ETHIKOS November/December 2007

No Place To Hide: Early Lessons from the Siemens Case

by Donna Boehme and Joe Murphy

With the first major penalties of €201 million ($284 million), plus €170 million in taxes, now announced by the Munich District Court in the widely reported and still unfolding Siemens AG bribery scandal, a number of early lessons and observations emerge for compliance and ethics professionals and for other multinationals operating in today’s transparent business environment.

Siemens, one of Germany’s industrial giants, has been caught up since November 2006 in a string of widespread corruption and bribery allegations. Still recovering from the European Commission’s levy in January of its second highest fine in history - over $500 million - for European cartel activity, the company has been managing a Pandora’s box of revelations stemming from an investigation by German prosecutors into “suspicious payments” initially estimated at over $500 million allegedly used to secure foreign contracts. An internal investigation has recently uncovered up to $2.3 billion in suspicious payments, nearly fourfold the original estimate. Although the recent penalties mark the resolution of the German investigation into the company’s telecom division, German, Italian, US, Swiss and other authorities continue to investigate alleged corruption in various parts of Siemens’ decentralized business empire around the world.

The scandal has shaken the topmost ranks of Siemens management, some of whom - a former chief financial officer and supervisory board member - are being prosecuted by German authorities individually. The case has also produced public statements of the company’s renewed commitment to more ethical behaviour. Following the resignations of the company’s Chairman, CEO and top executives and the appointment of a new CEO, Peter Loescher, in July, Mr. Loescher revealed his “first 100 days” plan, to make leadership, culture, organisational structure and compliance at the company his key areas of focus: "Compliance is a marathon for us, not a sprint … the important thing for us is that compliance becomes part of management culture internationally, from top to bottom and back again." Changing company culture and long-established business practices is an extremely difficult undertaking under the best of circumstances, so how the company makes good on this ambitious vision while managing the ever-increasing number of ongoing investigations worldwide will be the story to watch.
Even as the Siemens bribery story continues to unfold in jurisdictions around the globe, it is useful to note some early lessons and observations:

- **Adopting new standards is easier said than done**
  As most observers have noted, until 1999 payments to foreign governments to secure business were tax deductible under German law. This tells you almost all you need to know about how and why Siemens developed what appears to be a deeply institutionalized and intricate system of secret slush funds, phony consultancies and encrypted codes to facilitate bribes throughout its largely decentralized businesses. Yet it is also fair to note that bribery was, even pre-1999, illegal in the countries where it took place, and unethical by any measure. Further, the question remains as to whether any of the pre-1999 bribery involved sufficient contact with the US to trigger the US FCPA. (It should also be noted that the company, at the press time of this article, also faced allegations involving serious anticompetitive cartel behavior, and criminal violations of German labor law.)

Presumably senior management was made aware of changes in German law necessary to implement Germany’s ratification, along with 35 other countries, of the OECD Anti-bribery treaty on February 15, 1999. Yet now we know that existing bribery activities continued unabated even after the changes to German law. The lesson here is that merely issuing a revised Code of Conduct is woefully insufficient to change a deeply ingrained set of business practices (according to an October 4, 2007 Business Week article, Siemens employees reportedly dubbed the company’s code of conduct the “read, laughed and filed” code). Companies that make the mistake of trying to follow the bottom limits of legal behavior without championing ethics should learn from this that once a culture of taking short cuts and ignoring values is in place, it is only a matter of time before employees cross the line into illegal conduct. As other European companies must surely be scrambling to reassess their business practices abroad, they should take heed of Siemens’ disastrous example and conduct some serious compliance assessments and audits. They should also be prepared to take swift and decisive action to address any discovered problems systematically, through the implementation of an effective anti-bribery and compliance program actively endorsed and led by management.

Given the scope of Siemens’ alleged misconduct, it is difficult to imagine how all of this could have escaped management’s attention. Managers and compliance people should be reminded by this case of the need to get into the field and find out what is actually happening in the company. If Siemens’ employees are now willingly revealing to the media stories of management -condoned corruption and laughing at the code, is it not also likely that someone in management could have asked at least a few people in the field what was going on, if they had wanted to know? Companies should be reminded of the need for managers and compliance and ethics professionals to be asking these questions, instead of waiting for
prosecutors and the press to do so. The answers seem to be there for the asking.

- **A turning point for corruption prosecuted outside the US?**
  Since OECD member countries agreed to crack down on bribery in 1997, many have criticized the lack of vigorous prosecution of corruption outside the US. In a controversial decision last year, British authorities abruptly halted an investigation into BAE Systems, the major British defense contractor, for allegedly paying $1 billion in bribes to a Saudi prince, citing issues of “national security.” But Mark Pieth, chairman of the Organization for Economic Cooperation and Development Working Group on Bribery, has been quoted as saying the Siemens case is a good start that “could be viewed as a turning point.” Mr. Pieth has also said that it is important to see if German authorities pursue alleged wrongdoing at other units. Other commentators were disappointed by the amount of the German penalties, calling them an inadequate deterrent for bad behavior. Peter von Blomberg, deputy chairman of the German chapter of Transparency International, the nongovernmental corruption watchdog, said: "Companies that use corruption as a way of doing business must suffer penalties that they can feel." The authors believe that there will be far-reaching consequences of the Siemens case both in terms of willingness to enforce corruption laws outside the US and the degree to which senior management and boards will be held accountable by regulators and other company stakeholders. The case could be reminiscent of the Roche/BASF vitamins price-fixing saga which led to much harsher prosecution of competition laws outside the US and unprecedented cooperation among authorities.

- **Multi-jurisdictional liability - the gift that keeps on giving**
  Companies today operate in a world of unprecedented transparency, cooperation and information sharing among jurisdictions. Joint investigations, harmonization of best practices, and consultation have become the norm. According to several reports, the original German investigation into Siemens that led to a series of “dawn raids” was commenced after an anonymous complaint and requests for judicial assistance from Swiss and Italian officials. The matter has now snowballed into inquiries in the US, Switzerland, Italy, Greece, and Liechtenstein, with a number of other countries expressing an interest. In addition, as illustrated in the Roche/BASF vitamin price-fixing cases, successfully prosecuted cases are likely to be followed by a series of expensive class-action or private shareholder suits. The lesson for companies with global operations: not only is corrupt activity much more likely to be discovered, but it is also capable of creating enormous liability in multiple jurisdictions for many years following the initial discovery.

- **Accountability now sought at the most senior levels (including the Board)**
  Authorities and stakeholders today also appear much more willing to seek accountability at the most senior levels of management. When a scandal occurs, prosecutors are now asking: “Where was the Board?” With the resignation of
Siemens chief executive, Klaus Kleinfeld, and the head of the supervisory board, Heinrich von Pierer, accountability at Siemens has reached to the very top of the company (at the time of his resignation, von Pierer insisted, and continues to argue today, that it was not his job to know about the bribery schemes). So far several other high level company officials have been arrested (including a member of the company’s supervisory, or top tier, board- a first), and authorities are focused on accountability at the highest levels. The probe has recently been extended to include the company’s former finance chief who was also a member of its supervisory board. And there is developing case law and regulatory direction supporting the higher expectations on Boards and senior management. For instance, the 2004 revised US Federal Sentencing Guidelines call for boards to be “knowledgeable” about and exercise sufficient oversight regarding their companies’ compliance programs. These developments clearly illustrate that a “head in the sand” approach by the C-suite not only can lead to individual liability, but also can result irreparable damage to a company’s reputation and business. At a minimum, directors must be engaged in active oversight and enquiry regarding their companies’ approach to compliance and ethics, including obtaining periodic training for themselves to understand their accountabilities and risks.

**Compliance and ethics as a voice in the C-Suite**

More and more, we are seeing compliance and ethics emerging as a valued voice in the C-suite, in the form of a senior executive tasked with a specific mandate to develop and oversee the company’s approach to ethical business practices and the clout to implement critical measures. Ironically, Loescher’s announcement of his ‘100 day plan’ to address compliance in the company was marred by the abrupt resignation of Siemens’ then newly-appointed compliance chief. Daniel Noa, a highly respected former German prosecutor with impeccable credentials, resigned after only six months in the post. The *Financial Times* reported that Noa joined the company to find the compliance function had been embedded within the firm’s legal department, and that moving the lines of responsibility had undermined his authority as, "there was a lot of resistance internally still," according to an anonymous source quoted by the article. Recently, however, Siemens appears to have rethought its organizational structure. As of October 1, the company has appointed a new chief compliance officer, a former general counsel of a General Electric subsidiary, in a new executive board level position, along with other organizational restructuring designed to bolster internal controls.

Increasingly, companies are creating compliance and ethics offices with clear mandate, clout and authority, which includes direct access to the Board. This is consistent with the 2004 revised Federal Sentencing Guidelines, which contemplate that the person with day-to-day responsibilities for the compliance program must have direct, unfiltered access to a company’s “governing body”. According to Win Swenson, leading corporate governance expert and key architect of the Sentencing Guidelines (who in full disclosure is a partner of Compliance Systems Legal Group, where the authors are affiliated), says: “It is
no longer acceptable for large corporations to treat compliance and ethics as a second tier function. And even smaller corporations should give the function mandate, resources and direct access to the C-suite and the Board.” The concepts of clout, mandate, positioning and access are a common mainstay of deferred prosecution agreements and corporate integrity agreements in the US. Further, courts and prosecutors who are serious about assessing a compliance program’s bona fides will pay close scrutiny to how compliance and ethics functions are structured and resourced as a measure of a company’s actual commitment to integrity. The lesson for the C-suite and Boards: in order to create a meaningful and effective program, give your compliance and ethics function clout, mandate and access before problems occur. (For a comprehensive discussion of the role and positioning of the compliance and ethics officer, see “Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer” a white paper developed by the Ethics Resource Center and five other non-profit professional organizations supporting the compliance and ethics industry.)

- **The murky role of consultants: buyer beware**

  The German investigation focused on a large number of “sham” consulting contracts and an elaborate system of off books slush accounts to aid the company in winning overseas business. Ironically, at one point a Saudi company on the receiving end of bribes threatened the company with exposure to the SEC unless Siemens paid an additional $910 million in “consulting fees” (the company ended up settling on a $50 million payment). The incident is reminiscent of the old saying: “there’s no honor among thieves” and suggests parallels to the US antitrust leniency program under which the first company disclosing cartel activities may be granted immunity from prosecution. The use of fly-by-night consultants and local “off the books” accounts has been viewed for years as a “red flag” by prosecutors and compliance professionals. Further, as in the antitrust arena, today’s co-conspirator is becoming tomorrow’s witness for the prosecution. Companies engaged in a compliance risk assessment in this area would be wise to review their existing practices regarding consultants, including business due diligence before retaining them and written agreements covering expected standards of behavior. Guidance on what to look for and how to avoid these risks is readily available in the compliance literature, in government case settlements, and from anti-corruption practitioners. A company in today’s environment would be hard pressed to explain how it could miss these kinds of obvious red flags.

- **Heightened scrutiny on company culture**

  The case has also spotlighted a higher scrutiny by prosecutors on the degree to which illegal behavior is ignored or tolerated by management. Such a finding would negate the traditional “rogue employee” defense often employed by companies in the past. The Wall Street Journal has reported on arrest warrants and witness statements that “depict a company where payment of bribes was common and highly organized”. During a trial of two former executives accused
of bribes to obtain a lucrative contract with the state-owned Italian oil company Enel, witnesses have reportedly described a company culture where bribery was “known or tolerated” by senior management, including a system of front companies and slush funds in Liechtenstein for exactly these kinds of payments. Siemens should thus make an interesting case study under the US Federal Sentencing Guidelines standards which specifically direct companies to “otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.” The lesson for Boards and senior management is that it is no longer sufficient to show that the top of the house did not know about or participate in the wrongdoing, but also that the company culture did not tolerate or encourage illegal behavior. That is, admittedly, a tall order. But to begin, companies at least need to start asking questions about what their employees and agents are seeing and experiencing in the business. Management should at least know more about their company’s culture than a newspaper reporter could find by just a few phone calls to unhappy employees. Management and the compliance and ethics departments should be making those calls first to find out what is really happening in the company. Then, with that insight about the culture, they can begin to start working on changes.

- **Operational changes to avoid risky business practices**
  In addition to Loescher’s recently announced focus on compliance and appointment of a top chief compliance officer, the company has already instituted a number of changes to existing practices including: requiring central approval of certain consulting contracts, moving the reporting line of compliance personnel from the local business unit to central compliance, withdrawing from doing businesses in countries where bribes would likely be required, and tightening accounting and banking practices. One hopes that Loescher, like other CEOs in similar situations, will quickly see that just saying words of commitment will do little for the company; change will require difficult action and choices by senior and line management, and the CEO personally. See [Ethikos article on How the CEO and promote compliance](#) The company has already taken a tax charge of €168 million and reportedly has incurred legal fees in the amount of €190 million ($268 million) over the past nine months alone. The obvious lesson of Siemens is that preventing the fire is immensely preferable and far less costly than putting out the fire once the trouble starts, whether measured in terms of fines, penalties, consultants and legal fees, internal disruption, company time, or damage to careers, license to operate and reputation.

At a minimum, companies doing business in jurisdictions with a bribery/corruption risk should ensure that they have a clear, unambiguous written policy embraced by managers and communicated to at-risk employees, with adequate training and tools to enable and support those employees in making good business decisions. Employees should see decisions being made by senior management (as distinguished from mere rhetoric about values and the company’s code of conduct) that empower them to follow this lead. And
from a risk management perspective, companies should integrate into their existing business operations additional mechanisms to ensure the system works, and to enforce and monitor compliance with the policy. These include due diligence procedures to screen potential agents and intermediaries, performance management criteria that emphasize ethical leadership in addition to the bottom line, periodic compliance audits, adequate financial controls, and a safe, confidential means for employees to report concerns or wrongdoing. All of these mechanisms would likely be taken into account in any prosecutorial assessment of the company’s ethical culture and determination of whether offenses were really committed by “rogue employees” or alternatively, the predictable result of a corporate culture that tolerates or condones unethical conduct including corruption and bribery.

Much has been written and spoken about culture and “tone at the top”, but driving an ethical culture requires more than just words - it requires significant vision, commitment, expertise, resources, an empowered compliance and ethics function, and above all, visible action. Can Siemens do this? Despite the initial strong words from management, it is too early to tell. But the lessons are there, for all who want to learn from them.