Court of Justice of the European Communities

Judgment of 3 May 2005 (*Silvio Berlusconi and Others*), Joint Cases C-387/02, C-391/02 and C-403/02

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The European Union has been tightening its grip on the criminal laws of the member states. Article 31 of the Treaty on European Union introduced the framework decision as the appropriate instrument to harmonize criminal law. In this way, member states may be required to adopt minimum levels of criminal definitions and sanctions. This is a matter of 'third pillar' law. The case under scrutiny, however, is a perfect illustration of the delicate relationship between EU *first* pillar law and domestic criminal law.

Some (former) company directors, among them notably Prime Minister Silvio Berlusconi, were charged before different Italian courts with the publication of false company documents. After the events had occurred, however, the Italian criminal rules in question were modified significantly (at the hands of the main defendant's parliamentary majority), effectively alleviating the offences for the benefit of the defendants. Since these modifications were probably in conflict with European obligations, the Italian courts wanted to know which rules to apply and, thus, asked for a preliminary ruling from the Court at Luxembourg.

The legal issue involves three separate questions. Do the relevant EC-Directives, which prescribe appropriate penalties for *failure to disclose* annual accounts and other company documents, also cover *falsification* of these documents? Second, does the new (current) Italian legislation still meet the standards of Community law in the sense that it provides for 'appropriate penalties'? Last, but not least, should the obligations deriving from the member states' loyal application of Community law prevail over the general principle that defendants are to benefit from the most lenient criminal provision, or is the latter principle – as defendants argued – sacrosanct?

The general background of this case was a significant factor. It involved Mr. Berlusconi's well-known use of the Italian legislative process, in his capacity as

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prime minister, to serve his own business interests. Would the Court use this opportunity to serve him a legal rebuke from Luxembourg?

The Advocate-General, Ms. Kokott, did identify the above three questions and discussed them systematically, while the Court took a short cut to circumvent the most interesting issue of the hierarchy between Community law and the principles of criminal law. Before addressing these questions in greater detail, however, let me offer an overview of the relevant Community and domestic rules.

Legislative framework

The three EC-directives concerned were adopted within the framework of one of the major objectives of the Community: the freedom of establishment. These Directives, which are all based on Article 44, para. 2(g) of the EC Treaty, are closely inter-related and aimed at guaranteeing that companies offer a fair and reliable picture of their economic performance through the disclosure of factually correct annual accounts and other documents.[1] The First and Seventh Directives explicitly impose appropriate sanctions for a failure to comply with the publication obligations. At first blush, the Fourth Directive appears to limit the obligation to mete out appropriate sanctions to those specific entities that are exempt from publishing their accounts in accordance with the First Directive. However, both the Advocate-General and the Court correctly observed that the European legislature intended that the sanction regime would cover all infringements of publication obligations.[2]

The original Italian legislation on publication of false company documents was rather straightforward. Article 2621 (old) of the Italian Civil Code sanctioned:

> organisers, founding members, administrators, directors, auditors and receivers who, in reports, balance sheets or other company documents, fraudulently make untrue statements of substantive fact as to the constitution or economic position of the company or conceal in full or in part facts thereto.

[1] Under para. 2(g) of Art. 44 EC, it is the duty of the Council and the Commission 'to coordinate to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent throughout the Community.'

[2] First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required of companies by member states within the meaning of the second para. of Art. 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (hereinafter: 'First Directive'); Fourth Council Directive 78/660/EEC of 25 July 1978 based on Art. 54(3)(g) of the Treaty on the annual accounts of certain types of companies (hereinafter: 'Fourth Directive'); Seventh Council Directive 83/349/EEC of 13 June 1983 based on Art. 54(3)(g) of the Treaty on consolidated accounts (hereinafter: 'Seventh Directive').

It imposed a prison sentence of one to five years and a fine of LIT 2 million to 20 million and qualified the offence as one to be prosecuted *ex officio*, subject to a limitation period of 10 years. An aggravating factor was material loss 'on an appreciable scale' to the company as a result of the fraudulent behaviour, increasing the penalty by up to one half of the maximum term.

The new legislation, introduced by the Berlusconi government by way of legislative decree when it came to power in 2001, became effective 16 April 2002. The most conspicuous changes are threefold. The former Article 2621 offence was converted into a summary offence (*contravenzione)* carrying an imprisonment for a term of up to one year and six months. The corresponding limitation period was cut back to three years. Secondly, the graver crime of giving false information about a company that is detrimental to 'members' or creditors (new Article 2622) is still an indictable offence, punishable by imprisonment for a term of between six months and three years. However, it can only be tried upon the complaint of an injured party. The provision identified as relevant victims only members of the company and its creditors, thus restricting the scope of protection. Further, it raised the threshold by adding the requirement that a concrete loss must be suffered. Finally, in both provisions, thresholds were introduced to preclude criminal liability in cases where the misrepresentation of the actual situation was deemed to be limited.[3]

The scope *ratione materiae* of Article 6 of the First Directive

Article 6 of the First Directive admonishes member states to provide for appropriate sanctions in cases of failure to disclose documents as required by Article 2(1)(f) of that directive. This begs the question of whether the Directive calls for similar sanctions in case of disclosure of false accounts. The defendants in this case were opposed to such a 'broad' interpretation, arguing that the directive only aimed at minimum harmonisation. Both the Advocate-General and the Court made short shrift with that objection, pointing to the wider context as warranting an interpretation whereby the documents should be disclosed in the manner prescribed, i.e., by giving accurate information – on penalty of appropriate sanctions.

[3] The final parts of Arts. 2621 and 2622 are similar and read as follows: 'Criminal liability shall be excluded in any event where the false statements or omissions do not distort to an appreciable extent the representation of the assets, liabilities, economic position or financial position of the company or group to which that company belongs. Criminal liability shall also be excluded where the false statements or omissions distort the pre-tax financial results for the year by no more than 5% or distort the net assets by no more than 1%. Such acts shall not be punishable in any circumstances where they are the results of estimates which, viewed individually, do not differ from the true values more than 10%.'

Apart from this mainly grammatical and contextual interpretation, the Advocate-General took the trouble to elaborate on the intent and purpose of the provisions in the relevant directives. One of the major aims of these instruments is to protect the interests of third parties, in view of the wider purpose of encouraging business activity in the internal market. As outsiders, such third parties are utterly dependant on correct and reliable information, which is of paramount importance to their investments decisions.[4] From this perspective, disclosure of flawed information may be even more detrimental to the general climate of investment, which thrives by mutual confidence and trust, than the complete failure to disclose documents.[5] Both modes of interpretation lead to the same conclusion that the directives are intended to counter both the complete failure to disclose company documents and the disclosure of false annual accounts.

Appropriate sanctions

The duty of member states to discourage infringements of Community law by 'appropriate' sanctions derives from their general obligation to take all measures necessary to guarantee the full effectiveness of Community law (Article 10 EC). In its landmark decision, *Commission* v. *Greece,* the Court expounded on the concept by holding that member states should ensure that infringements of Community law are penalised under conditions – both procedural and substantive – that are analogous to those which apply to infringements of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive.[6] In this respect, Article 6 of the First Directive merely reiterates a widely accepted principle of Community law. Although the Court, for reasons given below, did not address the issue, it is interesting to ponder the question of why the new Italian legislation does not meet those standards.

Taking again the interests of third parties as a point of departure, the Advocate-General explained why, in her opinion, the whole regulation falls short of the exigencies of Community law. The relevant provisions on sanctions in the Directives do not preclude tolerance limits as such, in the sense that they allow repre-

[4] Conclusion, § 74: 'Being external to the company, they (i.e. third parties) are by definition in greater need of protection than, say, its principal members, who have disproportionately greater knowledge of the assets, liabilities, financial position and profit or loss of the undertaking concerned and are involved in, or can at least obtain information on, the decisions it takes.'

[5] Conclusion, §75: 'Whereas, in a situation where a company's annual accounts are not disclosed, a third party is forewarned and certainly cannot place his trust initially in a given representation of the assets, liabilities, financial position and profit or loss of the company concerned, he is likely to find it extremely difficult, if not impossible, without an in-depth knowledge of the undertaking, to identify errors in annual accounts which have been disclosed.'

[6] Case 68/88 *Commission* v. *Greece* [1989] ECR 2965, §§ 23 and 24.

sentations slightly deviating from the financial position of the company or group to go unpunished. However, the Italian provisions are too 'coarse', ignoring the psychological effects of *deliberate* misrepresentation. Both Articles 2621 and 2622 of the Italian Civil Code contain specific *mens rea* elements that require the fault to be deliberate and made with the intent to deceive or to secure enrichment. In such cases, even negligible distortions should not be tolerated, as they would encourage 'widespread and intentionally included inaccuracies in annual accounts' that would 'undermine the trust in the probity of annual accounts and would thus run counter to the objective pursued by the company law directives.'[7]

According to the Advocate-General, the combined effect of the limitations introduced by the new legislation is that the provisions are no longer capable of serving the legitimate interests of third parties. On the one hand, the significant reduction of the limitation period in cases of summary offences under the new Article 2621 reduces prosecution for such offences to mere theorety. After all, the intricate and protracted criminal proceedings usually cannot be completed before a limitation becomes effective. On the other hand, the scope of Article 2622 is too limited to compensate for any lack of efficiency of the former. Since the inception of prosecution depends on a complaint by those who actually suffered material loss, recourse to the protection of this provision is thwarted for those who may claim non-material damages 'which can arise where the public's trust in the probity of annual accounts is betrayed.'[8] Nor does the combined effect of provisions of civil, criminal and administrative law remedy the ineffectiveness of criminal law provisions. The imposition of administrative sanctions is dependant on criminal prosecution, because the fines themselves are too small to have any deterrent effect on the potential trespasser. In light of these considerations, the final judgment can only be that the entire new legal regimen fails to provide for appropriate sanctions.

The final question: Is there a hierarchy between Community law and the principle of retroactive application of the more lenient criminal provision?

As was mentioned in the introduction, the most interesting question in this case is whether Community law should reign supreme or whether it should yield to the principle in criminal law that defendants are entitled to benefit from the most lenient criminal provision. It is disappointing that the Court did not address the question. The succinct and pragmatic judgment of the Court pales against the richly nuanced and instructive argument of the Advocate-General. Yet, the sparse and unadorned approach of the Court stands to logic, and it is important to understand why.

[7] Conclusion, §§ 98 and 99.
[8] Conclusion, § 116.

The further elaboration of the concept of 'appropriate sanctions' as a yardstick to measure domestic law as well as the question of the hierarchy between Community law and principles of criminal law is relevant only if one accepts that Community law can defeat domestic law in this particular case. The Court acknowledged this when it explicitly held that the question of whether the principle of retroactive application of the more lenient criminal provisions also applies if it infringes (other rules of) Community law need not be answered.[9] Referring to its settled case-law, the Court argued that Directives can never, of themselves and independently of a national law adopted by a member state for its implementation, have the effect of determining or aggravating criminal liability of persons who act in their contravention.[10] This settles the case, at least in the pendant criminal proceedings, because the courts have no alternative but to apply the domestic criminal law without fear of competition from potentially overriding Community law.

The Advocate-General basically discussed the same issues, but reached an opposite conclusion. She began with the principle of legality (*nullum crimen, nulla poena sine lege)* and argued that it would be consistent with that principle to measure an act against the criminal provision applicable at the time of the act's commission.[11] Although she acknowledged the status of the principle of retroactive application of a more lenient criminal provision, she argued that this principle should be considered as an exception to the principle of *nullum crimen, nulla poena.* From this perspective, a prosecution and trial based on prior criminal provisions, which were applicable at the time the act was committed, dovetails with the *nullum crimen* principle. Community law merely serves as a corrective to prevent retroactive application of current provisions, rather than being itself an independent legal basis for the proceedings. As Community law prevails over national legislation and courts are bound to apply it *ex officio* without prior recourse to national constitutional courts, they are obliged to set aside a more lenient criminal provision enacted after the fact, in so far as that provision is incompatible with a directive.

From a strictly technical point of view, the judgment of the Court is superior to the AG opinion, because the Advocate-General failed to explain how the defendant could be deprived of the beneficial effects of the more lenient criminal provision without the intervention of Community law. This entails that the directives would have a direct effect on the criminal liability of the accused, because the

[9] Judgement, § 71.

[10] Judgement, § 74 Settled case-law since Case C-80/86, *Kolpinghuis Nijmegen*, [1987] ECR 3969, § 13.E

[11] Conclusion, § 146.

principle leaves courts no margin of discretion to choose between the different criminal provisions.

The dissent between the Advocate-General and the Court allows us to consider that the two lines of argument were possible. While the young Advocate-General chose the bold approach, the Court shied away from confronting a prime minister whose self-serving actions were in clear violation of EU law. Why, if not on strictly legal grounds? One may suppose that prudent considerations were involved. Bending domestic law to fit his own personal interests, as Mr. Berlusconi did, is a practice that puts to shame the Italian public, and this should be sanctioned by elections rather than by a court of law.

This is not incorrect; however, would it hurt to give the Italians a little help from Luxembourg?

The effect of the Court's judgment is to withhold from domestic courts the tools necessary to repair their member state's legislation conflicting with Community law. Thus, defendants can reap the profits of their state's violation of law. If the defendant and the state are in a personal union, as in this case, it is even more blatant. It remains to be seen whether the Commission will summon Italy before the Court for non-compliance as is the more secure avenue of action.

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