article 4 I. CCA, companies have to pay penalties and compensate for the damage caused by misconduct of the respective partner within a group, a consortium or a joint venture, Article 4 II. CCA. The CCA deals with a broad spectrum of criminal actions. The bribery of public officials is covered by Article 5 CCA as well as the prohibited concealment of the ultimate economic beneficiaries. Furthermore, it penalizes the distortion or hindrance of competition, e.g. in public tenders. The prohibited actions have to be committed at the expense of the public administration – these include not only numerous government and administration authorities in Brazil, but also foreign public officials.[2] Contrary to the criminal law provisions on individual, Brazilian prosecutors do not have to prove that the company affected acted deliberately or was aware of the misconduct. According to Article 2 CCA, the mere detection of an offence by the company suffices.

Finally, Article 7 VII. CCA provides a possibility for companies to mitigate sanctions. Having implemented "internal mechanisms and procedures of integrity and audit" on the date of the offence, which support "the effective enforcement of codes of conduct" and offer "incentives for the reporting of irregularities"[3] – thus having implemented an effective CMS – can be taken into account for legal sanctions. How exactly a CMS could be considered as a mitigating factor was however not yet stated precisely in the CCA.

New Regulations on the Clean Companies Act

More than a year after the introduction of the CCA new regulations have been enacted with immediate effect to substantiate the CCA in the context of current corruption allegations against politicians and companies in March and April of 2015.[4] These regulations clarify the necessity of implementing the CCA in unprecedented detail und provide precise provisions especially for calculating fines and evaluating existing CMSs of companies.

The Decree of March 18, 2015 explicitly demands in Article 42 the following core components of an effective CMS:

- Tone from the Top
- Comprehensive compliance policy applicable to all employees and managers
- Regular compliance training
- Regular compliance risk assessments
- Correct and transparent books and records
- Internal controls for financial reporting
- Specific compliance processes for public tenders

[1] "*Lei sobre a resonsabilização administrativa e civil de pessoas juridícas pela prática de atos contra a administração pública, nacional ou estrangeira, e dá outras providências*", Law Nr. 12.846 of August 1, 2013, unofficial English translation available at http://www.planalto.gov.br/ccivil_03/_ato2011-2014/2013/lei/l12846.htm

[2] Article 5 CCA is captioned "*Dos atos lesivos à administração pública nacional ou estrangeira*", i.e. harmful acts at the expense of national or foreign public administration.

[3] Article 7 VIII. CCA "(*Serão levados em consideração na aplicação das sanções:) A existência de mecanismos e procedimentos internos de integridade, auditoria e incentivo à denúncia de irregularidades e a aplicação efetiva de códigos de ética e de conduta no âmbito da pessoa jurídica*".

[4] Decree Nr. 8.420 of March 18, 2015, Ordinances of the Office of the Comptroller General (OCG) Nr. 909 and Nr. 910 each of April 7, 2015, OCG Normative Ruling Nr. 1 and Nr. 2.

- Independence and decision making authority of the compliance organization
- Whistleblower systems and protection
- Disciplinary action for misconduct
- Immediate remediation of detected misconduct
- Specific compliance processes for procurement procedures and the monitoring of business partners such as suppliers, service providers, intermediaries or agents
- M&A Compliance Due Diligence Processes
- Continuous monitoring and improvement of the CMS
- Transparency of donations and contributions to political parties or candidates

The Ordinance 909 of April 7, 2015 – unofficially already dubbed as "Compliance Ordinance" in some circles – provides an update of the obligations for companies to develop and operate CMSs. According to the Compliance Ordinance, companies under investigation need to submit a specific report. This compliance risk assessment, referred to as "Profile Report", has at least to specify the industrial sector and countries in which the company operates in, the corporate structure, reporting lines and decision making processes. Information concerning the number of employees, relations with domestic or foreign governmental authorities, the impact of operating licenses, the economic value of government business and its relevance for the financial results of the last three fiscal years as well as ownership structures including the participation in consortia or joint ventures have to be pointed out, too.

The Compliance Ordinance clarifies how to evaluate the effectiveness of the existing CMS. Another company report – the so-called "Observance- or Assessment Report" – has to indicate which of the aforementioned CMS core components have been implemented in what manner taking into account the specific corporate situation. Additionally, this report needs to prove the suitability by means of statistics and explain how the CMS of the company concerned can prevent the accused misconduct in the future.

Brazilian prosecutors can request additional documents and conduct investigations on their own account. If the evaluation by the authority reveals that the CMS is only partially implemented and therefore unsuitable, the affected company cannot claim mitigation.

Guidelines on Compliance Programs for Private Companies

Finally, the Comptroller General of the Union[5] - a branch of the Brazilian federal government – published end of September 2015 guidelines for private companies on the design and operation of compliance programs.[6] While the content is not compulsory in a legal sense, these guidelines are clearly formulating the Brazilian government´s expectations towards the design and operation of effective CMS in private business. The guidelines are based on a "Five-Pillar" model:

1. Top Management Commitment and Support
2. Responsibility and Autonomy of the Compliance Function
3. Compliance Risk Analysis
4. Compliance Rules and Instruments
5. Continuous Improvement

The authors of the guidelines emphasize that all pillars must be interdependent from each other. They should never be implemented in isolation. Only when functioning in a joint and combined manner companies can improve their CMS.

[5] *Controladoria-Geral da União* ("CGU")
[6] "*Programa de Integridade – Diretrizes para Empresass Privadas*", Brasilia, September 2015

Summary and Outlook

The CCA implementation provisions have the potential to catch up with modern anticorruption legislations such as the U.S. FCPA, the U.S. Sentencing Guidelines or the UK Bribery Act. The recent CGU Guidelines reflect strongly converging trends in the international fight against corruption. Given the multitude of publicly known investigations based on corruption allegations, it may not be unrealistic to assume that Brazilian authorities are actually going to adhere to the described new regulations immediately and further expanding their expertise in assessing effectively implemented CMSs on a case by case basis. All foreign companies already operating in Brazil or planning to do so in the future must recognize the significantly increased importance of risk-based compliance programs that are actually implemented closely to business operations. Companies without any compliance structures should at least conduct a compliance risk assessment as soon as possible. Companies that have already implemented a CMS should analyze its effectiveness by a Compliance Health Check. Especially in Brazil such a Compliance Health Check must include the review of a systematic implementation of Business Partner Checks. Local Joint Venture partners need to be examined just as thoroughly as well as corporate take-overs within Brazil in terms of a comprehensive M&A Compliance Due Diligence.

Eric Mayer
is Partner of Pohlmann & Company in Munich. He advises international corporations on the design and implementation of Compliance Management Systems focusing on business partner checks and M&A compliance due diligences.

Germany

Better safe than sorry – Obligations of the Supervisory Board of a factually insolvent corporation

Andrea Hienzsch

- A Supervisory Board that positively knows its company to be in crisis is subject to increased monitoring obligations.
- The Supervisory Board is only obligated to prevent the Management Board from making prohibited payments, if it is apparent to the Supervisory Board that the company is factually insolvent; a threatening insolvency does not trigger this obligation.

Background

Again, a Higher Regional Court had to take a position with regard to the liability of members of a Supervisory Board of a company in crisis: In its verdict dated March 6, 2015 (11 U 222/13 – not yet legally binding) the Higher Regional Court of Hamburg had to deal with the liability of members of a Supervisory Board of a factually insolvent corporation. The company's insolvency administrator sued the members of the Management Board and the Supervisory Board, both, for compensation of payments made to a debit account of the factually insolvent company. Due to its obligation to maintain the assets of the company, once a company is factually insolvent, its Management is obligated to ensure that payments made by the company's debtors are not paid to a debit account; failure to comply with this duty results in the Management being liable for these payments ("prohibition of payment"). In the present case, the insolvency administrator argued that the members of the Supervisory Board were obligated to urge the Management Board to implement a monitoring and early-warning system focused on the persistence of the company (sec. 91 para. 2 German Corporation Act) and to check the Management's statements regarding the company's financial situation for plausibility.

The Decision of the Higher Regional Court

The Court states, that the Supervisory Board was subject to "*increased monitoring obligations*" with regard to the above mentioned prohibition of payments and in connection therewith was obligated to "*get an exact picture of the economic situation of the debtor [the corporation] as well as to exploit all sources of information available pursuant to sec. 90 para. 3, 111 para 2 of the German Corporation Act*".

The dismissal of the claims by the Higher Regional Court is only owed to the factual circumstances of the present case: the insolvency administrator failed to demonstrate that the members of the Supervisory Board actually knew or should have known of the illiquidity of the company. Furthermore, a breach of duty also would not have led to a loss of company's assets: As all of the company's claims towards third-party debtors were already assigned to the bank (global assignment of receivables; *Globalabtretungsvereinbarung*) and were thus not part of the company's assets anymore, the payments to the debit account did not cause any financial damages for the company.

>>>

Consequences for the Supervisory Board

It remains to be seen how the Federal Supreme Court will decide on this as an appeal is currently pending.

One thing, however, can be concluded for sure: Even though the burden of proof lied with the insolvency administrator, the members of the Supervisory Board were very well advised to analyze and, if necessary, question the information obtained from the Management Board and keep record of their own course of action. The verdict of the Higher Regional Court of Hamburg again demonstrates, that not only the Management of an insolvent company may be held liable for making prohibited payments, but also the members of the Supervisory Board, if they have not sufficiently urged the Management to refrain from making such payments and file for insolvency in due time.

Andrea Hienzsch
is Associate at Pohlmann & Company in Munich. She was admitted to the bar in Germany in 2013. During her studies and her legal traineeship, she worked for several international law firms in Germany and in Washington D.C., USA.

Nicole Willms
is Partner at Pohlmann & Company. She advises German and international clients in the areas of corporate law, mergers & acquisitions and corporate restructurings as well as compliance and corporate governance.

USA

Enhanced prosecution of individuals by the U.S. Department of Justice – a challenge for companies and executives

Dr. Max Erhard

- In a memorandum released on September 9th the U.S. Department of Justice announced a stronger focus on individual wrongdoers during white collar crime investigations.
- The memorandum increases the general investigational pressure and enlarges the risk of employees and executives to be entangled in investigations.
- More than ever the numerous companies with a U.S. connection should take appropriate compliance measures to counter possible white collar crime in advance.

On September 9th the U.S. Department of Justice ("**DoJ**") released a memorandum by Deputy Attorney General Sally Yates.[1] The memorandum will bring a change for criminal and civil state investigations towards "seeking accountability from individuals who perpetrated the wrongdoing".[2]

The so called "Yates Memorandum" provides six directives to DoJ prosecutors that are to guide all DoJ investigations of corporate misconduct. These directives have the purpose to carry the responsible individual executives and employees into the focus of the investigation. The aim is to bring about fair and parallel outcome for corporations and individuals.

In short

Summarized the memorandum identifies the following six principles:

- To be eligible for any cooperation credit, corporations must provide to the DoJ all relevant facts about the individuals involved in corporate misconduct.
- Both criminal and civil investigations should focus on individuals from the inception of the investigation.
- Criminal and civil attorneys handling corporate investigations should be in routine communication with one another.
- Absent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals.
- Corporate cases should not be resolved without a clear plan to resolve related individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized.
- Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond that individual's ability to pay.

What are the implications for companies with potential U.S. nexus?

The memorandum has significant impact on companies with incidents of white collar crime and a U.S. connection. To generate a U.S. connection already a single phone call by an employee in the territory of the U.S. supporting bribery may be sufficient.

For these companies and their executives and employees there is an enhanced risk of becoming the subject of a criminal investigation.

[1] http://www.justice.gov/dag/file/769036/download
[2] Memorandum on "Individual Accountability for Corporate Wrongdoing", p. 1.

The Yates Memorandum sends out the clear political message not to neglect the prosecution of individuals – unlike experienced in cases connected to the financial crisis. The circumstance that individuals were not held accountable in the past, led to considerable resentment among the general public. It is expected that the DoJ will implement the directives laid out in the Memorandum and deliver first results quickly.

The thereby increased investigational pressure and consequently enlarged risk of significant individual penalties will induce many employees to disclose possible violations to the investigating authorities to qualify for a penalty reduction themselves. This tendency will even be enhanced by the significant financial incentives[3] that have been introduced for disclosure of violations in some sectors.

At the same time there is reason to believe that the willingness to cooperate during an internal investigation of these violations will decrease. Because an involved employee will hardly assist in the investigation of an offence, for example in the context of a settlement, if he can be certain that his employer will pass on all relevant facts of his involvement to the DoJ. Employees might also withhold information until they can use them during their own negotiations with the DoJ. An exemption may be antitrust cases where as part of the DoJ's Corporate Leniency Policy individuals may still be granted impunity together with the employing company.

[3] Under Sec. 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law No. 111-203) whistleblower may receive a reward of 10 to 30 % of the money collected through the initiated investigation.

Outlook

This drain of information will cause increasing problems for involved companies to come up with the information level needed for cooperation credit. It gets harder to even qualify for such a credit. As a consequence internal investigation by external law firms that are essential for a productive cooperation with the DoJ will become more time and cost intensive.

More than ever the numerous companies with a U.S. connection should take appropriate compliance measures to counter possible white collar crime in advance.

Dr. Max Erhard
is Associate at Pohlmann & Company in Frankfurt. He studied law at the Albert Ludwigs University of Freiburg and earned his doctorate with a thesis on a competition law topic.

World

Internships for relatives of public officials – an "expensive favor"

Clemens Blettgen / Charlotte Salathé

- The FCPA prohibits companies from improperly influencing public officials with "anything of value".
- The Bank of New York Mellon was ordered by the SEC to pay a hefty fine for giving internships to relatives of government officials.
- As a result companies should further enhance the monitoring of their hiring practices.

The Bank of New York Mellon Case

On August 18th of this year, the Bank of New York Mellon ("**BNYM**") was ordered by the *Securities Exchange Commission* ("**SEC**") to pay a total of 14.8 million USD for the violation of anti-bribery provisions of the *Foreign Corrupt Practices Act* ("**FCPA**")[1] and internal accounting control provisions.

In 2010 and 2011 three internships were given by BNYM to relatives of government officials, who are working for the Middle Eastern Sovereign Wealth Fund, a government fund, which is an important client of BNYM. In an internal email to a colleague a BNYM employee described the provision of the internships as an "expensive favor" – how true.[2] As requested by the affected government officials, their sons and nephew were granted customized one-of-a-kind training programs without meeting the criteria of BNYM's ordinary internship programs. The interns had the possibility to work in a number of different BNYM business units for a period of several months, exceeding the value usually provided to BNYM interns even though their performance was below-average. Whether paid or not "[t]he internships were valuable work experience, and the requesting officials derived significant personal value in being able to confer this benefit on their family members".[3]

Therefore, the SEC charged BNYM with violating Section 30A of the Securities Exchange Act "by corruptly providing valuable internships to relatives of foreign officials from the Middle Eastern Sovereign Wealth Fund in order to assist BNY Mellon in retaining and obtaining business".[4] Furthermore the SEC accused BNYM of having violated their duty by "failing to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that its employees were not bribing foreign officials".[5] It follows that the existence of an internal FCPA-related policy is not sufficient to meet the requirements of the SEC, but rather its monitored compliance has to be ensured.

The BNYM case recalls an incident that occurred in China in 2006, when JP Morgan hired the son of China's current commerce minister Gao Hucheng. Despite very low job performance and immature behavior, JP Morgan did not only hire him, but also saved him during major job cuts and later was prepared to offer him another position if he had responded to their queries. In return for sparing the son from job cuts, the minister indicated repeatedly that he would be willing to "go extra miles" for the bank.[6]

[1] 15 U.S.C., § 78dd-1 et. seq.
[2] BNYM Order, No. 16.
[3] BNYM Order, No. 21.; One of the interns was unpaid, the other two were paid above the normal salary scale for BNYM undergraduate interns but below the scale for postgraduates as they had already graduated from college.
[4] BNYM Order, No. 31.
[5] See above.
[6] Wall Street Journal – "In J.P. Morgan Emails, a Tale of China and Connections": http://www.wsj.com/articles/in-j-p-morgan-emails-a-tale-of-china-and-connections-1423241289

Broad reach of the FCPA

Even though the offenders in both cases were banks, it is legitimate to assume that soon the SEC will also target other industries concerning the "anything of value" provision under the FCPA. Giving internships to relatives of business partners and friends is a common practice within the public industrial and even more so in the private sector. Thus more and more companies around the globe should be aware that their hiring practices are being closely monitored by the US authorities. The FCPA, with its broad reach, directly applies to US and foreign companies listed on the US Stock Markets and furthermore to any US or foreign natural or legal person that takes action to support bribery while in the territory of the United States (§ 78dd-3 FCPA).

With the BNYM Order the SEC applies the controversial "quid pro quo" approach frequently used by the Department of Justice for criminal corporate prosecutions. The SEC initiated a cease-and-desist proceeding (according to Securities Exchange Act, Section 21 C) on the condition that the bank would pay the fine. This conduct sets a precedent for potential future judgments even though the SEC is no judicial body, resulting in harsh criticism from various law experts.

How to tackle the issue

In order to stay compliant, firms should focus on paying closer attention to their HR department and the practices and procedures within. A state-of-the-art Compliance Management System should also include internal controls for these particular issues with the aim of not only being risk-based and fully integrated, but also distinguish itself through practicability and applicability for all employees of a company. Additionally it is crucial to raise awareness and understanding of the broad reach of the FCPA within the entire organization and to train the hiring personnel adequately. They should be encouraged to second guess any internship or employment request or recommendations given to them by higher level management.

In the end, companies have to ensure that all employees receive regular trainings concerning external rules and regulations as well as internal policies and not only understand but also implement them into their daily business routine.

Clemens Blettgen
is Consultant at Pohlmann & Company in Frankfurt. During his studies with focus on Cartel Prevention he gained international experience in Consulting, Project Management and Antitrust Risk Management.

Charlotte Salathé
is Junior Associate at Pohlmann & Company in Frankfurt and Legal Trainee at the regional court in Hanau. Since 2013 she is taking part in international mandates in the area of Compliance.

Corporate. Compliance. Governance.

We'd like to know your areas of interest.
Please send us your suggestions via e-mail to:
update@pohlmann-company.com

Pohlmann & Company

Ulmenstraße 37-39
D-60325 Frankfurt a.M.
P: +49 (0)69 260 1171 40

Nymphenburger Straße 4
D-80335 München
P: +49 (0)89 217 5841 70

1000 Rue de La Gauchetière 24th Floor
Montréal, QC H3A 4W5, Canada
P: +1 514 448 7487

www.pohlmann-company.com

update@pohlmann-company.com

Subscribe to the International Compliance Update here.

Imprint (Link)