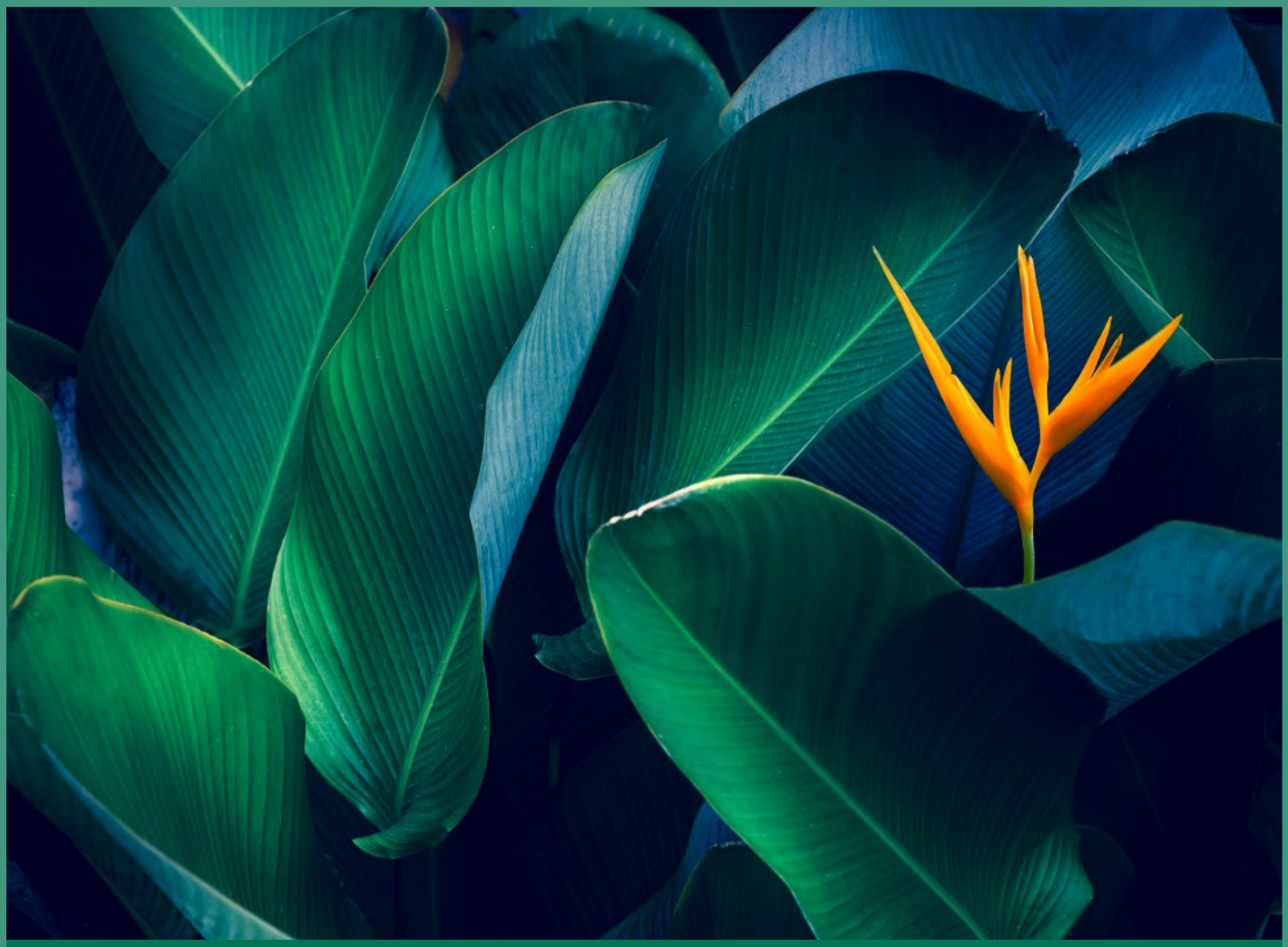


Corporate liability for crimes against the environment

Driving a culture of compliance and sustainability

mazars

Introduction

Environmental protection is one of the most important social, governmental and transnational tasks of our time. To approach this challenge, various disciplines must be included, reinforcing and reflecting each other. Criminal law comes in as a sanctioning instrument, when other measures have not sufficed to ensure compliance with environmental laws and regulations. The importance must not be underestimated.

In financial terms, crimes against the environment can be considered the third largest crime sector in the world.

The financial damage caused to the global community has been estimated at up to USD 258 billion annually.[1] However, environmental crimes have impacts beyond those posed by regular criminality. They harm human health, cause irreversible ecological damages and compromise our ability to achieve the sustainable development goals.

The range of perpetrators is not only to be found in organized crime, but also in regular businesses. Even though companies and corporations are increasingly adopting sustainability efforts, they are always at risk of individual wrongdoings. This is especially true for highly developed organizations based on their division of labour, which can lead to a diffusion of responsibility. Moreover, an immanent conflict between growing stakeholders' expectations on sustainable products, on the one side, and competitive markets, on the other side, may facilitate criminal behavior to achieve the economic goals set by management.

A prominent and illustrative example is the 'Dieselgate' scandal which originated from the German car manufacturer Volkswagen. In 2006, aiming to become the world's leading automaker, Volkswagen called for tripling the company's U.S. revenues by focusing its sales strategy on 'Clean Diesel' vehicles. Almost a decade later, as Volkswagen had fulfilled its long-held goal, the U.S. Environmental Protection Agency (EPA) alleged Volkswagen for violations of the Clean Air Act by having installed defeat devices to circumvent given emission standards.[2]

In January 2017, Volkswagen plead guilty on criminal charges of conspiracy, fraud, making false statements and obstruction of justice.[3] As has been reported, U.S. authorities have extracted USD 25 bn in fines, penalties, and restitution from Volkswagen.[4] Yet in Germany, the situation appears different. In absence of a corporate criminal law, German authorities could only treat the case as an administrative offence. In 2018, state proceedings ended by imposing a total fine of EUR 1 bn.[5]

The diesel scandal had its effect on the public and raised questions among the German government and legislators:

- How can Criminal Law contribute to strengthen integrity in the economic area?
- How can corporations benefitting from business-related crimes be held liable adequately?
- How can board members and upper management be incentivized to invest in compliance and investigate suspected violations diligently?

This paper aims to provide some answers by picking up the discussion and looking into the government's plan in Germany to introduce a new sanction regime for company-related criminal offences. Special attention will be paid to crimes against the environment, the effective combating of which is more urgent than ever before.

* Views and opinions expressed in this article are those of the author.
1 "The Rise of Environmental Crime", UNEP/Interpol 2016.
2 "Notice of Violation, Clean Air Act", EPA 18 September 2015.
3 www.justice.gov/opa/pr/volkswagen-ag-agrees-plead-guilty-and-pay-43-billion-criminal-and-civilpenalties-six.
4 "How VW Paid $25 Billion for Dieselgate - And Got Off Easy", Roger Parloff in: ProPublica 6 February 2018.
5 The total sanction consisted of a fine of EUR 5 million and the disgorgement of economic benefits in the amount of EUR 995 million.

1. Crimes against the environment

The term environmental crime is not universally agreed on. Often it is understood to include any unlawful act harming natural resources, aimed to benefit individuals or companies. The most well-documented crimes include

- the illegal release of substances into the air, water, or soil,
- illegal trade in wildlife or substances that deplete the ozone layer,
- illegal shipment or disposal of waste, or
- endangering protected areas.

As environmental crimes can be as profitable as drug or human trafficking, it is also highly attractive for organized crime groups. Illegal logging, as an example, accounts alone for estimated USD 51-152 bn in annual damages. Losses of government revenues through lost tax income due to criminal exploitation account for estimated USD 9-26 bn annually.[6]

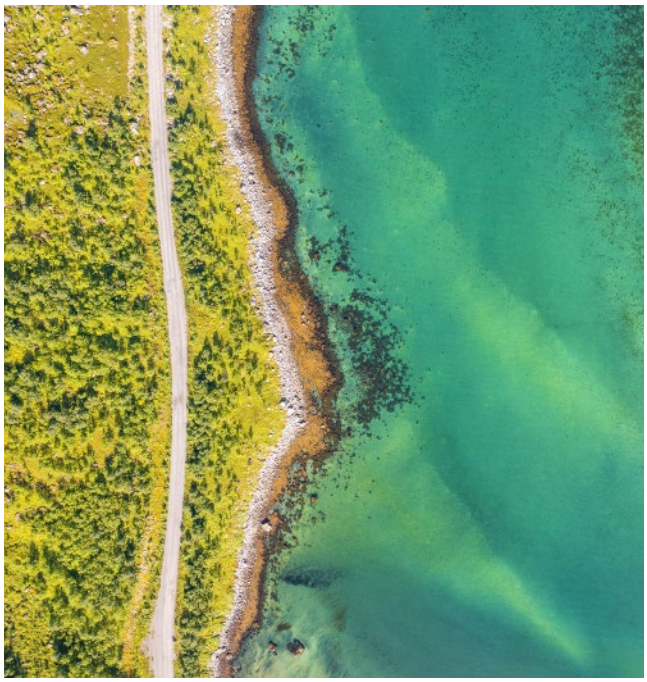
From a legal point of view, crimes against the environment are linked to an increasing variety of environmental laws and regulations both at the international and national level. As most offences require an 'unlawful' act, the deliberate violation of environmental regulations and standards forms the ground for criminal liability and prosecution. However, crimes against the environment should not be seen in a narrow sense.

Environmental crimes committed in a business context are often also linked to classical areas of white-collar crime like bribery of public officials, fraud, forgery of documents, or accounting and tax offences.

In addition, crimes against the environment are not only a phenomenon of organized crime, but also of regular business activities.

- Modern phenomena can be seen, for instance, in carbon credits and emissions trading – one of the world's fastest growing commodities market. In 2021, the value of global carbon markets grew to EUR 760 bn.[7] It is therefore not surprising the market is also abused for fraudulent purposes. Already in 2009, Europol reported that in some countries up to 90% of the market volume could be due to fraud.[8] Emissions trading schemes are also associated with money laundering risks as they offer an easily tradable financial product administered and guaranteed by states.[9]
- In cases of so-called greenwashing, customers and investors are misled by the deliberate exaggeration of the sustainability of a product. Since investors are increasingly focused on environmental, social, and governance (ESG) aspects when making investment decisions and many funds consider ESG factors in their investment strategies[10], inevitably, there is also room for deception. The U.S. Securities and Exchange Commission (SEC), for instance, charged BNY Mellon Investment Adviser for misstatements concerning ESG considerations[11]. Other investigations into greenwashing allegations were recently commenced against Goldman Sachs Asset Management[12] or against German Bank fund subsidiary DWS.[13]

Besides the wide range of offences that can be connected to environmental crimes, their cross-border dimension must be considered. In the case of international corporations, risks may arise from decentralized structures and independently operating foreign branches. At the same time, the consequences of individual offences often extend across national borders. An effective response therefore requires an international harmonization of environmental crimes as well as the closest possible cooperation between national prosecution authorities.



6 "The Rise of Environmental Crimes", p. 7.
7 www.statista.com/statistics/1334848/global-carbon-market-size-value/.
8 In particular, carousel transactions occurred by which emission allowances were sold several times across EU borders in fraudulent schemes and VAT was unlawfully refunded to traders by tax authorities; www.europol.europa.eu/media-press/newsroom/news/carbon-credit-fraud-causes-more-5-billion-euros-damage-for-european-taxpayer.
9 "Erkennung von Geldwäsche im Emissionshandel" (Detection of Money Laundering in Emissions Trading), Umweltbundesamt 19/2020.
10 Morningstar found that at the close of 2020 the number of "sustainable" open-end funds and exchange-traded funds available to U.S. investors had experienced a nearly fourfold increase over the past decade with a significant acceleration beginning in 2015; Morningstar Manager Research (Feb. 10, 2021), available at www.sec.gov/comments/climate-disclosure/cll12-8899329-241650.pdf.
11 www.sec.gov/news/press-release/2022-86.
12 "SEC investigating Goldman Sachs for ESG claims", Financial Times of 11 June 2022
13 "ESG's legal showdown: There's nothing to suggest DWS is a one off", Financial Times of 14 June 2022.

2. Prosecution of Environmental Crimes in the EU

In the European Union, around 80 percent of environmental laws applicable in Member States are shaped by the European Institutions. Today, several hundred directives, regulations and decisions are in force in this area.[14] However, the prosecution of criminal infringements remains in the sole competency of each Member State.

In 2008, the EU introduced the directive on the protection of the environment through criminal law, defining a range of serious infringements and obliging Member States to introduce – as a minimum rule – *"effective, proportionate and dissuasive"* sanctions for such offences.[15]

Although the 2008 directive has led to some harmonization, the European Commission still found considerable enforcement gaps in all Member States and at all levels of the enforcement chain (police, prosecution and criminal courts). Over the past 10 years the number of environmental crime cases successfully investigated and sentenced remained very low. Moreover, the sanction levels imposed were too low to be dissuasive.[16]

To address the growing gap between criminal justice response and the criminological situation on the ground, the European Commission continues its efforts to create a level playing field across the EU.

In December 2021, as part of the wider package of initiatives to fulfill the European Green Deal, the Commission proposed a revision of the 2008 directive aimed to establish common ground for additional criminal offences (such as illegal timber trade, illegal ship recycling or illegal water abstraction) and to clarify existing definitions to provide more legal certainty.[17]

Regarding the liability of corporations, the Commission's proposal obliges Member States to ensure corporate liability where environmental offences have been committed for their benefit. It also provides that Member States should make sure that legal persons can be held accountable for a lack of supervision and control that has made possible the commission of the respective offence.[18] Similarly to the 2008 directive, Member States shall ensure that a legal person held liable faces *"effective, proportionate and dissuasive"* sanctions.[19] In which way this is implemented, remains up to the Member States. Insofar, the European Commission takes account of national legal traditions and provides that sanctions for legal persons can also be of non-criminal nature.[20]

[14] Examples include Directive 84/360/EEC of 28 June 1984 on the combating of air pollution from industrial plants, Directive 91/689/EEC of 12 December 1991 on hazardous waste, Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora, Directive 94/62/EC of 20 December 1994 on packaging and packaging waste.
[15] Directive 2008/99/EC of 19 November 2008.
[16] Evaluation of Directive 2008/99/EC, SWD (2020) 259 final of 28 October 2020.
[17] Proposal of 15 December 2021 for a Revision of Directive 2008/99/EC, COM (2021) 851 final.
[18] Article 6 (Liability of legal persons), COM (2021) 851 final.
[19] The imposition of effective, proportionate and dissuasive" sanctions against companies is also stipulated in a variety of international legal instruments. Examples include, inter alia, the UN Convention of 31 October 2003 against Corruption, the OECD Convention of 17 December 1997 on Combating Bribery of foreign public officials in international business transactions or the EU Directive 2018/1673 of 23 October 2018 on combating money laundering by criminal law.
[20] Article 7 (Sanctions for legal persons), COM (2021) 851 final.

3. Concepts of Corporate Liability

Considering the differences of national legal systems in the area of corporate criminal liability, a distinction can be made between two basic concepts, namely classic corporate criminal law systems under which actual criminal sanctions can be imposed, and systems where companies are held responsible under administrative law.

Classic corporate criminal law is primarily found in common law tradition. U.S. law has known about corporate criminal liability for over a hundred years now. In 1909, the U.S. Supreme Court confirmed the criminal liability of corporations.[21]

"While corporations cannot commit some crimes, they can commit crimes which consist in purposely doing things prohibited by statute, and in such case they can be charged with knowledge of acts of their agents who act within the authority conferred upon them."

Countries from the continental European legal sphere only began to sanction companies under criminal law much later.[22] The difficulty is rather dogmatic and lies in the 'concept of personal guilt' according to which a criminal sentence may only be imposed if the perpetrator can be personally blamed for his act. Obviously, since a legal person may not act itself, but only through its organs and employees, it cannot be meaningfully accused of personal guilt in a human sense. Hence, corporate criminal liability is repeatedly questioned by widespread circles in academia and practice.

Depending on the individual concept, legal systems know different forms of sanctions tailored to companies like, for instance, the restriction or prohibition of a business activity, the withdrawal of a permit or of subsidies, the exclusion from public award procedures or, as a last resort, the dissolution of a company. As can be seen from the example of the diesel scandal, the effects of these conceptual differences can be quite tangible.

[21] New York Central & Hudson River Rail Road Co. v. United States; www.supreme.justia.com/cases/federal/us/212/481/.

[22] European countries with corporate criminal law in the classical sense include Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Hungary, Iceland, Ireland, Italy, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovenia, Spain, Switzerland, United Kingdom and Cyprus. Other countries with corporate criminal law are, for example: Argentina, Australia, Brazil, Canada, China, India, Indonesia, Israel, Japan, New Zealand, South Africa, South Korea and the United States.

4. Current Approach in Germany

Germany has not yet codified a corporate criminal law. For the sanctioning of companies, recourse is made primarily to the Administrative Offences Act (Gesetz über Ordnungswidrigkeiten, OWiG). Section 30 provides the central norm according to which

"a fine can be imposed on companies if a member of management commits a criminal (or administrative) offence and thereby violates company-related duties or enriches the company."

The concept is based on a factual approach and refers to persons who actually exercise management or control functions including members of a supervisory board, compliance officers or auditors.

Alternatively, Section 30 OWiG also permits the imposition of a fine in case of

"offences committed by non-leading employees, if proper supervision would have prevented the offence or made it considerably more difficult."

The maximum fine is up to EUR 10 million in the case of intentional offences, and up to EUR 5 million in the case of negligent offences. So far, the fine has also been intended to skim off the economic advantage gained from the offence and may, for this purpose, exceed the maximum amount.

Clearly, the current law was designed for purely administrative offences. When it comes to the prosecution and punishment of criminal corporate behavior, several inadequacies can be observed:

- The maximum fine applies irrespective of the size of the company concerned and does not allow for severe sanctions against financially strong corporations. Corporate sanctions can best develop their preventive effect, if tailored appropriately to the individual financial circumstances. This is currently not guaranteed when it comes to financially strong multinational corporations.[24] Small and medium-sized enterprises, on the other hand, are hit much harder and are thus unfairly disadvantaged.
- According to the procedural design and its so-called 'principle of opportunity', even the prosecution of most serious corporate criminal crimes is left to the discretion of the competent authorities. As police and prosecution authorities generally tend to be overloaded while, at the same time, considerable differences in staffing levels can be observed, practical experience shows that proceedings are often not initiated.
- Prosecution authorities and courts can basically only choose between a monetary fine and the abatement of action. With this limited set of sanctions, it is made difficult to find adequate responses to the diverse manifestations and causes of corporate crime.
- In principle, criminal offences committed abroad may only be sanctioned in Germany if the individual perpetrator was of German nationality. For the sanctioning of companies, however, this leaves room to evade corporate liability by the targeted use of foreign employees abroad.

As a result, a reform of corporate criminal liability has been demanded for years - accompanied by lively discussions among practitioners as well as academics.

[24] Even if there are corporate fines in considerable amounts in individual cases, these sums ,however, are largely due to the confiscation of assets and thus only "neutralize" the economic advantages gained from the offence, without any real punishment being associated with it.

5. Reform of the German Sanction Regime

In 2020, the German government introduced a draft 'Corporate Sanctions Act' (hereafter referred to as "Draft CSA"). The draft bill finally failed in parliament, due to opposition from the CDU/CSU parliamentary group. However, since the new federal government took over in 2021, the reform of corporate criminal liability remains on the political agenda. Insofar, the coalition agreement of the governing parties states:

"We are protecting honest companies from unlawful competitors. We are revising the rules on corporate sanctions, including the level of sanctions, to improve the legal certainty of companies with regard to compliance obligations and to create a precise legal framework for internal investigations."

How this will be done in detail remains open. Nevertheless, important cornerstones seem to have already been set while debating the draft CSA in 2020. It can be expected that following aspects will be part of the upcoming legislative reform.

Tougher Penalties

The current limits for monetary fines will be significantly increased. Administrative fines shall be replaced by 'corporate sanctions', which, like a criminal fine, will be based on the economic capacity of the company concerned. In cases against companies with an annual turnover of more than 100 million euros, the draft CSA of 2020 provided for monetary sanctions up to 10 per cent of the worldwide group turnover (5 per cent in the case of a negligent corporate offence). As a decisive factor the draft bill referred to the worldwide turnover of all entities operating as an 'economic unit', meaning that the group operates under uniform management. Depending on the size of the company and the magnitude of the offence, this approach will allow for sanctions amounting to several billions of euros – from a German perspective a situation only seen in European antitrust proceedings and in foreign legal systems.

Principle of Legality

German prosecution authorities, when suspecting a business-related crime, shall be obliged to initiate criminal proceedings against the respective company. The public prosecutor's office shall have no discretion in this respect any longer.

Offences Abroad

The geographical reach of the current sanction regime shall be extended to criminal offences committed abroad. It is therefore expected that corporations based in Germany may, in principle, be sanctioned for crimes committed by employees anywhere in the world, regardless of the perpetrators' nationalities. Even crimes committed abroad by external third parties or by foreign agents working for German companies may lead to a corporate sanction in Germany.

On the other hand (corresponding to aforementioned reactive elements), German companies can expect significant incentives for investing in compliance systems and for internal investigations into alleged violations.

Incentives for Compliance

Under the current regime, compliance measures are to be taken into account when assessing the appropriate level of sanctions. In particular, courts should consider whether a corporation has designed its internal processes in a way that violations are at least made significantly more difficult in the future. However, in absence of an explicit regulation and an established case law, there is still a lack of legal certainty impairing the incentive to invest in compliance.

Beside the introduction of clearer sentencing rules, the Draft CSA provided courts with the possibility of instructing companies to implement certain compliance measures to prevent future offences. At the same time, compliance with the instructions ordered shall be monitored by a competent institution, namely a law firm or auditing company.

Parallels to the U.S. enforcement approach are obvious. The U.S. Department of Justice signaled its preference for the use of corporate monitorships in criminal matters where appropriate. Especially when compliance management systems are untested, ineffective or inadequately resourced, the Department's attorneys shall consider imposing a compliance monitor.[25]

Under the terms of its 2017 Plea Agreement, for example, Volkswagen agreed to an independent compliance monitor, overseeing the company's efforts to implement a compliance program preventing and detecting violations of environmental laws and fraud. During the monitorship nearly 300 new or revised internal regulations and policies had been implemented. Volkswagen undertook efforts to institutionalize a "Three Lines-of-Defense" model throughout its product development process to ensure that

[25] U.S. Department of Justice, Memorandum dated 28 October 2021; www.justice.gov/dag/page/file/1445106/download.

- business units are operating effectively (First Line-of-Defense),
- there is a supervisory and monitoring process to ensure compliant operations (Second Line-of-Defense), and
- annual risk assessments lead to internal audits of key processes (Third Line-of-Defense).[26]

Further safeguards included, for instance, the introduction of a uniform Code of Conduct and implementing a group-wide whistleblowing system.[27]

Incentives for Internal Investigations

Besides honoring compliance safeguards, it shall work in favor of a company concerned when it contributes to the resolution of the case. In this context, the Draft CSA 2020 envisaged a reduction of corporate fines by 50 per cent, provided that

- the company's internal investigation made a significant contribution to clarifying the facts of the alleged offence,
- the company continuously and fully co-operates with the authorities and voluntarily discloses its main findings and evidence, and
- employee interviews carried out during the investigation respect the principles of fair trial and comply with certain procedural requirements.

The court was expected to consider, in particular, the timing of disclosure, the nature and scope of facts disclosed and the extent of support provided to prosecuting authorities.

Again, parallels can be seen with the U.S. enforcement practice, which regularly rewards the willingness of companies to cooperate with significant sanction reductions. In case of the diesel scandal, Volkswagen gave U.S. prosecutors access to an internal investigation that comprised more than 700 interviews, more than 100 million documents and forensic email reviews on a massive scale. In return for its cooperation, Volkswagen received a credit of 20% from its criminal fine finally settled with the U.S. Department of Justice.

[26] Independent Compliance Auditor Report dated 16 June 2020.

[27] www.Volkswagen-newsroom.com/en/press-releases/Volkswagen-ag-successfully-completes-independent-compliance-monitorship-under-agreements-with-us-authorities-6382.

6. Investigation Readiness

For responsible business leaders, the incentives outlined above should be reason enough to establish an ‘investigation readiness’ within the organization. Companies are well advised to clarify suspicious cases in a timely and professional manner and to have the necessary processes and resources in place.

From a defensive point of view, internal investigations also help to avert consequential damages as, for instance, claims by injured consumers or competitors, regulatory consequences such as exclusion from tenders or a drop in turnover because of lost reputation.

On the other hand, losses and damages suffered by the company itself must be assessed and compensated in a swift manner. To identify, protect and enforce its own legal positions and claims, it is again important to clarify the facts of the case. Monetary damages must be quantified, and evidence must be obtained and documented in a way permissible to be used in court.

A successful internal investigation therefore requires quick, legally secure and precise action. To ensure an independent approach, it has become established practice to commission external audit or law firms with leading the investigation, at least in more complex cases. Depending on the individual circumstances, various disciplines within the company concerned should be involved.

- The compliance department can contribute its knowledge of the company‘s risk situation as well as of existing safeguards and controls. Similar applies to internal audit since its general task is to identify weaknesses in the company‘s risk management.
- Before interviewing employees, HR departments and (as given) workers councils should be consulted in consideration of potential labor law concerns.
- The early involvement of IT and data protection officers ensures fast and legally compliant access to relevant data systems.
- To ensure the integrity of digital evidence, tried and tested filtering, scoring and analysis tools should be used by skilled IT-forensic experts.

Overall, companies are well-advised to design and implement a case management system, which specifies the responsibilities, procedures and reporting channels to be followed when conducting internal investigations.

Finally, implementing an ‘Investigation readiness’ within an organization does not only help to avoid and mitigate criminal or administrative sanctions. It also serves in preventive terms as awareness is raised among employees that misconduct will be followed up consistently and not be tolerated.

Conclusion & Outlook

A well-balanced corporate sanctioning regime serves to incentivize companies to invest in compliance and to contribute to the investigation of potential wrongdoings. The overall purpose is to strengthen integrity in the economic area – which applies to classical areas of white-collar crime as well as to modern forms of crimes against the environment.

In fact, fighting corporate crime should be considered an integral part of environmental protection as legal frameworks require effective sanctioning instruments. Not only against individual perpetrators, but also against the organization behind them. Corporate affiliation conveys collective values and goals, which can have a formative effect and can reach as far as a criminal corporate attitude. Therefore, the criminogenic aspects of corporate structures must be adequately reflected in legal frameworks both at national and international level. However, experience has shown that existing systems of corporate criminal liability are not always sufficient to achieve compliance with the laws for the protection of the environment.

On the other hand, topics of sustainability receive increasing attention among companies, its board members and supervisory bodies. Next to social issues and aspects of good governance, environmental challenges are at the center of discussion and affecting almost all economic sectors and global value chains. Broadening ESG reporting requirements[28], increasing due diligence obligations[29] and new legal frameworks for the protection of whistleblowers[30] continue to drive the development towards an economic culture of compliance and sustainability.

Ongoing legislative efforts to strengthen corporate criminal liability will also play its part.

[28] See for example Proposal for a Corporate Sustainability Reporting Directive (CSRD), COM (2021) 189 final.
[29] See for example Proposal for a Directive on Corporate Sustainability Due Diligence, COM (2022) 71 final.
[30] See for example Directive (EU) 2019/1937 on the protection of persons who report breaches of Union Law.

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