WHISTLEBLOWING 2.0: WHAT WILL THE SECOND DRAFT OF THE WHISTLEBLOWER PROTECTION ACT BRING ALONG?

ON THE GERMAN LEGISLATOR'S RENEWED ATTEMPT AT LONG OVERDUE REGULATION OF WHISTLEBLOWING AND ITS SYNCHRONIZATION WITH ADDITIONAL PROVISIONS

Executive Summary

- On 13 April 2022, the Federal Ministry of Justice and Consumer Protection (MINISTRY OF JUSTICE) presented the second draft of a Whistleblower Protection Act [1] (Ref-E HinSchG).
- Previously, in summer 2021, the former federal government's attempt to transpose the EU Whistleblower Protection Directive[2] of 16 December 2019 into national law within the required deadline of 17 December 2021 had failed.
- As a result, the EU Commission initiated formal infringement proceedings against the Federal Republic of Germany on 27 January 2022.[3]
- The new legal obligations provided for in the second draft now presented, which can be reasonably expected to enter into force this year, are intended to better protect whistleblowers in the private sector, but also in the public sector as a whole, than before and to provide for more legal clarity overall for all employers with at least 50 employees.
- The provision of reporting channels on violations in connection with professional activities ("whistleblowing") has been a legal obligation in foreign jurisdictions[4] for many years and has now become a recognized international compliance management best practice.
- In addition to some recent European Corporate Governance Codes, the German Corporate Due Diligence in Supply Chains Act[5] (LkSG), which was passed on 16 July 2021 and will already come into force on 1 January 2023, also requires the establishment of a complaints´ procedure, largely in line with the requirements of the proposal for a new EU Corporate Sustainability Due Diligence Directive[6] (RL-E).
- A large number of companies from all sectors as well as public authorities will thus quickly have to set up completely new whistleblowing systems for the first time, while existing reporting channels will have to be reviewed for their compliance with new legal requirements.

Background

Headline-grabbing corporate crises and compliance scandals in Germany such as Wirecard or Dieselgate, the Cum-Ex affair or misconduct in connection with COVID-19 have once again brought the role of whistleblowers to the fore. For almost exactly two decades, companies listed in the

[1] Draft of a law for better protection of whistleblowers and for the implementation of the Directive on the Protection of Persons Reporting Breaches of Union Law ("Whistleblower Protection Act – Hinweisgeberschutzgesetz / HinschG").
[2] Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons reporting infringements of Union law, ABl. L 2019/305, 17.
[3] Letter of formal notice Article 258 TFEU – Article 260(3) TFEU, ec.europa.eu/atwork/applying-eu-law/infringements-proceedings/infringement_decisions/index.cfm?lang_code=EN&typeOfSearch=true&active_only=0&noncom=0&r_dossier=&decision_date_from=&decision_date_to=&title=32019L1937&submit=Search
[4] Such as the U.S. Sarbanes-Oxley Act 2002 or the French Loi Sapin II 2016.
[5] See our GSK update of 21.06.2021 at GSK-Update-The-new-German-law-on-corporate-due-diligence-in-supply-chains.pdf
[6] See our GSK update of 09.03.2022 at GSK-Update-EU-Corporate-Sustainability-Due-Diligence-Directive.pdf

USA and their subsidiaries have been aware of the legal obligation to set up reporting channels and to protect whistleblowers according to the U.S. Sarbanes-Oxley Act ("SOX"). And the U.S. authorities recently reported record figures for the past two pandemic years 2021 and 2020, both in terms of the number and value of cash awards paid out to whistleblowers.[7]

In Germany, a total of seven draft laws for the protection of whistleblowers have been dealt with since 2008, each without result. In December 2020, the Federal Ministry of Justice (MINISTRY OF JUSTICE) presented a first draft bill for a Whistleblower Protection Act (HinSchG), which, however, could not be passed in June 2021 due to a lack of consensus in the federal government at the time - unlike the Supply Chain Due Diligence Act.

Already on 16 December 2019, the EU's Whistleblower Directive 2019/1937 had entered into force requiring transposition into national law by 17 December 2021 at the latest.[8] Due to the failure of the first draft bill, the new federal government was thus already behind schedule in its first week in office so that the formal opening of EU infringement proceedings against the Federal Republic of Germany was announced on 17 January 2022.

The MINISTRY OF JUSTICE's new draft bill has in the meantime been submitted to the respective ministries for approval. The federal states and the associations to be involved are requested until 11 May 2022 to submit their comments on this draft. In view of the pending EU infringement proceedings it seems all the more urgent that a government draft emerges from this consultation process that will ultimately stand a fair chance of gaining majority support and can be adopted by the German Bundestag as soon as possible.

Until now, the protection of whistleblowers beyond special industrial sectors such as banks or insurance companies was only regulated by national jurisdiction, in particular by civil and labour courts. In 2011, the European Court of Human Rights (ECHR) ruled that the dismissal of a German whistleblower who had made public abuses in nursing homes was a violation of freedom of expression under Article 10 of the European Convention on Human Rights.

Since then, clear legal requirements to protect whistleblowers from reprisals - the retaliation that is not uncommon in everyday work - but also from the misuse of information have been the subject of controversial debate.

Reporting procedure according to the latest draft of the Whistleblower Protection Act

Now, a new whistleblower protection act is to provide legal clarity and oblige all companies and public authorities - or in general "*employers*" - with more than 50 employees to set up internal reporting functions as soon as it comes into force. Companies with fewer than 250 employees are to be given a little longer until 17 December 2023 thanks to a transitional provision. Irrespective of the specific number of employees, this obligation is also to apply explicitly to investment services companies, data provision services, credit and financial services institutions and asset management providers.

[7] Under the so-called "*Whistleblower Bounty Program*" of the U.S. Dodd-Frank Act of 2008, which applies to SOX-obligated companies, whistleblowers are entitled to 10% to 30% of the fine payable by the company concerned in excess of USD 1 million. Over the last decade, a rough total of USD 1 billion has been paid out to individual whistleblowers. See also https://www.sec.gov/spotlight/dodd-frank/whistleblower.shtml.

[8] Denmark was the first EU state to enact a national whistleblower law on 24 June 2021 followed by Sweden on 28 October 2021. The current critical state of timely and comprehensive implementation throughout the EU can be found here: https://www.whistleblowingmonitor.eu/.

In accordance with the character of a universal regulation, the new draft bill for a whistleblower protection act covers reports and disclosures of information by employees that concern criminal offences, certain administrative offences, violations of environmental protection regulations, requirements for the ecological production of food or the protection of privacy.
In the concrete design of the internal reporting functions and structures, the draft grants a significant deal of discretion. The confidentiality of the whistleblower and the subject of the report must be maintained, contact must be maintained with the whistleblower and, upon request, a personal meeting must be made possible. Receipt of a report must be acknowledged within seven days; a reasoned response must be given after three months at the latest. Anonymous reports do not have to be processed and channels that allow reports to be made by telephone or in text form meet the legal requirements.

Complaints procedure under the proposal for an EU Corporate Sustainability Due Diligence Directive

A similarly far-reaching entrepreneurial leeway is granted by the European provisions accompanying the future Whistleblower Protection Act which are contained in the proposal for a new EU Corporate Sustainability Due Diligence Directive[9]. According to these, companies only have to ensure that a procedure is in place which ensures that the actual or potentially affected persons, trade unions and other employee representatives as well as civil society organisations (non-governmental organisations or NGOs) can file complaints and provide for "appropriate follow-up measures". However, this draft EU directive does not regulate how this procedure is to be designed concretion detail.

Complaints´ procedure according to the Corporate Due Diligence in Supply Chains Act

The German Corporate Due Diligence in Supply Chains Act, which was passed on 16 July 2021 and will come into force on 1 January 2023, also requires the establishment of a mandatory internal complaints´ management procedure as a new corporate duty. In the interest of strengthening the criticism and control function of the public, this is intended to enable informed persons to point out human rights and environmental risks as well as violations of human rights or environmental obligations by companies and their suppliers.
Although the corporate complaints´ management obligations are only formulated in rather general terms, they are by no means to be underestimated in substance. For example, anonymous complaints must also be dealt with. The complaints´ management procedure should not only be geared towards the company itself, but should also include direct and indirect suppliers. As a result, not only the supply chain, but the entire corporate value chain must be mapped accordingly. However, not only persons who have obtained information about violations in connection with their professional activities are entitled to file complaints, but also explicitly domestic trade unions and NGOs. In addition, there is a "popular right of complaint" open to everyone. Furthermore, there is a need for publicly accessible rules of procedure that contain clear and comprehensible information on how to reach the dedicated reporting function. Any lack of language or writing skills must be duly taken into account. The responsibles within the company must be independent and not subject to directives, i.e. as a rule they must be employed in an executive position. Not only do incoming complaints have to be treated confidentially, but proactive measures which may well go beyond those under the German Whistleblowing Draft Act must also be taken to ensure that the person making the report is effectively protected from discrimination and punishment. Finally, the entire complaints´ management procedure must be evaluated on an ad hoc basis, but at least annually, and adapted to current developments. The resulting findings must be integrated into the risk analysis provided for under the new Corporate Due Diligence in Supply Chains Act.

[9] EU Corporate Sustainability Due Diligence Directive 2022/0055 of 23.02.2022; see our GSK update of 09.03.2022 at GSK-Update-EU-Corporate-Sustainability-Due-Diligence-Directive.pdf

Whistleblower protection in national Corporate Governance Codes

This notwithstanding, the protection of whistleblowers is not the exclusive domain of formal legislation. "Soft law" in the form of various national Corporate Governance Codes (CGC) has since long offered guidance with the character of recommendations on whistleblowing. These codes mostly set voluntary standards for responsible corporate management and control or "*good governance*", to which the executive board and supervisory board of listed German companies must submit an annual public declaration of compliance. The protection of whistleblowers is explicitly addressed in the German, Dutch, British and Danish CGCs.

In the German CGC this has been addressed since 2017 and is also included in the latest draft version of 21 February 2022 with exactly the same wording: "*Employees should be given the opportunity to provide protected information on legal violations in the company in a suitable manner; third parties should also be given this opportunity*".[10]

The Dutch CGC goes further: the board should establish a procedure, published on the company's website, for reporting actual or alleged irregularities within the company and its affiliated companies. It must be ensured that employees have the possibility to make a report without jeopardising their legal position.[11]

The UK CGC also contains provisions to this effect and states that employees should have the opportunity to raise concerns confidentially and, if they wish, anonymously. The board should routinely review this opportunity and the resulting reports. It should also ensure that provisions are made for a proportionate and independent investigation of such matters and for follow-up action.[12]

The Danish CGC stipulates that the board of directors shall establish a whistleblower system and an accompanying procedure that gives employees and other stakeholders the opportunity to report serious violations or suspicions of such violations quickly and confidentially.

Labour law challenges

When implementing whistleblowing systems in Germany, the works council's participation rights must also be observed under the co-termination principle. These are always affected if the “company's order” is affected. The latter regularly is the case when establishing whistleblowing systems and a reporting function.

The use of technical equipment to support a whistleblowing system also triggers a right of co-determination of the works council. In order to take into account any concerns of the works council when planning the implementation of the technical equipment, prior alignment between the employer and the works council should take place.

In addition, it is necessary to inform employees about the implementation of a whistleblowing system and to provide them with easy-to-access user information. With regard to these measures, the works council must be informed and consulted. The works council can also have a co-determination right regarding the concrete implementation of such measures.

If the staffing of the company's internal reporting function results in hirings or transfers, the works council must be involved. In the course of this, the works council could also exercise its right of objection. It should be noted that

[10] Draft of the GCGC of 21.01.2022 under A.4, www.dcgk.de/de/konsultationen/aktuelle-konsultationen.html?file=files/dcgk/usercontent/de/Konsultationen/2022/220121%20Entwurf%20Deutscher%20Corporate%20Governance%20Kodex%202022.pdf.

[11] Dutch Corporate Governance Code, clause 2.6.1, www.mccg.nl/binaries/mccg/documenten/codes/2016/12/8/corporate-governance-code-2016-en/Dutch-corporate-governance-code-2016.pdf.

[12] UK Corporate Governance Code p. 5 clause 6, www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF.

even if the reporting function is integrated in an already established body, a "transfer" may be considered. Overall, it is advisable to proactively involve the works council from the very beginning in order to achieve a positive response to the whistleblowing system in the company and a high level of acceptance among the entire workforce.

Implementation recommendations for companies

The Ministry of Justice´s renewed attempt to introduce a German Whistleblower Protection Act makes the implementation of whistleblowing systems more urgent for all employers, but not necessarily easier in view of new corporate obligations to protect human rights and environmental requirements that have been introduced in parallel and are not always exactly synchronised.

International compliance management best practice is unanimous: whistleblowing systems are an important feature of corporate culture as credible proof of serious efforts towards transparency and integrity. Even entrepreneurs in smaller companies recognise the need for the greatest possible openness, if only because of the strong signal it has in day-to-day operations, for example for quality management or continuous improvement. Worldwide, whistleblowing systems are a well-recognised essential module of effective compliance management systems and do typically not harm companies but rather protect them from an increasing number of legal and reputational risks. Effectively implemented whistleblowing systems help to reliably uncover misconduct, but also to avoid significant financial damage. Even the sheer likelihood of detection is significantly promoted. The most recent study by the renowned *Association of Certified Fraud Examiners* (ACFE) on economic crimes from 2022[13] reviewed 2,110 fraud cases at the expense of companies in 133 countries worldwide which led to a total loss of 3.6 billion US dollars and had an average loss ratio of more than 1.8 million US dollars per case. 46% of all cases were discovered through tips, more than three times as the next most common source of detection, corporate audit at 16%. 55% of these tips were provided by employees, 18% by customers, 16% by anonymous whistleblowers and 10% by business partners.

Moreover, the legal point of reference for reports must not be left to the employees, most of whom often have no legal training. A risk-based and company-specific code of conduct creates the required clarity about the company's expectations of all employees and also external business partners as to who should report what and when.

The good news, especially for smaller companies, is that even under the latest Whistleblower Protection Act draft, whistleblower functions can be operated jointly.

The efficient implementation of centralized whistleblowing systems at group-level of conglomerates for all group companies also remains feasible according to the draft - in contrast to what the EU Commission once had opined in the past.

And the outsourcing of a whistleblowing system to external third parties such as the already known ombudspersons remains possible - whereby the companies themselves clearly remain responsible for actually responding appropriately to detected violations.

Nevertheless, whistleblowing under international and national laws, meeting potentially conflicting interests of employers, employees and external third parties that are worthy of protection, especially in times of security challenges and economic uncertainty is not an easy matter and therefore requires more than ever a high level of attention and consistency.

[13] Occupational Fraud 2022: A Report to the Nations, ACFE, s. https://legacy.acfe.com/report-to-the-nations/2022/?_ga=2.229786012.1627494131.1651076189-840372803.1651076189.

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