Constitutional Court: Greater Safeguards Against "Punitive" Administrative Penalties

March 29, 2019

In the much-awaited Judgment No. 63, filed on March 21, 2019 and published on March 27, 2019 on Issue No. 13 of the Italian Official Gazette ("Judgment"), the Italian Constitutional Court found that the principle of retroactive application of the most favorable law applies to the administrative penalties set forth under Legislative Decree No. 58 of February 24, 1998 ("Italian Securities Act") against market abuse, thereby upholding the views expressed by the Milan Court of Appeals in its Order No. 87 of March 19, 2017 ("Order").

In sum, the Court found that:

— Administrative penalties against market abuse set forth under the Italian Securities Act have a "punitive nature;"

— As such, these penalties must comply with the safeguards "that the Constitution and international human rights law," including the European Convention for the Protection of Human Rights and Fundamental Freedoms ("ECHR"), "provide for criminal matters," including the principle of retroactive application of the most favorable law;

— More in general, the entire "body" of safeguards and principles applicable to "criminal matters" pursuant to the ECHR applies to administrative penalties having "a 'punitive' nature and purpose" according to the criteria set out by the European Court of Human Rights ("ECtHR");

— As a result, Art. 6(2) of Legislative Decree No. 72 of May 25, 2015 ("Decree") violates the Constitution insofar as it bars the retroactive application of the amendments introduced by Art. 6(3) of the Decree (i.e., the inapplicability of the fivefold increase of penalties under Art. 39(3) of Law No. 262 of December 28, 2005) to administrative sanctions against market abuses under Articles 187-bis and 187-ter of the Italian Securities Act.

In addition to the critical topic specifically addressed by the Court, the Judgment is remarkable for the abovementioned, broadly-worded principles included in its reasoning, which suggest that the Italian Constitutional Court's stance to the relationships between Supervisory Authorities and supervised subjects may become more libertarian in the future.

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I. The Order

With an order served on September 26, 2016, Consob ordered an individual to pay an administrative penalty equal to Euro 100,000, after finding that he had forwarded to his wife, on February 6, 2014, an email showing the capital strengthening plan of the company where he was employed – which was disclosed to the market a month later – thereby violating Art. 187-bis(1)(b) of the Italian Securities Act. Consob also ordered a two-month suspension from the exercise of business activity as ancillary penalty, pursuant to Art. 187-quarter(1) of the Italian Securities Act.

The applicant appealed the Order, challenging, among other things, the administrative penalty's quantification. In particular, the applicant argued that Consob had violated Art. 6(3) of the Decree (entered in force after the violation found by Consob) which – for the administrative penalties set forth under the Italian Securities Act – barred the fivefold increase provided by Article 39(3) of Law No. 262 of December 28, 2005.[1] Therefore, the applicant submitted that the lowest applicable penalty amounted to Euro 20,000 (instead of Euro 100,000, which had been effectively imposed).

In its defense, Consob argued, among other things, that the application of Art. 6(3) of the Decree was barred by Art. 6(2) of the same Decree, which prevents the applicability of the amendments introduced by the Decree to violations committed – as in this case – before the "entry into force of the provisions issued by Consob and the Bank of Italy, according to their respective areas of competence." According to Consob, Art. 6(2) of the Decree – which is the Government's enactment of the delegation of legislative power to "assess whether the *favor rei* principle extends to amendments of legislation in force at the time of a violation"[2] – reflects the lawmaker's specific discretionary decision to prevent the more favorable amendments to the penalties under the Italian Securities Act to apply retroactively.

Faced with the issue and arguing on the basis of the ECtHR's established case-law whereby "the safeguards" under the ECHR "apply to all punitive provisions, regardless of their qualification as criminal sanctions in the jurisdiction of origin" (such as Art. 187-bis, of the Italian Securities Act, in the Milan Court's view), the Milan Court of Appeals raised an issue of constitutionality of Art. 6(2) of the Decree in relation to, among others, Articles 3 and 117 of the Constitution, insofar as Art. 6(2) of the Decree prevents the retroactive applicability of the most favorable law in the context of the penalties set forth under Art. 187-bis TUF.[3]

II. The Judgment

After recalling the constitutional basis of and the limits to the principle of retroactive application of the most favorable law to criminal matters, the Constitutional Court found that:

i. The abovementioned principle also applies to administrative penalties with a "punitive" nature, among which are the penalties against market abuses;

ii. The exception provided by Art. 6(2) of the Decree to the principle's application violates the Constitution, given that it is inconsistent with the "positive test of reasonableness" under constitutional law; and

iii. As a result, Art. 6(2) of the Decree violates the Constitution "insofar as it prevents the retroactive applicability of the amendments introduced by Art. 6(3) to the administrative penalties set forth" under Art. 187-bis of the Italian Securities Act against insider trading and,

[1] Art. 39(3) of Law No. 262 of December 28, 2005 (Savings Act) provides that the "financial penalties set forth under," among others, the Italian Banking Act and the Italian Securities Act, "that have not been amended by the present Act, are increased fivefold." Law No. 154 of October 7, 2010 had conferred upon the Government the power to review the lowest and highest statutory limits of administrative penalties set forth under the Italian Banking Act and the Italian Securities Act (Art. 3(1)(i)). More recently, Legislative Decree No. 107 of August 10, 2018 amended Art. 187-bis of the Italian Securities Act, which now provides for an administrative penalty ranging from Euro 20,000 and Euro 5,000,000.

[2] Art. 3(1)(m) and (1) of Law No. 154 of October 7, 2014.

[3] Order, Italian Official Gazette No. 25 of June 21, 2017.

"consequently," under Art. 187-ter of the Italian Securities Act against market manipulation.[4]

The Constitutional Basis of the Principle

Preliminarily, the Court recalls that – in accordance with its settled case-law – the principle of retroactive application of the most favorable law to criminal matters is not based on Art. 25(2) of the Constitution,[5] but on a different, "twofold and competing [constitutional] basis,"[6] i.e.:

— First, the "domestic law" principle of equality pursuant to Art. 3 of the Constitution that "requires, in principle, that similar facts are treated with the same punishment, regardless of whether the facts were committed before or after the law repealing or mitigating the criminal penalty,"[7] given that, normally, it is not "reasonable to punish (or continue punishing more severely) a person for a fact that, under the new law, someone else may commit without consequences (or with lighter consequences);"[8]

— Second – in light of the ECtHR case-law since the *Scoppola v. Italy* decision[9] – the principle ("originally provided for under international law" and "now accepted in the Italian legal system through Art. 117(1) of the Constitution,")[10] set forth by Art. 7 ECHR and other "international human rights rules binding on Italy" having a similar content, including Art. 49(1) of the Nice Charter.[11]

This constitutional basis implies that – differently from the protection stemming from the principle of non-retroactive applicability of the least favorable law pursuant to Art. 25(2) of the Constitution, which constitutes an "absolute and imperative value"[12] – the protection stemming from the principle of retroactive application of the most favorable law to criminal matters is not unlimited: pursuant to the Constitutional Court's settled case-law, a similar protection may be "subject to limitations and exceptions," as long as any such limitation and exception comply with "a positive test of reasonableness," not being enough for them to be "not manifestly unreasonable."[13]

[4] Judgment, paras. 6-7.

[5] The direct purpose of Art. 25(2) of the Constitution is to "protect the freedom of each individual self-determination, safeguarding each person from being surprised with the imposition of a criminal penalties that could not be expected at the time the fact was committed." Although this purpose prohibits "the retroactive application of criminal laws introducing new offences or more severe penalties against existing offences," it does not prevent "the retroactive applicability of laws that, to the contrary, abolish existing offences or mitigate existing penalties against an offence." This may be explained by noting that "the most favorable law comes into existence after the fact has been committed, which the offender had freely determined to commit on the basis of the previous (and to him or her less favorable) legal framework" (Constitutional Court, Judgment No. 394 of November 23, 2006, referred to at par. 6.1 of the Judgment).

[6] The Court deems that – although the basis is twofold – the safeguard expressed by the principle is based on the same common purpose, that is, the right "of the offender to be judged, and potentially punished, on the ground of the legal system's current appreciation of the disvalue of the fact committed, and not on the ground of the appreciation underlying the law in force at the time the fact was committed."

[7] Constitutional Court, Judgment No. 394 of November 23, 2006.

[8] Constitutional Court, Judgment No. 236 of July 22, 2011.

[9] ECtHR, September 17, 2009, *Scoppola v. Italy*, that based on Art. 7 of the ECHR stated the principle whereby "if the criminal law in force at the time the offence was committed and the following criminal laws enacted before the final Judgment is issued are different, the judge should apply the law containing the provisions most favorable to the defendant" (par. 109). Similarly, *see also* the following decisions: April 27, 2010, *Morabito v. Italy*; January 24, 2012, *Mihat Toma v. Romania*; January 12, 2016, *Gouarré Patte v. Andorra*; and July 12, 2016, *Ruban v. Ukraine*, all referred to by the Judgment.

[10] Constitutional Court, Judgment No. 236 of July 22, 2011.

[11] Judgment, part. 6.1.

[12] Constitutional Court, Judgment No. 236 of July 22, 2011.

[13] Judgment, par. 6.1. *See also* Constitutional Court, Judgment No. 394 of November 23, 2006.

Applicability to "Punitive" Administrative Penalties

After clarifying the constitutional basis of the principle of retroactive application of the most favorable law, the Court states that it also applies to administrative penalties "with a 'punitive' nature and purpose."

The Court refers to the ECtHR's settled case-law, as well as its own precedent dealing extensively with the matter, and finds that:

— The ECtHR has never dealt with the whole "system of administrative penalties", but only with "single and discrete" penalties that – although qualified as administrative by domestic law – presented "'punitive' features in light of the ECHR legal framework";

— In its own precedent, the Court deemed ungrounded the issue of constitutionality on the potential contrast, among others, between Art. 117(1) of the Constitution and Art. 1 of Law No. 689 of November 24, 1981 in relation to the whole system of administrative penalties, because – in light of the ECtHR's case-law – there is no obligation upon the contracting States to provide for the general application of the "principle of retroactive application of the most favorable law" with respect to any and all administrative penalties;

— However, with regard to "single administrative penalties with a 'punitive' nature and purpose" (which therefore qualify as having a "substantially criminal nature" based on the criteria set out by the ECtHR), the entire "body of principles identified by the ECtHR in connection with 'criminal matters'" – including the principle of retroactive application of the most favorable law – cannot but apply. In this respect, no preclusion arises from the circumstance that – to date – the ECtHR may not have already had the chance to express its view on this specific topic, since "the view that an Italian court may not apply the ECHR until the ECtHR has expressed its view on the same specific issue must be rejected";[14]

— The above conclusion is also consistent with the relevant Court's case-law on criminal matters on the basis of Art. 3 of the Constitution. Where "the administrative penalty has a 'punitive' nature" there is no reason "in principle" – that is, unless there are "imperative reasons relating to the protection of other constitutionally relevant interests" that pass the abovementioned "positive test of reasonableness" pursuant to Art. 3 of the Constitution – to continue applying to the offender "a penalty, if the same fact is no longer considered unlawful; nor to continue applying a penalty in an amount that is subsequently considered excessive (and therefore disproportionate) in relation to the legal system's different appreciation of the disvalue of the offence."[15]

'Punitive' Nature of Administrative Penalties Against Market Abuses and the Unreasonableness of the Exception

The Court has no hesitation in finding that the administrative penalty set forth under Art. 187-bis of the Italian Securities Act has a punitive nature and must therefore comply with "the safeguards that the Constitution and international human rights law provide for criminal matters, including the principle of retroactive application of the most favorable law."[16]

In addition, the Court finds that the exception provided by Art. 6(2) of the Decree to the principle does not pass the "positive test of reasonableness," given that, among other things:

— The mere need to avoid negative repercussions on ongoing administrative proceedings does not constitute a constitutionally relevant opposing interest that may justify the exception to the principle of retroactive application of the most favorable law, considering that the application of the most favorable law to proceedings that are

[14] Constitutional Court, Judgment No. 68 of April 7, 2017.

[15] Judgment, par. 6.2.

[16] Judgment, par. 6.3.

pending at the time of its entry into force represents the very essence of the principle;

— The statutory exception "unreasonably [sacrifices] the right of perpetrators of insider trading to receive a penalty that is proportionate to the lawmaker's changed appreciation of the disvalue of the offence."[17]

Therefore, the Court finds that Art. 6(2) of the Decree violates the Constitution "insofar as it prevents the retroactive application of the amendments introduced by Art. 6(3) of the Decree to the administrative penalties against the offence provided by Art. 187-bis,"[18] as well as – "consequently" and "for the same reasons highlighted for" Art. 187-bis of the Italian Securities Act – insofar as it does not provide for the retroactive application of the amendments introduced by the abovementioned Art. 6(3) also to "the penalties set forth under Art-187-ter" of the Italian Securities Act against market manipulation.[19]

III. Conclusions and Outstanding Issues

The Judgment – which is particularly clear in its reasoning – has the distinct merit of taking a further step forward in adopting a more libertarian approach to the relationship between "punitive" administrative penalties and constitutional safeguards.[20]

The Judgment is also remarkable for two statements of principle set out in the reasoning, where the Court states that:

— On the one side, when an administrative penalty has a "'punitive' nature and purpose," the whole "body of principles laid down by the Strasbourg Court regarding 'criminal matters' shall apply to it";

— On the other side, in order to apply to a specific case a specific principle or safeguard established by the ECtHR in connection with "criminal matters," there need not be a precedent by the ECtHR on similar facts finding that that principle or safeguard applies to that specific case because "the view that an Italian court may not apply the ECHR until the ECtHR has expressed its view on the same specific issue must be rejected."

The above statements suggest that the constitutional safeguards provided for in relation to "criminal matters" may apply to "punitive" administrative penalties beyond the specific cases and issues already addressed by the Court and/or by the ECtHR.

In particular, the Court's observations suggest that, among other things:

— The principles and safeguards provided by the ECHR (as interpreted by the ECtHR) for "criminal matters" may apply to *all* financial penalties imposed by any Supervisory Authority that "have a 'punitive' nature and purpose" pursuant to the criteria established by the ECtHR – and, therefore, not only to the penalties imposed by Consob against market abuses – even if the ECtHR has not yet held the specific penalty's "substantially criminal nature;"[21]

— *All* the principles and safeguards provided by the ECHR (as interpreted by the ECtHR) for "criminal matters" – including the scope of legal privilege, presumption of innocence, prohibition of self-incrimination, etc.[22] – apply to the

[17] Judgment, par. 6.4.

[18] Judgment, par. 6.4.

[19] Judgment, par. 7.

[20] The Judgment states that, in general, "the failure to generalize the retroactivity of advantageous changes related to sanctions" is "suspected of unreasonableness" and, therefore, needs a "specific justification in terms of the need to protect constitutionally relevant counter-interests". Judgment, paragraph 6.4.

[21] Consider, for instance, the pecuniary administrative penalties that can be imposed by the Bank of Italy for the violation of banking regulations and for the prevention of money laundering, which – in the light of, among other things, their amount and the interests for the protection of which are laid down – seem to satisfy the so called *Engel* criteria established by the ECtHR to assess the "substantially criminal nature" of a sanction.

[22] With reference to the relationship between the prohibition of self-incrimination and the obligation of supervised subjects to cooperate with supervisory authorities, we recall that – by order dated February 16, 2018 No. 3831, published in the Italian Official Gazette No. 14 of April 4, 2018 – the Supreme Court (third civil panel) raised an issue of constitutionality of Article 187-*quinquiesdecies* of the Italian Securities Act (with

abovementioned penalties, regardless of any specific precedent by the ECtHR on that matter.

In brief, the Judgment is not only remarkable for the specific issue addressed (and its solution), but also welcome for the passages of its reasoning that suggest an increased protectiveness in the approach taken by the Court *vis-à-vis* the relationships between Supervisory Authorities and supervised subjects.

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reference to Articles 24, 111, and 117 of the Constitution, the latter in connection to, among others, Article 6 of the ECHR) insofar as the provision "sanctioning the conduct consisting in not promptly complying with Consob's requests or in delaying the exercise of Consob's functions also applies to those that Consob – in the exercise of its supervisory functions – argues have abused of inside information."