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## Yearbook

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**Manager release from liability and digital transformation versus  
irrationality in the light of current legal judgements from the  
Federal Court of Justice**

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# Yearbook 2018

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# Manager release from liability and digital transformation versus irrationality in the light of current legal judgements from the Federal Court of Justice

Josef Scherer

My former positions as a public prosecutor and judge and my current work as a lawyer in economic (criminal) matters, a compliance ombudsman, an external compliance officer and a consultant in the area of governance, risk and compliance (GRC) have several common denominators: All functions deal proactively with obligatory behaviour of companies, managers and employees, or reactively with compliance violations.

There is a good reason for this. The “perceived” intensification of liability and sanction risks for executive boards, directors, supervisory boards and even shareholders faced with the accusation of having acted in breach of their duties can be objectively measured. In the 10-year period from 1986 to 1995, there were as many judgements on manager liability as in the previous 100 years [see Bayer 2014, p. 897 ff.]. For the following 10-year periods 1996-2005 and 2006-2015, a further doubling was measured or estimated [see Scherer/Fruth 2015]. As a result, there is a growing collective need from those affected for appropriate tools to support management and employees alike in performing their duties in a legally sound manner: processes that also ensure the effectiveness (“practice”) of compliance.

## Companies, managers and employees are faced with new challenges in their day-to-day work

Everyday business is frequently still dominated by e-mails, Excel spreadsheets and MS Office. The processes are often not documented or are not up to date, or in some cases not traceable. If processes are adapted, expensive IT specialists have to find the time to support the companies. E-mails are distributed to everyone according to the watering can principle, and everyone is sinking in an e-mail flood. Where processes exist, they are not adequately supplemented by governance, risk or compliance components.

Furthermore, for almost every (process) area of a company (strategy and planning, human resources, risk, compliance, purchasing, operations and sales, IT, quality management, internal control system etc.) there are currently standards from ISO, DIN, COSO, IDW, DIIR etc. For compliance, ISO 19600, ISO 37001, IDW PS 980, COSO I and the universal standard “Compliance management system” ([www.gmrc.de](http://www.gmrc.de)) are currently applicable. With the exception of the universal standard, these primarily involve stand-alone systems. But not everyone benefits from stand-alone systems. Particularly for senior management and employees, a large number of parallel “stand-alone worlds” mean an undynamic (ineffective) and expensive bureaucracy [see Scherer/Fruth 2017].

Of course, it would be ideal if the departments in a company could update their processes themselves at any time in a single, integrated management system, without any expensive IT specialists. Processes would not only be documented but designed in such a way that – similar to an order with Amazon, except with much more incorporation of interfaces with the employees involved – people would have to do the right things right, as set out in a human workflow.

E-mails would only be distributed to the actual recipients responsible and all information, including compliance rules in directives, would be provided for the relevant process steps.

Documentation and evaluation of meeting compliance requirements or process cycle times would be carried out automatically. At the same time, employees’ knowledge of how to succeed would be reflected in the processes and “process-based intellectual capital” created. Workflow management would guide people and employees through the process and thus encourage them to comply with time, legal, and system requirements. This could prevent many problems that result from human thinking, decision-making and action being so susceptible to errors.

## Goodbye to homo oeconomicus: Proof of irrationality

Richard Thaler proved that people tend to act irrationally, both in their private and their professional lives. Parallel to the finding that people require leading or guiding towards rational and critical thinking and action, the theory of “paternalistic liberalism” [see Thaler/Sunstein 2008] by Richard Thaler correctly states that pure liberalism does not cause all people (privately or professionally) to behave correctly or more rationally.

However, directionism – which strictly stipulates all activities and threatens sanctions for deviations – is no more effective. This is also shown by the fact that merely issuing new rules continuously does not bring about greater (legal) security. Generally, there are enough rules. The (real) problems arise because rules are frequently not followed [see Scherer/Fruth 2015].

For this reason, terms such as “data protection” or (technical) “security” are only relative.

The skill for senior management, therefore, would be the ability to provide people (themselves and their employees) with sufficient motivation to act rationally. According to the above theory, this requires “nudges” to overcome the inner weaker self [see von Münchhausen 2006], which always wants to talk us out of rational action. However, another prerequisite is first of all the understanding of how and why we often act so irrationally, how manipulations in everyday life can be identified and the insight that, at least professionally, we have an obligation (compliance requirement!) to think, decide and act rationally and without manipulation wherever possible.

### Is there such a thing as “homo rationalis”?

From the 1970s through to 2000, there was a predominant assumption among academics that rational behaviour and clear thinking are fundamentally created within us / in our brains. Exceptions (irrational thinking, action etc.) are caused by (exceptional) emotions such as fear, sympathy or hate.

However, Kahnemann and Tversky moved away from this assumption, stating that we are subject to constant systematic errors in reasoning due to the construction of our cognitive mechanism [see Kahneman 2011].

### Intuitive, competent, good “gut feeling” thinking

There are entrepreneurs who appear to have acted very successfully for decades with an “excellent commercial gut feeling”, without having to be instructed in “correct behaviour” by clever advisors with a background in economics or the law. What can an advisor offer this type of entrepreneur if they constantly – frequently more successfully than their advisor – prove they can take optimum action?

Is this “good gut feeling” merely chance? Probably not. A successful old hand is likely to (be able to) rely on experience acquired over many years of what works and what to avoid, and will have their own models or rules of thumb (“bias”).

This is all fine as long as the initial situation, general conditions and consequences of acting in the same way also remain the same. But what if the conditions or rules change? A few careless decisions based on old models can have disastrous consequences.

Particularly in successful companies that have grown quickly, the organisational structure often cannot change fast enough. Because of the globalisation that has been experienced, including by SMEs, managers now have to deal with international (legal) frameworks to ensure that appropriate requirements for market entry are met and to avoid running into liability problems.

The two short books by Dobelli [see Dobelli 2011 and Dobelli 2012] contain 104 (!) specific examples of these “errors of reasoning” from everyday management. Readers will certainly recognise the majority of them from their own day-to-day work. As the possibly significant negative consequences of “improper thinking and decision-making by managers” and the typical errors have now been academically demonstrated and – in practice too – have been recognised, in some situations we could even talk about a “recognised academic and professional standard” in terms of thinking and decision-making methods.

Any contravention of these findings could be referred to as negligence (foreseeability and preventability of the negative outcome caused by incorrect thinking / decision-making) or lack of conscientiousness of senior management (as set out in sections 43 Limited Liability Companies Act (GmbHG), 93 Companies Act (AktG), 347 German Commercial Code (HGB) etc.).

In some “authentic” examples cited by Dobelli or Kahneman, intent can also be assumed (*dolus eventualis*: considering the negative outcome caused by acting in breach of duties to be “possible and resigning oneself to it”).

For example, we can look at the example set out by Kahneman of the banker investing on behalf of their fund investor (head of asset management at a large financial services provider) who (mis) invested very large sums (“tens of millions of dollars”) in shares in a certain automotive manufacturer without obtaining the appropriate information such as chart analyses, stock picking etc. and based solely on the feeling that “they know how to build cars” [see Kahneman 2011, p. 24].

The Federal Supreme Court’s statements on the Business Judgement Rule – in the decision of 2016 overturning the acquittal of HSH Nordbank directors (Az 5 StR 134/15) are very instructive in this context: Here too, unlucky “intuition” among those acting for the bank may have played a greater role than “rational, considered thinking”.

### “Homo rationalis” through Human Workflow Management

With standardised procedures based on workflows, people and employees, who are susceptible to errors due to normal human weaknesses, would only be able to make errors if they deliberately acted outside the specifications of the process and circumvented controls in a malicious way.

The processes mapped as workflows can be linked to all the other systems and programs in the existing IT environment, for example SAP, merchandise management systems or document management systems. Everyone involved in the process would know what they have to do when, how and where.

As well as those involved in the process, the so-called “monitoring functions” (lines of defence) would always know the current position of the process or where there are any delays [see Scherer 2017, p. 79-81]. This would allow real-time information and save on the need for a lot of investigation, calls and meetings. “Compliance” would also be ensured by constantly updated incorporation of components for meeting requirements from laws, legal judgements, binding internal rules or guidelines (for example allowance or data protection guidelines), as well as recognised academic and professional standards and, in some situations, also industrial standards (such as ISO or COSO etc.).

If tasks are not conducted properly, there would be no more crisis calls or attacks for superiors, but automated, effective and efficient escalation to resolve the weakness.

Process optimisation and adaptation would no longer be a matter of gut feeling, but would be carried out highly efficiently and effectively based on genuine current process indicators. Realistic process cost accounting could represent both the input to the relevant process step or the output in payment flows. This would be the basis for calculating value contribution according to actual processes.

### Integrated GRC management system on demand

As almost all standards (ISO, COSO, IDW etc.) for quality, risk, compliance and ICS management systems can be compressed to a uniform, largely redundant structure and content, the professional sector should take the opportunity to “upgrade” the existing (compliance) management system to an integrated and comprehensive management system that facilitates compliance not just in individual areas but with the requirements set out in the principles of proper corporate management and governance as a whole. Because of the numerous redundancies, the work involved is reasonable and offers huge potential savings.

All of this has been a reality for some time now and is the “recognised academic and professional standard” for good practice companies!

If they do not want to act in breach of their duties in a way that would trigger liability (sections 93, 107 Companies Act (AktG), 43 Limited Liability Companies Act (GmbHG), 347 German Commercial Code HGB)), companies and their bodies (supervisory board, executive board / directors, shareholders) undertake to stick to this “recognised academic and professional standard” [see Scherer/Fruth 2009, Scherer/Fruth 2014 and Scherer/Fruth 2015].

Therefore they should document their processes, enhance them with appropriate governance, risk and compliance components and digitalise them.

### Releasing managers from liability: The first decision of the Federal Court of Justice on the liability exclusion effect of a (certified) compliance management system

#### Federal Court of Justice (BGH), Judgement of 09 May 2017 – 1 StR 265/16, Rn. 110 (Beck RS 2017, 114548):

“Also significant for assessment of fines is the extent to which the co-defendant is complying with its duty to prevent legal violations from within the company and has installed an efficient compliance management system, which must be geared towards prevention of legal violations (see Raum, *Compliance in the context of duties under criminal law and fines*, 2017 in Hastenrath (ed.), *Compliance Communication*, 2017).

Whether the co-defendant has *optimised appropriate rules as a consequence of this procedure and has designed its internal operational processes in such a way that it will be much more difficult for comparable violations of standards to occur in the future may also play a role.* [Bold by the author]

Quoted from Raum [Raum 2017, p. 40, Rn. 29]: On: **Institutional (manager) duties:**

“A key effect of a compliance system is to ease the burden on management under criminal law and for the purposes of fines. [...] If a proper (!) compliance system is in place, the institution is exculpated under criminal law and in terms of fines, if no accusation of guilt can be made against it, including in terms of any personal special knowledge.”

#### Significance and impact of standards (ISO / IDW / etc.) and certifications on manager and corporate liability:

“In this context, it is important to discuss the significance that can be ascribed to the recently formulated IDW (PS 980) and ISO (19600) directives/standards, and the certifications offered by business consultants. [...] By their nature, these issues in the above

assessment scheme belong at the point where the assessment is made as to whether there has been a violation of supervisory duties. The directives/standards can set standards which can, in turn, influence the decision on whether everything reasonable has been done to prevent such violations.”

“Neither directives nor certifications can replace the case-by-case assessment required in the event of a violation. The standards cannot replace the independent assessment of the courts. In and of itself, a certification (on whatever basis) has no exculpatory effect for the body or for the company. To this extent, the certification can at best have individual significance as evidence that those responsible have made efforts to prevent legal violations from within their company.”

“Directives of this kind can therefore actually constitute criminal liability.” “The rules created with ISO 19600 [...] can create a framework for guidance.”

### Summary

Despite significantly increased requirements for the quality and compliance of management decisions and the evidence that people actually tend to act irrationally, human workflow management processes – enhanced by governance, risk and compliance components in an integrated management system – can still achieve considerable value contributions and, at the same time, reduce the risk of liability for management and employees. These positive effects can be effectively communicated to all so-called “interested parties” (customers, authorities, employees, bank etc.): “Do good and talk about it”.

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