

## German Federal Labor Court: Improper Compliance System Invalidates Suspected Corruption Termination

***The Federal Labor Court confirmed that an employers' suspicion of an employees' corruption does not justify termination without notice if employer lacks a functioning compliance system.***

### I. Introduction

In recent years, companies are increasingly exposed to the risk of corruption and to the adverse consequences associated with it. These include, *inter alia*, penalties, disgorgement of profits, claims for damages by shareholders and contracting parties, internal and external investigations, debarment from government contracts and reputational damages.

Many companies have implemented anti-corruption guidelines to counter corruption risks. To ensure that employees follow and “live” such guidelines, the guidelines must be communicated through training courses and other means to the employees (the company always has to check whether and to what extent the works council must be involved). Furthermore, the employer must be able to impose adequate sanctions, including an extraordinary notice of termination with immediate effect in case of a serious violation. By way of a termination without notice, the company demonstrates internally and externally, in particular *vis-à-vis* the investigating authorities, a clear commitment to compliance and underlines the effectiveness of its compliance programs.

- However, in Germany the dismissal of an employee is not automatically legally permitted in case of a serious violation. This is the case, in particular, if the compliance system is not properly implemented in practice.

In a recently published decision, the German Federal Labor Court considered the issue of a termination without notice based on a suspected compliance violation of an employee and held it to be invalid because the employee correctly assumed that the employer approved of his behavior and the deviation from the compliance guidelines (BAG, 21.6.2012, Az. 2 AZR 694/11).

Against this background the question arises which arrangements employers have to make with regard to their compliance systems in order to retain a termination right for cause, *e.g.*, in case of a corruption or another substantial compliance violation by an employee.

## II. Termination without Notice Due to Corruption or Other Compliance Violations

### 1. Corruption as a Cause “as such” for Termination Without Notice

It is widely recognized that the bribing of business partners and public officials constitutes a cause “as such” for termination without notice within the meaning of Sec. 626 para. 1 of the German Civil Code (*Bürgerliches Gesetzbuch – BGB*).

Pursuant to Sec. 1 Para. 2 Sentence 4 of the Employment Protection Act (*Kündigungsschutzgesetz – KSchG*), the employer bears the burden of proof for the reason for termination. If employers are not able to prove a bribe or another substantial compliance violation in court (as it is often the case in practice), suspicion of a violation can be sufficient for a termination for cause (so-called dismissal on grounds of suspicion). This requires that the confidence in the employee has been lost solely because of the suspicion, the employer must have made every available effort to clarify the circumstances and the employee must be heard in the form and time period required by German courts.

### 2. Weighing of Interest Pursuant to Sec. 626 para. 1 German Civil Code

If a good cause “as such” exists, it has to be further ascertained whether it is a reasonable burden for the terminating party to continue the employment relationship—at least until the expiry of the notice period for termination—taking into account the particular circumstances of the individual case and **considering the interest** of both parties. In making this determination, it is not decisive whether the employee committed a criminal offence. An act of the employee that significantly violated his obligation to consider the interests of his employer is sufficient to justify a termination without notice.

When balancing these interests, one significant consideration is whether the employer initiated or tolerated the bribe or the other substantial compliance violation.

- In a case decided by the Regional Labor Court of the State of Hesse, the conscious and serious violation of internal compliance guidelines by the employee was sufficient to justify the termination without notice (LAG Hessen, 25.1.2010, Az. 17 Sa 21/09). According to the court, the fact that the employer did not tolerate the violation and did not give the employee the impression that the employer would tolerate it was crucial for the prevailing interest of the employer for a termination without notice.
- The case of the Labor Court of Munich (ArbG München, 2.10.2008, Az. 13 Ca 17197/07) had a different outcome. An employee had forwarded funds of the company that were likely used for bribes. In the opinion of the court, the termination without notice was disproportionate and against good faith as the employer initiated or at least tolerated the behavior of the employee.

### 3. The New Decision of the German Federal Labor Court

The recent decision of the German Federal Labor Court is in line with these decisions. The case concerned dismissal on grounds of suspicion for corruption. The decision confirms that the mere suspicion of corruption does not justify termination without notice if the employer has no functioning compliance system and if its compliance guidelines only exist “on paper”.

- In this case, an employee submitted expense claims prepared by himself to his employer with the remark “purchase order support” over a period of approximately one and a half years. Against the receipt of such expense claims, the employer paid the employee a sum of EUR 23,700 in cash. After an internal audit the company terminated the employment contract. The lower (fact-finding) courts were not able to determine whether the employee took the money solely or partially for himself or

otherwise used it improperly. The company declared a termination on the grounds of suspicion in order to terminate the contract with immediate effect.

The German Federal Labor Court held the dismissal to be invalid. Dismissal on grounds of suspicion is ineffective if the suspicion could also be explained by the occurrence of events that would not justify a termination. The company made the employee aware of internal anti-corruption guidelines that prohibited the behavior of the employee. However, the Regional Labor Court (as the facts-finding instance) determined that the supervisor of the employee tolerated his behavior prohibited by the guidelines. The German Federal Labor Court did not object to this finding of facts because, in the opinion of the court, it cannot be excluded that a supervisor would allow his employee to behave in violation of the anti-corruption guidelines. The German Federal Labor Court further held it irrelevant whether the employer did not properly organize his company. At least, the employee had no reason to believe that the preparation of expense claims by himself was only approved by his supervisors without the employer's (*i.e.*, its legal representatives) knowledge and acceptance thereof. According to the court, there was no clear instruction to cease the previous practice concerning the preparation of expense claims.

#### **4. Functioning Compliance System as Key Criterion for Weighing of Interests**

The decision of the German Federal Labor Court emphasizes how important it is to have a **functioning compliance system** that is truly “**lived**” in the day-to-day business of a **company**. If supervisors deviate from the compliance guidelines by tolerating, supporting or even instructing employees to violate compliance guidelines, the management must expect that termination without notice will be invalid, even in case of a significant violation of compliance guidelines. This applies, in particular, if the employee is under the impression that the management accepts his behavior and the behavior of his supervisors.

Further, instructions of supervisors regularly prevail over compliance guidelines. This is so even if these instructions contain a clause according to which instructions of supervisors that deviate from compliance guidelines shall be irrelevant.

### **III. Summary and Practical Advice**

The consequences of the judgment of the German Federal Labor Court and the practical advice can be summarized as follows:

- An effective termination because of a suspicion of corruption or of another significant compliance violation requires an effective compliance system. If compliance guidelines of the employer are not clearly communicated to the employee, if violations of compliance guidelines are tolerated or supported by supervisors or if employees receive the instruction to deviate from compliance guidelines, the employer has to expect that a termination without notice may be ineffective even in case of a significant violation of compliance guidelines. In order to avoid a negative impression by their staff and their business partners, companies should verify the effectiveness of their compliance systems and, if necessary, improve it, especially through regular trainings, but also through examinations and controls. The credibility of the compliance system requires that violations be punished under civil and labor law.
- In order to effectively prosecute violations of compliance guidelines under labor law, companies should ensure that supervisors rigorously implement compliance guidelines by instructing employees not to violate internal compliance guidelines. In addition, management should make clear that it does not tolerate any deviations from compliance guidelines, including through instructions by supervisors.

- Especially in the event many employees have committed violations (possibly even “systematically”), at least one employee who has violated the compliance guidelines should participate in the internal investigation in order to uncover the violations and remedy them going forward. This applies, in particular, in the context of principal witness regulations and amnesty programs, e.g. in antitrust proceedings or investigations by the SEC. In these cases, termination (without notice) is mostly counterproductive as the employer, after having terminated the employment contract, can no longer insist on the duty of disclosure by the employee which, at least from a practical point of view, would be very difficult to enforce. Alternatively, a termination agreement should be considered that provides a duty by the outgoing employee to collaborate in the investigations of the compliance violation.

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