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Protecting Companies In A Challenging Environment: Compliance Programs Under Italian Law – The First Nine Years

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Italy is second only to the United States in the number of enforcement actions against corporations allegedly engaged in wrongdoing. International corporations are far from immune, as demonstrated by the prosecution of several industrial companies (e.g. Siemens, those involved in the Oil-for-Food case, a number of pharmaceutical players) and financial institutions (e.g. in the Parmalat case, or in a series of investigations on derivative trades with Italian public authorities).

All these actions are based on a piece of legislation (Legislative Decree No. 231/2001 – "Law 231") which in 2001 introduced without much fanfare the hitherto unknown criminal liability of legal entities for crimes committed by their managers and employees.

It has been nine years since the entry into force of Law 231. This memorandum highlights the key developments and lessons of the first nine years of this statute.

Because of Law 231, corporate compliance programs have increasingly become an important feature for corporations as well as the focus of decisions of the Italian courts, provided that Law 231 exempts the company from liability if it can be demonstrated that, before the crime was committed, the company adopted and effectively implemented an adequate compliance program to prevent the commission of ("*Law 231 Compliance Program*").

Although the adoption and implementation of a Law 231 Compliance Program is not mandatory by law, the lessons in this last decade show that, in practical terms, Italian companies and foreign companies doing business in or into Italy that have in place effective instruments to prevent the commission of the crimes and to monitor the risky areas in which they operate, may avoid potential liability under Law 231 (provided that some further conditions are met).

This has been recently confirmed by the decision of the Court of Milan dated November 17, 2009, on Impregilo S.p.A.[1] The company was under trial, pursuant to Law 231, for insider trading crimes allegedly committed by two of its top managers. For the first time since 2001, the Court has considered Impregilo's compliance program adequate and effectively implemented according to the specific requirements provided by Law 231 and recognized that the wrongdoers committed the crimes by eluding the compliance program fraudulently; thus, Impregilo has been discharged.

1. Brief Introduction to Law 231

Law 231 is modeled in part after the U.S. Sentencing Guidelines for Organizations and was passed to meet the requirements of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 1997.

The major novelty introduced by Law 231 is the principle imposing direct liability of all corporations (and other organizations) for certain crimes committed in their own interest or advantage by their directors, top managers, or employees, provided that some conditions are met. The company's liability is in addition to the criminal liability of the individuals that materially committed the crime. Although defined as an "administrative liability" it is *de facto* a criminal liability.

Under Law 231, in particular, companies may be directly liable when individuals (a) who hold representative, administrative, or executive positions in the company or in any of its branch granted with financial and organizational autonomy, or who *de facto* manage it, or (b) who are subject to the direction and supervision of one of the persons under (a), commit one or more crimes listed in Law 231, in their own interest or advantage to the company, unless the company adopted and effectively implemented a suitable Law 231 Compliance Program before the crime was committed.

Criminal Offences Contemplated By Law 231

Since its introduction in 2001, the Italian legislator has constantly widened the scope of the application of Law 231 by expanding the list of relevant crimes, which currently include, among others:

- crimes against Public Administration, (*e.g.* undue receipt of public funds, fraud to the detriment of the State or public entities, extortion and corruption[2]),
- computer crimes;
- corporate crimes;
- market abuse;
- crimes against the person, among which manslaughter and serious accidental injuries committed in violation of the provision on health and safety in the workplace;
- money laundering;
- crimes against trade and industry;
- crimes related to copyright violations.

Exemptions From Liability

Law 231 provides that a company can be exonerated from liability if it proves that:

(a) the individuals who committed the crime acted solely in their own interest or on behalf of third parties and not in the interest of the company; or

(b) the company has adopted effective and specific internal compliance measures.

With reference to (b), the company must prove that it established and implemented effective internal control systems for the purposes of preventing offences, before any offence was committed, by implementing an adequate Law 231 Compliance Program tailored to the characteristics of the company and setting up a supervisory body properly vested with independent initiative and inspection powers (so-called "*Organismo di Vigilanza*").

The proof of the corporation's innocence is difficult to establish in cases of crimes committed by directors or top managers of the corporation. The company must demonstrate not only that an adequate Law 231 Compliance Program was in place at the time that a crime was committed but also that the individual committing the offense acted fraudulently by circumventing the internal control system.

The implementation of the Law 231 Compliance Program after the commission of one of the relevant crimes cannot exempt the company from its liability, but it can grant a reduction of the applicable sanctions and it avoids the application of debarments. Italian Courts have also ruled that the *ex post* implementation of an effective Law 231 Compliance Program can exclude the risk of reoccurrence of the crime and therefore avoid the application of protective interim measures.[3]

Sanctions

If a company is found liable under Law 231, it may be subject to any combination of the following sanctions:

(a) monetary fine up to €1,500,000 (in case of a plurality of crimes up to €4,500,00);

(b) seizure of the profits resulting from the crime;

(c) publication of the Court's decision;

(d) disqualifying sanctions (so-called blacklisting).

Disqualifying sanctions may have a considerable impact on the company as they include, among other things, disqualification from performing part or all of its business, suspension or revocation of authorizations, permits, licenses or concessions, which were functional in the commission of the crime; prohibition to negotiate with the Public Administration, exclusion from benefits, loans, contributions, as well as revocation of those which have already been granted; and prohibition against advertising goods or services offered by the corporation, and considering that they can be applied also as precautionary measures.[4]

Law 231 and Foreign Entities

Pursuant to Law 231, Italian companies are liable in relation to crimes committed in Italy and abroad, provided that, in such last case, no prosecution against the company has been initiated in the foreign State in which the relevant crime was committed. Law 231 does not provide specific provisions in relation to foreign companies. However, some of the recent cases[5] dealing with the issue at hand have stated that the provisions of Law 231 may be applicable also to foreign companies when their representatives commit a crime – contemplated by Law 231 - in the territory of Italy, or abroad, if the consequences of the crime were felt in Italy.

As a consequence, a non-Italian company may be held liable under Law 231 in connection with its activities "into" Italy.

Law 231 and Groups

Law 231 does not expressly provide for its application to groups of companies. However, with regard to this matter, the main issue is to identify the company or companies (of the group) in whose interest the crime was committed.

Should the holding company be the sole party to have received benefits from the crime, it will be the sole entity liable under Law 231. On the other hand, if the crime has been committed in the interest of one or more subsidiaries, the holding company (also if a foreign company) could theoretically be considered liable as well, as it may have received a direct or indirect benefit.

According to this last principle, the Court of Milan[6] affirmed the liability of the holding company for bribery committed by its directors in the interest of a subsidiary (the bribes were aimed at adjudicating a contract for the subsidiary).

Consequently, in the case of a multinational group having a holding company abroad and a subsidiary in Italy, it is possible that if a representative of the foreign holding company commits a crime in the interest or for the benefit of the Italian subsidiary, the foreign controlling company will be held liable as well.

2. The Law 231 Compliance Program

As anticipated above, Law 231 exempts the company from liability if it can be demonstrated that, before the crime was committed, the company adopted and effectively implemented a Law 231 Compliance Program.

Law 231 provides that each Law 231 Compliance Program must be tailored to the specific structure, business, and characteristics of the company, but it does not give details on the structure and content of any such program.[7]

The experience accrued in approximately nine years of effectiveness of the law has shown that in order to be adequate, a Law 231 Compliance Program has to:

- identify the area in which it is most likely that crimes will be committed by managers or employees (risk analysis);
- establish appropriate procedures to be followed in relation to the company's activities at risk (*i.e.* depending on the company's business, procedures on joint venture, on agent and consultant agreements, acquisition and disposition, sponsorship, gifts, charitable and political contributions);
- establish a system of internal control and monitoring on the applicability of the above mentioned procedures by the Supervisory Body that must remain fully independent;
- establish a system of continuous updating of the Law 231 Compliance Program itself;
- identify the safest way to manage financial resources in order to avoid such crimes being committed;

- make the Law 231 Compliance Program compulsory for all managers and employees and provide training for the personnel operating in the risk areas;
- provide a reporting duty to be complied with the Supervisory Body;
- introduce disciplinary measures to sanction non-compliance.

Law 231 Compliance Program in the Court Precedents

Italian Courts have stated that the mere execution of guidelines or reproduction of precedents is not sufficient to exempt the company from its liability under Law 231, if the Law 231 Compliance Program does not prove to be effective.

In particular, in 2003 the Court of Rome stated that: *"The Compliance Program cannot be considered able to prevent crimes when: it doesn't specifically address the corporation's area where the crime for which the corporation is currently prosecuted was perpetrated; it doesn't ensure effective autonomy and independence of the supervisory body; and, it doesn't state that only a qualified majority of the board of directors can modify it"*.[8]

In another decision, the Court of Milan confirmed that: *"effectiveness, specificity and dynamism are structural characteristics of Compliance Programs. The effectiveness of a Compliance Program depends on its concrete fitness to create decision mechanisms able to eliminate or at least to diminish significantly the risky areas, to punish offenses, but also to identify the risk areas and the wrongdoing areas. Absolutely necessary is the total transparency of the balance sheets; without it the program would be ineffective and would be only a conventional recommendation to respect the ethical code of conduct"*.[9]

In addition, the Court of Naples[10] has stated that the effectiveness of the Law 231 Compliance Program is also based on: (i) the establishment of specific procedures that give rules in connection with the so called risk areas; (ii) a specific control system to verify the use and implementation of such procedures and; (iii) appropriate and specific sanctions to prevent the violation of the procedures.

The Decision of the Court of Milan of November 17, 2009

As anticipated in the introduction, for the very first time since the introduction of Law 231, with its 17 November decision the Court of Milan[11] discharged Impregilo, a major Italian company doing business in the construction sector, recognizing that the Law 231 Compliance Program adopted by the company was adequate and effectively implemented.

In the case at hand, the company was charged under Law 231, in relation to insider trading crimes allegedly committed by the Chairman and by the CEO of the company, after the adoption by the company of the Law 231 Compliance Program. As a consequence, the Court of Milan had to assess if such program, already adopted by the company, was adequate to prevent this kind of crimes.

The Court clarified, as a general rule, that the assessment on the adequacy of the Law 231 Compliance Program had to be an *ex ante* assessment; in other words, the judge had to verify if, in theory, such a program could be appropriate to prevent the specific crime really committed by the company's managers.

In order to make this kind of assessment (*ex ante*), the Court has verified that the company adopted the Law 231 Compliance Program in 2003, before many other companies in the same market and that such program were compliant with the guidelines set forth by *Confindustria* (the National Confederation of Italian Industry) and *Borsa Italiana*.

In addition, the Court also verified that according to the program, the person in charge of the internal auditing was appointed as Supervisory Body; that the Compliance Program provided for some measures to prevent the specific crimes committed by the top managers, among which, procedures to manage and disclose to the market information price sensitive. According to the Court, the Compliance Program also provided for a specific control system on the applicability and effectiveness of such procedures.

Finally, the Court verified that the Impregilo's Compliance Program was fraudulently circumvented by the two top managers that committed the crimes. For that reason, the Court of Milan concluded that the company could be exonerated from liability under 231.

3. Conclusions – *De facto* Duty to Adopt the Law 231 Compliance Program

As a consequence of the above, for all Italian companies and foreign companies doing business in or "into" Italy, even if the adoption and implementation of the Law 231 Compliance Program is not mandatory by law[12], it is in practical terms a way to try to avoid liability under Law 231. Moreover, compliance program must be built in full compliance with the requisites set forth by Law 231 (including the institution of a Supervisory Body) and in a particularly careful way, to ensure the respect of the necessary risk prevention and control systems, plus the continuous training of the company's personnel.

This conclusion is also reinforced by a recent (even if so far only) case that ruled that the directors of a company are responsible for preventing the company from a potential liability under Law 231 through the adoption of a Law 231 Compliance Program. Based on this principle, the Court of Milan[13] allowed a company that suffered a sanction under Law 231 for crimes committed by its top managers in the absence of a compliance program, to take action for damages against its managing director who had failed to adopt the Law 231 Compliance Program.

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[1] Impregilo S.p.A. is the leading Italian engineering and general contracting group in the construction and environmental sectors. It is listed on the Italian Stock Exchange.

[2] With reference to the crime of corruption, it is important to stress that according to Italian law the definition of a public official is more comprehensive than the definition provided by the FCPA, since it includes not only any person acting in an official capacity, but also any person in charge of providing a public service (*i.e.* whoever performs a public service for whatever reason, where public service means an activity that is governed in the same way as a public function, except that the power vested in the latter is absent). As a consequence of this wide definition of a public official as illustrated above, the sphere of application of Law 231 is extremely large.

[3] With regard to *ex post* Law 231 Compliance Program, see Court of Naples, order June 26, 2007; Court of Rome, Judge for the Preliminary Investigations, order April 4, 2003.

[4] For the main conditions for the application of blacklisting as precautionary measures, Court of Milan, April 27, 2004, *Siemens* case (by which Siemens AG was banned from selling gas turbines to the Italian Public Administration for one year); Court of Potenza, February 12, 2009, April 8, 2009, and May 7, 2009, *Tempa Rossa* case (by which Total Italia S.p.A. was initially suspended from operating a concession assigned from the Basilicata regional government, and then, upon appeal, was reinstated by the Court as operator of the Concession under the supervision of a Judicial Commissioner); and Court of Milan, November 17, 2009, *ENI* case (by which the judge decided not to impose the precautionary measures because of the lack of the conditions required by the law for such application).

[5] The Court of Milan's decision of April 27, 2004 (regarding the applicability of precautionary measures) is considered a milestone with respect to the applicability of Law 231 provisions to foreign entities. The Court stated that the German company, Siemens AG, could be subject to the sanctions of Law 231 if (i) its managers were found guilty of bribery of Italian public officers and (ii) Siemens AG's Compliance Programs and internal control systems were deemed to be inadequate. Siemens AG subsequently entered into a plea agreement whereby, pursuant to Article 444 of the Code on Criminal Procedure, the company agreed to pay approximately €180 million to the damaged party, and a fine of half a million Euros (reduced in consideration of the fact that Siemens AG had paid damages), and to the seizure of an amount equal to the bribe paid (€6 million). The Court of Milan's decision of July 25, 2006 authorizing the plea agreement was the first definitive decision issued against a foreign entity in this subject matter.

[6] Court of Milan, September 20, 2004 (*I.V.R.I. Holding S.p.A.*); Court of Milan, December 14, 2004 (*COGEFI S.p.A.*); see also Court of Milan, May 14, 2008 (*Unipol S.p.A. and FINSOE S.p.A.*).

[7] An important support for the Italian companies in such matter was represented by *Confindustria* (the National Confederation of Italian Industry) that issued guidelines in 2004 for the implementation of Compliance Programs (*i.e.* Organizational Law 231 Compliance Program) under Law 231. The Guidelines were revised in 2008 in order to update the scheme of Compliance Programs to offences lastly added to the list of crimes contemplated by Law 231 (as crimes against the safety of workers, cybercrimes, cross border crimes, money laundering, and related offences).

[8] Court of Rome, Judge for the Preliminary Investigations, order of April 14, 2003 (*Soc. Finspa*).

[9] Court of Milan, order of October 28, 2004 (*Siemens AG*).

[10] Court of Naples, Judge for the Preliminary Investigations, order of June 26, 2006.

[11] Court of Milan, November 17, 2009 (*Impregilo S.p.A.*).

[12] Compliance programs are mandatory only for companies listed on the STAR segment of the Milan Stock Exchange.

[13] Court of Milan, February 13, 2008, decision no. 1774.