OPINION OF ADVOCATE GENERAL TIZZANO

delivered on 21 February 2002 [1]

I — Introduction

1. By the action it brought on 27 April 2000, the Grand Duchy of Luxembourg, pursuant to Article 230 EC, seeks the partial annulment of Commission Decision 2000/216/EC of 1 March 2000, which excludes from Community financing certain expenses incurred by the Member States under the European Agricultural Guidance and Guarantee Fund (EAGGF), Guarantee Section [notified by number C(2000) 488] (OJ 2000 L 67, p. 37, hereinafter 'Decision 2000/216' or the 'contested decision'). The applicant Government seeks in particular the annulment of the part of the decision which, with reference to the financial years 1996, 1997 and 1998 and in relation to arable crops, provides that the sum of LUF 56 106 800, equal to 5% of the costs sustained by Luxembourg, is not chargeable to the EAGGF.

1 — Original language: Italian.

II — Legal background

A — *General provisions concerning the clearance of accounts*

2. Council Regulation (EEC) No 729/70 of 21 April 1970 on the financing of the common agricultural policy (OJ, English Special Edition 1970 (I), p. 218); hereinafter 'Regulation No 729/70') states in Article 1(2)(b) that the European Agricultural Guidance and Guarantee Fund (hereinafter the 'EAGGF'), Guarantee Section, is required to finance in particular intervention intended to stabilise the agricultural markets.

3. Article 3(1) of that regulation provides that:

'Intervention intended to stabilise the agricultural markets, undertaken according to Community rules within the framework of the common organisation of agricultural

markets, shall be financed under Article 1(2)(b).'

4. Pursuant to Article 5(2)(c) of Regulation No 729/70, as amended by Council Regulation (EC) No 1287/95 of 22 May 1995 (OJ 1995 L 125, p. 1; hereinafter 'Regulation No 1287/95'):

'The Commission, after consulting the Fund Committee:

...

(c) shall decide on the expenditure to be excluded from the Community financing referred to in Articles 2 and 3 where it finds that expenditure has not been effected in compliance with Community rules.

Before a decision to refuse financing is taken, the results of the Commission's checks and the replies of the Member State concerned shall be notified in writing, after which the two parties shall endeavour to reach agreement on the action to be taken.

If no agreement is reached, the Member State may ask for a procedure to be initiated with a view to mediating between the respective positions within a period of four months, the results of which shall be set out in a report sent to and examined by the Commission, before a decision to refuse financing is taken.

The Commission shall evaluate the amounts to be excluded having regard in particular to the degree of non-compliance found. The Commission shall take into account the nature and gravity of the infringement and the financial loss suffered by the Community.

A refusal to finance may not involve expenditure effected prior to twenty-four months preceding the Commission's written communication of the results of those checks to the Member State concerned. However, this provision shall not apply to the financial consequences:

— of irregularities as referred to in Article 8(2);

— concerning national aids, or infringements, for which the procedures referred to in Articles 93 and 169 of the Treaty have been initiated'.

5. Article 8(1) of Regulation No 729/70 then provides that:

'1. The Member States in accordance with national provisions laid down by law, regulation or administrative action shall take the measures necessary to:

— satisfy themselves that transactions financed by the Fund are actually carried out and are executed correctly;

— prevent and deal with irregularities;

— recover sums lost as a result of irregularities or negligence.

The Member States shall inform the Commission of the measures taken for those purposes and in particular of the state of the administrative and judicial procedures.'

6. With particular reference to Article 5(2)(c) of Regulation No 729/70, as amended, attention should be paid to Article 8(1) and (2) of Commission Regulation (EC) No 1663/95 of 7 July 1995 laying down detailed rules for the application of Council Regulation (EEC) No 729/70 regarding the procedure for the clearance of the accounts of the EAGGF Guarantee Section (OJ 1995 L 158, p. 6; hereinafter 'Regulation No 1663/95'). Those provisions state that:

'1. When, as a result of any enquiry, the Commission considers that expenditure was not effected according to Community rules, it shall communicate to the Member State concerned its findings, the corrective measures to be taken to ensure future compliance, and an evaluation of any expenditure which it may propose to exclude pursuant to Article 5(2)(c) of Regulation (EEC) No 729/70. The communication shall make reference to this Regulation. The Member State shall reply within two months, and the Commission may modify its position in consequence. In justified cases the Commission may agree to extend this period for reply.

After expiry of the period allowed for reply, the Commission shall initiate a bilateral discussion, and both parties shall endeavour to come to an agreement as to the measures to be taken. The Commission shall then formally communicate its conclusions to the Member State, referring to Commission Decision 94/442/EC.

2. The decisions referred to in Article 5(2)(c) of Regulation (EEC)

No 729/70 shall be taken after an examination of any report drawn up by the Conciliation body according to the provisions laid down in Decision 94/442/EC.'

7. Article 1(1) of Commission Decision 94/442/EC of 1 July 1994 setting up a conciliation procedure in the context of the clearance of the accounts of the European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee Section (OJ 1994 L 182, p. 45, hereinafter 'Decision 94/442') provides that:

'1. For the purposes of the clearance of EAGGF Guarantee Section accounts, a Conciliation Body, hereinafter referred to as the "Body", is hereby set up in the Commission. Its tasks shall be:

(a) to examine any matter referred to it by a Member State which, following inspections pursuant to Article 9 of Regulation (EEC) No 729/70 and bilateral discussion of the findings of such inspections, receives formal notification from the competent Commission departments, with reference to this Decision, of the conclusion that certain items of expenditure incurred by that Member State are not chargeable to the EAGGF Guarantee Section,

(b) to try to reconcile the divergent positions of the Commission and the Member State concerned,

and

(c) at the end of its investigations, to draw up a report on the outcome of its efforts at reconciliation, making any remarks it deems useful should all or some of the points of dispute remain unresolved.'

8. Pursuant to Article 1(2)(a) of Decision 94/442,

'the position of the [Conciliation] Body shall be without prejudice to the Commission's final decision on the clearance of the accounts ...'.

9. Article 2 of Decision 94/442 provides that:

'1. A Member State must refer a matter to the Body within 30 working days of its receipt of notification as referred to in

Article 1(1)(a), by sending a reasoned request for conciliation to the Secretariat of the Conciliation Body, the address of which will be notified to the Member States through the EAGGF Committee.

2. A request for conciliation is admissible only where the financial adjustment recommended by the Commission in respect of a budget heading:

either,

— exceeds ECU 0.5 million; or

— represents more than 25% of the Member State's total annual expenditure under the budget heading concerned.

In addition, if, during the bilateral discussions referred to in Article 1(1)(a), the Member State claims, and demonstrates, that the matter is one of principle relating to the application of Community rules, the Chairman of the Body may declare a request for conciliation to be admissible.

3. ...

4. The Body shall conduct its investigations as informally and promptly as possible, basing itself on the evidence in the dossier and on a fair hearing of the Commission staff and national authorities concerned. At the end of its investigations it shall send them the report referred to in Article 1(1)(c).

5. Where, within four months of a case being referred to it, the Body has failed to reconcile the positions of the Commission and the Member State, the conciliation procedure is deemed to have failed. The report referred to in Article 1(1)(c) shall state the reasons why the positions could not be reconciled.

6. The report drawn up within the stipulated limit shall be sent:

— to the Member State which referred the matter to the Body;

— to the other Member States in the framework of the EAGGF Committee;

and

— to the Commission when the accounts clearance decision is proposed.'

10. As regards the financial consequences of investigations revealing deficiencies in the control procedures of a Member State, the Commission prepared a document establishing the guidelines to be followed in cases of this kind (Document VI/216/93 of 3 June 1993), subsequently corrected and replaced by Document No VI/5330/97 of 23 December 1997 (hereinafter 'the guidelines') in which the reform of the procedure for the clearance of EAGGF accounts, introduced by Regulation No 1287/95, was taken into consideration. According to the approach described therein, and following from the clearance of accounts for the 1990 financial year, if it is not possible to determine the actual amount of irregular payments, and therefore to calculate the financial loss to the Community, the Commission must apply flat-rate financial adjustments or correction factors of 2, 5 or 10% of the declared expenses, depending on the degree of the risk of loss.

11. As regards the financial corrections relating to the deficiencies of the controls carried out by the authorities of the Member States, the guidelines distinguish two categories: key controls and ancillary controls:

'— key controls are those physical and administrative checks required to verify substantive elements, in particular the existence of the subject of the claim, the quantity, and the qualitative conditions including the respect of time limits, harvesting requirements, retention periods, etc. They are performed on-the-spot, and by cross-checks to independent data such as land registers.

— ancillary controls are those administrative operations required to correctly process claims, such as verification of the respect of time limits for their submission, identification of duplicate claims for the same subject, risk analysis, application of sanctions and appropriate supervision of the procedures.'

12. On the basis of the guidelines, the Commission is required to apply the various flat-rate correction factors as follows:

'When one or more key controls are not applied or applied so poorly or so infre-

quently that they are completely ineffective in determining the eligibility of the claim or preventing irregularity, then a correction of 10% is justified, as it can reasonably be concluded that there was a high risk of wide-spread loss to the Fund.

When all key controls are applied, but not in the number, frequency or depth required by the regulations, then a correction of 5% is justified, as it can reasonably be concluded they do not provide sufficient level of assurance of the regularity of claims, and that the risk to the Fund was significant.

When a Member State has adequately performed the key controls, but completely failed to operate one or more ancillary controls, then a correction of 2% is justified in view of the lower risk of loss to the Fund, and in view of the lesser seriousness of the infringement.'

In exceptional cases higher correction factors may be decided, up to 100%.

B — *Legislation in the arable crops sector*

13. Council Regulation (EEC) No 1765/92 of 30 June 1992 (OJ 1992 L 181, p. 12, hereinafter 'Regulation No 1765/92') established a support system for producers of certain arable crops.

14. By Council Regulation (EEC) No 3508/92 of 27 November 1992 (OJ 1992 L 355, p. 1, hereinafter 'Regulation No 3508/92'), a new system for the administration and control of Community aid by the authorities of Member States, called the 'integrated administration and control system' (hereinafter the 'IACS') was set up for some Community aid schemes, including the EAGGF, to improve the effectiveness and usefulness of those schemes (see third recital).

15. Article 8(1) of Regulation No 3508/92 requires Member States to carry out 'administrative checks on aid applications', while the first sentence of paragraph 2 of that article provides that '[a]dministrative checks shall be supplemented by on-the-spot checks covering a sample of agricultural holdings.'

16. As regards aid applications, Article 6(1) to (5) of Commission Regulation (EEC) No 3887/92 of 23 December 1992 laying

down detailed rules for applying the integrated administration and control system for certain Community aid schemes (OJ 1992 L 391, p. 36, hereinafter 'Regulation No 3887/92') provides that:

'1. Administrative and on-the-spot checks shall be made in such a way as to ensure effective verification of compliance with the terms under which aids and premiums are granted.

2. The administrative checks referred to in Article 8(1) of Regulation (EEC) No 3508/92 shall include cross-checks on parcels and animals declared in order to ensure that aid is not granted twice in respect of the same calendar year without justification.

3. On-the-spot checks shall cover at least a significant percentage of applications. The significant percentage shall represent at least:

— ...

— 5% of "area" aid applications. However, this percentage shall be reduced to 3% for area aid applications numbering more than 700 000 per Member State in the calendar year.

...

4. Applications subjected to on-the-spot checking shall be selected by the competent authority on the basis of a risk analysis and an element of representativeness of the aid applications submitted. The risk analysis shall take account of:

— the amount of aid involved,

— the number of parcels and the area or number of animals for which aid is requested,

— changes from the previous year,

— the findings of checks made in past years,

— other factors to be defined by the Member State.

5. On-the-spot checks shall be unannounced and cover all the agricultural parcels and animals covered by one or more applications. Advance warning limited to the strict minimum necessary may however be given, although as a general rule this should not exceed 48 hours.

...'

17. Pursuant to Article 12 of Regulation No 3887/92:

'Every inspection visit must be the subject of a report setting out, in particular, the reasons for the visit, the persons present, the number of parcels visited, those measured, the measuring methods used, the number of animals of each species found and, where applicable, their identity numbers, and the reasons for rejection, total or partial, or acceptance of the application.

It will be open to the farmer or his representative to sign the report. He may either merely attest his presence at the inspection or also add his observations.'

III — Legal analysis

A — *Introduction*

18. The applicant Government raises three pleas in law, of which only the second and third concern the entire period of the contested decision (financial years 1996-1998), as we shall see in more detail later on:

— in the applicant's view, the Commission infringed the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, as amended, by refusing to finance the expenses incurred prior to 26 May 1996;

— the Commission made errors of reasoning and assessment as it did not take into account the information provided by the Luxembourg authorities in order to assess correctly the financial consequences of the irregularities found;

— the Commission infringed the guidelines and the principle of proportionality.

1997 (financial years 1996, 1997 and 1998), and was thus extended unlawfully to the financing of 5% of the expenses for the 1995 crop, for a sum of LUF 17 939 235. Decision 2000/216 should therefore be annulled to that extent.

B — *First plea in law: infringement of Regulation No 729/70*

1. Arguments of the parties

19. The Luxembourg Government points out first of all that under the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, the refusal to provide financing may not relate to expenditure effected prior to 24 months preceding the written communication of the results of the checks carried out by the Commission's departments to the Member State concerned. In the case at issue, according to the Luxembourg Government, that communication was given in a letter dated 26 May 1998 (annex 13 to the application) in which the Commission stated its intention to propose that part of the expenses in respect of a period not exceeding 24 months prior to the date of receipt of the notice should be excluded from Community financing. The refusal of financing could not therefore affect expenses incurred before 26 May 1996. However, the contested decision covers the expenses incurred from 1995 to

20. In reply to the objection of the Commission that a communication within the meaning of Article 8 of Regulation No 1663/95 was also sent to the Luxembourg authorities on 13 February 1996 (annex 8 to the application), which, like that of 26 May 1998 described above, also concerned the results of checks carried out by the Commission (respectively in December 1995 and June 1997), the Luxembourg Government states that only the second letter refers specifically to Regulation No 1663/95, as required by Article 8 of that regulation, while the letter of 13 February 1996 makes no reference to it. Moreover, the 13 February 1996 letter does not contain any assessment of the expenses which the Commission intends to exclude from Community financing; and furthermore, it asks the Luxembourg authorities to present their observations within six weeks, instead of the two months provided for in Article 8(1) of Regulation No 1663/95. It follows that, unlike the letter of 26 May 1998, the February 1996 letter cannot constitute a communication within the meaning of the aforementioned Article 8, nor were the Luxembourg authorities ever given to understand that it was a communication of that nature. The applicant goes on to state that this is even more serious, because that provision introduced formal obligations into the procedure for the clearance of EAGGF accounts in order to guarantee respect for the rights of the

Member State concerned to a fair hearing. As the protection of those rights is a fundamental principle of Community law, even within the framework of an administrative procedure, it follows that the conditions laid down in Article 8 must be considered as essential procedural requirements.

21. Finally, Luxembourg argues that, under the principle of legitimate expectations, the Commission should have adhered to its letter of 26 May 1998, where it stated that it intended to exclude from Community financing part of the expenses in respect of the maximum period of 24 months prior to the date of receipt of the communication, thus implying that the term mentioned would not be exceeded. Given that the contested decision also concerns expenses declared before 26 May 1996, the applicant infers from this that the Commission did not adhere to its own statements and therefore damaged the legitimate expectations of Luxembourg.

22. While it acknowledges that the letter of 13 February 1996 did not refer expressly to Regulation No 1663/95, the Commission objects first of all that the reference does not constitute an essential guarantee of respect for the rights of the Member State concerned to a fair hearing and could therefore not be regarded as an essential procedural requirement. It also points out that in this case there cannot be any doubts concerning the nature of the letter, because it clearly states the type of procedure in its subject line ('Clearance of EAGGF accounts — Guarantee') and the sector concerned ('Arable Crops Sector') and that in the annex the irregularities found are described analytically. In addition, the heading of the letter showed that it came from the department of the Directorate-General for Agriculture responsible for the clearance of EAGGF accounts. According to the Commission, therefore, the Luxembourg authorities could not reasonably have mistaken the nature of the communication; moreover, both in correspondence and in subsequent contacts, they never expressed the slightest doubt about the nature of the procedure initiated by the Commission. It was only after receiving the final report from the Conciliation Body, by letter of 24 January 2000, that they raised the question of the 24-month period laid down in the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70.

23. The Commission also acknowledges that in the letter of 13 February 1996 there was no indication of the amount of expenses which it intended to exclude from EAGGF intervention, but it argues that, at such an early stage in the procedure, an indication of that kind was not required; on the other hand, the Member State concerned could easily have estimated the corrections itself on the basis of the results of the checks made by the Commission and

the details given in the guidelines. In the case at issue, it was simple to deduce from the letter of 13 February 1996 that the irregularities involved essential elements of the Luxembourg checks and that therefore the correction factor would be at least 5%.

24. The Commission then states that the period of six weeks given to the Luxembourg authorities to answer the letter of 13 February 1996 was a simple administrative error which could certainly not deprive the letter of its nature as a communication within the meaning of Article 8 as stated above, especially as its content was unequivocal, as has been seen. In its view, the error did not in any case cause damage to Luxembourg, given that the Luxembourg Government took two months to provide its observations and that the Commission also took account of these. As Article 8 provides that, in justified cases, the Commission may extend the deadline provided for, it is clear that the important aspect is that the Member State concerned was able to make effective use of the time necessary to present its observations, as happened in this case.

25. As regards the alleged damage to the rights to a fair hearing, the Commission refers to the case-law of the Court which states that a procedural irregularity may justify the annulment of a decision only if it is proved that, without it, that decision might have been different. According to the Commission, during the course of the procedure the applicant failed to provide proof of that damage or of the effect it might have had on the final decision. The claim made by Luxembourg must therefore be dismissed, particularly as the procedure for the clearance of EAGGF accounts is not completed with the communication of the results of the checks by the Commission and that as a whole the rights of the State to a fair hearing have been fully guaranteed.

26. Finally, with regard to the alleged infringement of the principle of legitimate expectations, the Commission objects that the expenses incurred more than 24 months before 26 May 1998, the date on which the second communication was sent, were the subject of a separate preliminary procedure (see letter of 13 February 1996) and that the phrase concerning the intention to exclude some expenses (see paragraph 21), to which the applicant refers, is no more than a standard expression which takes up the substance of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, as amended, without quoting it specifically. It is therefore not possible to attribute the meaning indicated by the Luxembourg Government to that phrase, particularly as that Government is well aware of the practices of the Commission. This point is also confirmed indirectly by the fact that the question was never discussed during the various contacts which took place subsequently between the competent Community departments concerned and the national authorities. In any event, the Commission observes that the possibility of proceeding with financial corrections

would be compromised if excessive formal requirements were imposed, given that collecting information takes a great deal of time, especially in complex cases, and that sometimes it is the Member States which create problems, and even refuse to cooperate, despite their obligations in such matters. [2]

2. Assessment

(a) Introduction

27. I should point out immediately that there is no disagreement between the parties on the fact that the letter of 26 May 1998 meets the requirements of Article 8 of Regulation No 1663/95 and therefore constitutes a proper communication within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, as it was sent in due time in respect of the expenses incurred in 1996 and 1997 (financial years 1997 and 1998). In actual fact, the disputed points concern exclusively the irregularities of the letter of 13 February 1996 and consequently whether that can be identified and described as a proper communication within the meaning of the aforementioned provision, that is, able to produce the stated consequences on the financial corrections to the expenses of 1995 (1996 financial year).

28. Before I examine those irregularities analytically, I believe it would be appropriate to point out that the Rules of Procedure introduced by Regulation No 1287/95, and subsequently stated in greater detail in Regulation No 1663/95, aim to improve the guarantees of the clearance procedure and make them more transparent (see first recital in the preamble to Regulation No 1287/95), to ensure legal certainty and at the same time protect the right of Member States to be fully informed at the various stages of the procedure and to present their own observations in turn. [3] As the Court has emphasised, 'the final and conclusive decision on the clearance of accounts must be taken at the conclusion of a specific procedure giving effect to the *audi alteram partem* rule, during which the Member States concerned must be provided with all the guarantees necessary for them to present their point of view'. [4] It is also for that reason that the procedure is carried out in the various stages mentioned above (see paragraphs 4 to 9): the communication of the results of the checks carried out by the Commission, [5] the subsequent 'bilateral discussion' between the parties, [6] the document in which the Commission communicates its final conclusions, [7] and, if appli-

2 — The Commission points out that the obligation can be seen not just in general in Article 10 EC, but also in Article 9 of Regulation No 729/70 and now in Article 9 of Council Regulation (EC) No 1258/99 of 17 May 1999 on the financing of the common agricultural policy (OJ 1999 L 160, p. 103), which replaced and repealed Regulation No 729/70.

3 — See in particular Article 5(2)(c) of Regulation No 792/70, as amended, Article 8 of Regulation No 1663/95 and Articles 1 and 2 of Decision 94/442.

4 — Case C-245/97 *Germany* v *Commission* [2000] ECR I-11261, paragraph 47, which contains further references.

5 — See the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70.

6 — See the second subparagraph of Article 8(1) of Regulation No 1663/95 and Article 1(1)(a) of Decision 94/442.

7 — See the second subparagraph of Article 8(1) of Regulation No 1663/95 and Article 1(1)(a) of Decision 94/442.

cable, the attempt at conciliation on the initiative of the Member State concerned. [8]

29. Moreover, the terms of Article 8 of Regulation No 1663/95 follow this line of argument, as by laying down detailed rules for the application of Article 5 of Regulation No 729/70 they specify the content and form of the communication pursuant to the fifth subparagraph of Article 5(2)(c) in a much more precise and analytical way. [9] The reform of the procedure introduced by Regulation No 1287/95 is also in the same vein, where it shows the intention to reduce the delays which were a feature of the previous procedure for the clearance of accounts. This can be done either by reducing the time for taking decisions on the clearance of accounts as much as possible (see fourth and fifth recitals in the preamble to Regulation No 1287/95), or by providing a 'maximum period to which the consequences to be drawn from the checks on conformity may be applied' to be determined by the Commission departments (see sixth recital in the preamble to Regulation No 1287/95), a period which is now fixed at 24 months in the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, as amended. The purpose is clearly to avoid legal uncertainty for the Member States which may arise where the Commission can refer for discussion expenses incurred in other years before the adoption of the decision on the clearance of accounts.

8 — See the third subparagraph of Article 5(2)(c) of Regulation No 729/70 and Article 2(1) and (2) of Decision 94/442.

9 — See Case C-373/99 *Greece* v *Commission* [2001] ECR I-9619, paragraph 82, and, most recently, Case C-170/00 *Finland* v *Commission* [2002] ECR I-1007, paragraphs 26 and 27.

(b) Irregularities in the letter of 13 February 1996 and their consequences

30. I shall now look at whether the irregularities alleged by the applicant Government prevent the letter of 13 February 1996 from being identified and described as a communication within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70. Those irregularities concern: the absence in the letter of any reference whatsoever to Regulation No 1663/95, the indication of a period of only six weeks, rather than two months, for the Luxembourg Government to reply to the letter and the failure to assess the expenses which the Commission intended to exclude. I will examine those irregularities separately, for obvious reasons; however I should point out that their presence together clearly produces a different emphasis from that which each of them may have when considered separately.

31. (i) To begin, therefore, with the alleged absence in the letter of any reference to Regulation No 1663/95, I note that the reference is specifically required by Article 8 of that regulation. However, the Commission objects that this is merely a formality and therefore is not essential for the legality of the document, where its aim is achieved. This is in fact what happened in this case, as there were no doubts either concerning

the fact that the letter was part of a procedure for the clearance of accounts, or concerning the agricultural sector involved.

32. I have no difficulty in acknowledging that, in itself, the omission in question does not appear to be an essential formal defect, even if I do not understand why the Commission should not comply with the provisions which it itself imposed in Regulation No 1663/95. [10] In any case, as I have already stated, it is also judged in relation to the other irregularities, to assess whether, in that context, the failure to make the reference meant that the Government concerned was prevented from identifying the letter in question with certainty as being a communication for the purposes of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70. In my view, that appears to be the result in this case, as I shall describe below.

33. (ii) Secondly, the applicant Government complains that the letter from the Commission dated 13 February 1996 laid down for it a period of only six weeks for any observations, instead of the two months stated in Article 8 of Regulation No 1663/95. The Commission replies that this was a simple administrative error and that in any case what was important was that the Member State concerned was able to make effective use of the time required to prepare its observations. In the case at issue, the Commission points out, even though Article 8 provides that in justified cases it can extend the normal period of two months, the applicant Government did not need to request an extension; in spite of that fact, the Commission took into account the reply from the Luxembourg authorities of 11 April 1996, even though it reached the Commission after the end of the six-week period.

34. In the same way as for the preceding irregularity, I find it difficult to call this an essential formal defect such as could *per se* justify the annulment of the contested decision. However, I must point out that here again an obligation laid down by the Commission itself was not fulfilled, and that the irregularity may also contribute, with the others, to placing in question the description of the letter in issue as a communication for the purposes of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70.

35. (iii) Finally, the Luxembourg Government puts forward the failure to evaluate, in the letter of 13 February 1996, the expenses for which exclusion was proposed. In its view, this was both an infringement of its rights to a fair hearing and an infringement of Regulation No 729/70 or, rather, of the terms laid down in the first subparagraph of

10 — See, to that effect, the aforementioned case *Finland* v *Commission* (paragraph 34).

Article 8(1) of Regulation No 1663/95 for the communications provided for by the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70.

36. With regard to the first point, if I have understood the meaning of the complaint correctly, the applicant Government objects that the omission in the letter of 13 February 1996 of any evaluation of the possible financial corrections prevented it from presenting its observations at the first stages of the procedure on an aspect which, within the meaning of Article 8 of Regulation No 1663/95, constitutes a necessary part of the communication of the results of the checks made by the Commission. Without that information, it could not have taken a position as regards the extent of possible financial corrections, by disputing, for example, the evaluation of the nature and gravity of the irregularities in the checks and the financial loss for the Community. [11] Essentially, that Member State could not have proposed a different level of financial correction, again on the basis of the parameters in the guidelines, by providing the relevant data and information.

37. However, I believe the Commission is justified in replying to those complaints by referring to the settled case-law of the Court which states that 'a procedural irregularity will entail the annulment of a decision in whole or in part only if it is shown that in the absence of such irregularity the contested decision might have been substantively different.' [12] In the case at issue, as the Commission pointed out without being challenged, the applicant did not provide any proof of the effect that the alleged infringement of the rights to a fair hearing had on the final decision; even though it had the opportunity subsequently, it did not raise any argument on whether the financial corrections indicated by the Commission in its final conclusions of 16 July 1999 were well founded (annex 20 to the application).

38. That being so, however, I must say that for our purposes, the important point is not so much the damage to the rights to a fair hearing as I have just described; what is important is to ascertain whether the omission prevented Luxembourg from identifying the letter of 13 February 1996 as a valid communication within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70 and whether, therefore, that omission contributed to depriving that letter of the essential elements for it to be described as

11 — On this point, I note that under the fourth subparagraph of Article 5(2)(c) of Regulation No 729/70, 'the Commission shall evaluate the amounts [of the financial corrections] to be excluded having regard in particular to the degree of non-compliance found. The Commission shall take into account the nature and gravity of the infringement and the financial loss suffered by the Community.'

12 — The Commission cites Case 150/84 *Bernardi* v *Parliament* [1986] ECR 1375, paragraph 28, and the Opinion of Advocate General Ruiz-Jarabo Colomer in Case C-263/95 *Germany* v *Commission* [1998] ECR I-441, paragraph 12; and also, for example, Case 41/69 *Chemiefarma* v *Commission* [1970] ECR 661, paragraph 52; Case C-301/87 *France* v *Commission* [1990] ECR I-307, paragraph 31; Case C-142/87 *Belgium* v *Commission* [1990] ECR I-959, paragraph 48; Case C-288/96 *Germany* v *Commission* [2000] ECR I-8237, paragraph 101, which contain further references.

such, thus prejudicing the legal position of Luxembourg. I recall that recently, in the aforementioned judgment in *Finland* v *Commission*, the Court stated that the provisions of Article 5(2)(c) of Regulation No 729/70 and Article 8(1) of Regulation No 1663/95 may also be the subject of an evaluation which is not purely formalistic, provided that the rights of the Member States are fully protected (paragraph 34).

39. To deny that disputed point, the Commission firstly objects that the omission in question was not in itself unlawful as an *indication of the quantity* of the financial corrections is not required in the preliminary phase of the procedure. However, I must reply that the first subparagraph of Article 8(1) of Regulation No 1663/95 does not require a precise indication of the amount of the corrections, but simply an 'evaluation', which, when the procedure is at this stage, may also be preliminary. At all events, it is clear that the letter of 13 February 1996 did not contain *any* evaluation, either of quantity, or by way of indication.

40. The other objection raised by the Commission does not appear to me to be decisive either, namely, that an indication of the amount would be pointless as the Member State would easily be able to calculate the possible financial corrections on the basis, firstly, of the results of the checks, and secondly, from the indications in the guidelines. First of all, I should point out that it is not always easy for the Member State concerned to evaluate the amount of the financial correction which the Commission may propose on the basis of the nature and gravity of the irregularities found during the checks; and often the positions of the Member States and the Commission diverge on this very point. Secondly, even an evaluation merely indicating the possible financial corrections in the communication of the results of the checks, while it does not prejudice the procedure, as the defendant contends, aims to allow a more useful and complete dialogue between the parties and therefore to ensure compliance with the procedural guarantees which the reform of the system intended to improve. Moreover, it is not by chance that the current practice of the Commission, from which it inexplicably departed in this case, is to send a communication to the Member State concerned, in the preliminary phase of the procedure, containing a first indication of the possible financial corrections. [13]

41. It therefore seems to me that, especially if they are taken together, the irregularities described — over and above their varying degrees of gravity — have prevented the letter in question from fulfilling the function for which the most precise formal

13 — See page 4 of the document entitled 'The clearance of accounts procedure', prepared by the Directorate-General for Agriculture and available on the internet (see http://europa.eu.int/comm/agriculture/publi/fact/clear/clear_en.pdf, containing the text completed on 11 August 2000) and the facts in the cases still pending before the Court, C-377/99 *Germany* v *Commission* (concerning 1995 financial year, when Regulation No 1663/95 was not yet in force) and C-337/00 *Germany* v *Commission* (1996 financial year).

instructions were laid down, and that is to allow the Member State concerned to identify with certainty, within a procedure which is characterised by the considerable volume of correspondence, the essential stages of that procedure, meaning those which are capable of producing autonomous legal consequences. In the case at issue, it was such a stage, given that only one communication drawn up in the due forms and identifiable as such could preclude the Commission from refusing the financing of expenses effected more than 24 months prior to the communication in question. What is important here is therefore not only the infringement of the formal obligations or the guarantees of the rights of the State concerned to have a fair hearing, but also, and above all, the failure to comply with the precise requirements of legal certainty, which are intended to enable the State to determine retrospectively the date from which the period of 24 months starts and therefore be aware of which expenses are under discussion. The legislation on this aspect, as emphasised recently by Advocate General Jacobs, represents a reasonable balance between the need for legal certainty on the part of the Member States and the financial interests of the Community; but for that reason, its aim is only achieved if the States are able to establish the exact date. [14] I should also point out that the current text of Regulation No 729/70 concerning the 24-month period is rather more stringent than the previous wording because it gives the term a peremptory nature, whereas in the previous Article 5(2)(b) of Regulation No 729/70 [15] it had, as the Court stated, a merely indicative nature. [16]

42. It follows that, as the letter of 13 February 1996 does not constitute a communication within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, the Commission could not refuse to finance expenditure incurred prior to 24 months before the only formal communication of the results of its checks, that is to say, the letter of 26 May 1998. By deciding otherwise, it has infringed that provision.

(c) Infringement of legitimate expectations

43. Finally, and still within the terms of the first plea in law, I must look at the argument based on the alleged infringement

14 — Advocate General Jacobs made this point in his Opinion in Case C-130/99 *Spain* v *Commission* [2002] ECR I-3005: 'Thus to comply with Article 5(2)(c), the Commission is required only to carry out checks and notify the results thereof within a period of 24 months after the expenditure has been incurred by the affected Member State; it is not required to complete the clearance of accounts procedure within that period. In my view, that system does not impose an unreasonable burden on the Commission, but strikes a reasonable balance between, on the one hand, the need of the Member States for legal certainty and, on the other hand, the financial interests of the Community' (paragraph 95).

15 — Under that paragraph, the annual decision for the clearance of accounts, adopted in accordance with the previous clearance of accounts procedure, had to be adopted before the end of the year following the year under consideration, but the failure to meet that deadline did not have any consequences, unlike the provision currently in force.

16 — See, in particular, Case C-55/91 *Italy* v *Commission* [1993] ECR I-4813, paragraph 69, where there are further references.

of legitimate expectations. As stated above, the applicant Government maintains that, by applying financial corrections for expenditure incurred more than 24 months before the communication of 26 May 1998, the Commission infringed the principle of legitimate expectations. In that letter, it announced its intention of excluding from Community financing part of the expenses relating to the maximum period of 24 months prior to the letter, thus implying that no financial corrections would be applied for expenses incurred before 26 May 1996; however, that is what happened.

44. I must say first of all that, even though this point is presented as an argument within the first plea in law, in actual fact it constitutes a plea on its own, particularly as it has nothing to do with the alleged infringement of Regulation No 729/70, already discussed. If that is the case, it is exposed to a serious objection of inadmissibility, as it was raised for the first time by Luxembourg in the reply, that is at a stage when, according to Article 42(2) of the Rules of Procedure, the introduction of new pleas is prohibited. But apart from that consideration of a procedural nature, I essentially agree with the objection of the Commission that the phrase raised by the applicant Government is merely a standard wording which reiterates the substance of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70 as amended, without quoting it specifically, and that therefore it cannot have given rise to any legitimate expectations.

45. That observation appears to me to be entirely convincing, and therefore it is not necessary to address further the other objection raised by the defendant, which I find unconvincing. The Commission points out that there could not be legitimate expectations of Member States on compliance with the 24-month period, as, in cases of delay in the collection of information due to the poor cooperation of Member States, the financial corrections may apply even before that period. However, I must object that, for the reasons already given (see paragraph 41), the period in question must be considered to be peremptory. In addition, as regards the difficulties arising from the poor cooperation of the Member States, I note that the Commission was not requested to clear the EAGGF accounts finally within the 24-month period, but as we can see clearly from the provision in question, was requested only to ensure that the first checks should be carried out and the results communicated within that period of time. [17]

46. In conclusion, I take the view that the first plea in law is well founded for the

17 — See the opinion of Advocate General Jacobs in *Spain* v *Commission*, already referred to, paragraph 95.

reasons given in paragraphs 38 to 42, and that therefore the contested decision should be annulled in the part concerning the expenses incurred in the arable crops sector declared by Luxembourg prior to 26 May 1996.

C — *Second plea in law: erroneous reasoning and manifest error of assessment due to failure to take account of various items of evidence*

1. Introduction

47. With the pleas in law which I shall now move on to discuss, not only are the financial corrections relating to the expenses incurred before 26 May 1996 disputed, but also those concerning the entire period of time covered by the contested decision, that is, the financial years 1996-1998.

2. Arguments of the parties

48. On this aspect, the applicant Government does not deny the irregularities of its own control system which were found during the checks carried out by the Commission for the aforementioned financial years, but it considers that they cannot be applied in general to the whole system: the financial correction of 5% is therefore excessive, in its view. It also points out that in the final report of 11 January 2000 (document No 99/LUX/136, annex 25 to the application; hereinafter 'the final report'), the Conciliation Body looked at whether the application of such a correction was well founded for the whole period under consideration, given the improvements which had been made to the Luxembourg control system over the years. That body therefore suggested to the Commission that it should examine in particular the supplementary information contained in a note from the Luxembourg Government of 23 November 1999, and also check the justification for a financial correction of 5% identical for all of the years concerned (1996, 1997 and 1998). The contested decision, however, did not take those observations into consideration, thereby committing an error in reasoning in addition to a manifest error of assessment.

49. As regards the alleged error of reasoning, however, the Commission refers to the settled case-law of the Court, that 'in the particular context of the preparation of decisions relating to the clearance of accounts the statement of reasons for a decision must be regarded as sufficient if the Member State to which the decision was addressed was closely involved in the process by which the decision came about and was aware of the reasons for which the Commission took the view that it must not

charge the sum in dispute to the Fund'.[18] Consequently, states the defendant, in the examination of the reasoning, account should also be taken of the correspondence in which the Commission expresses its own point of view.

50. With regard to the error of assessment, the Commission objects firstly that the applicant admits that errors were committed, not only in terms of the administrative checks on applications, but above all in terms of the on-the-spot checks, which the guidelines describe as essential. Those errors, which at times even revealed structural shortcomings in the Luxembourg system, already *per se* required the application of corrections of 5%, according to the Commission. Moreover, as regards the gravity of the irregularities found, the improvements made to the Luxembourg control system were not at all sufficient, as they were not even subsequent to the period under consideration and therefore had no influence with respect to the financial corrections in question. The application of those corrections at the rate of 5% for the entire period under review must therefore be considered to be justified. Not even the Conciliation Body deemed such financial corrections to be unlawful; in fact, it found that the irregularities were manifest.

18 — Case C-22/89 *Netherlands* v *Commission* [1990] ECR I-4799, paragraph 18; also see Case C-27/94 *Netherlands* v *Commission* [1998] ECR I-5581, paragraph 36, and Case C-28/94 *Netherlands* v *Commission* [1999] ECR I-1973, paragraph 82.

3. Assessment

51. The objections of the Commission appear to me to be well founded. The documentation available in the case at issue, to which the defendant refers, shows clearly the reasons for the Commission's decision to apply financial corrections at the rate of 5%. Not even the Luxembourg Government, 'closely associated with the proceedings for that [contested] decision', had any difficulty in being aware of and understanding those reasons. In the light of that documentation, the accuracy of which has not been called into question by Luxembourg, I consider that the Commission has declared the reasons for its adoption of Decision 2000/216 in a satisfactory and correct manner.

52. With regard to the argument on the manifest error of assessment, which is closely linked to the preceding point, I must point out first of all that, according to settled case-law, Article 3 of Regulation No 729/70 allows the Commission to charge to the EAGGF only the amounts paid in accordance with the relevant Community provisions and that, therefore, if an expense has been incurred which does not comply with those provisions, the Commission must refuse financing in full.[19] The Court has also stated that, 'in this case, the

19 — See, in particular, Case C-50/94 *Greece* v *Commission* [1996] ECR I-3331, paragraph 26.

Commission, instead of rejecting all the expenditure affected by the infringement, has endeavoured to establish the financial impact of the unlawful action by means of calculations based on an assessment of what the situation on the relevant market would have been if the infringement had not occurred. ... the burden of proving that those calculations are not correct rests on the State seeking to have the disallowance annulled.' [20] This case-law has been confirmed subsequently, in particular after the guidelines were adopted. [21]

53. It therefore follows from that case-law that in the case at issue, given the irregularities found and, moreover, not disputed, the Commission had the right to refuse the financing of the expenses declared by Luxembourg in full. As it only refused 5% of the total amount of expenditure in question on the basis of the criteria laid down in the guidelines, it cannot now be accused of acting in a disproportionate manner. On the other hand, while it is true that the Luxembourg Government presented a series of observations on the assessments of the Commission, it is also true that it was not in a position to show either that the irregularities did not affect essential elements in the control system, nor that in the period under consideration (1996, 1997 and 1998 financial years) the improvements to the system had such an effect as to reduce considerably the risks of financial losses to the Community, thereby justifying a reduction in the financial correction factors applied, at least for part of the expenses.

54. It is true that while the Conciliation Body, in its final report, acknowledged that the high number and gravity of the deficiencies in the Luxembourg checks could, according to the guidelines, justify a flat-rate correction factor of 5%, it suggested that the Commission re-examine the proposal to apply a factor of 5% for three consecutive years in view of the fact that improvements had been made. However, that body also noted that the checks carried out by the Commission in June 1997 did not show improvements as regards the on-the-spot checks, described by the guidelines as key controls and therefore able by themselves to justify a correction factor of 5%. If there were improvements, therefore, they were essentially limited to the administrative checks, and were not, as the Commission points out, sufficient to reduce significantly the risk of financial losses to the Community, not to the point of allowing a reduction in the correction factor from 5 to 2%, or even the removal of some of those corrections.

55. The second plea in law cannot therefore be upheld.

20 — Case 347/85 *United Kingdom* v *Commission* [1988] ECR 1749, paragraph 15.

21 — See Case C-50/94 *Greece* v *Commission*, cited above, paragraph 7 et seq.

D — *Third plea in law: infringement of the guidelines in document no. VI/5330/97 and of the principle of proportionality*

56. In this plea in law, the applicant Government puts forward again arguments which have already been stated, to a large extent, in the previous plea. It complains that the Commission infringed the guidelines inasmuch as, in fixing the financial correction factor, it did not take account, as an extenuating circumstance, of the fact that from 1996 the competent national authorities had made considerable efforts to improve the situation, as was, moreover, recognised by the Conciliation Body. It then adds that a factor of 5% is totally disproportionate to the risk of losses for the EAGGF, which was in actual fact non-existent.

57. For its part, the Commission acknowledges once again the improvements made by Luxembourg, and also admits that, according to the guidelines, if the national authorities have taken effective steps to remedy any identified deficiencies, the lowest correction factor or no correction factor must be applied. The Commission objects, however, stating its own final conclusions of 16 July 1999, that in this case the improvements were clearly insufficient to be taken into account in the way the applicant wished and that in 1997 there were still irregularities which were considered to be serious in essential elements of the controls in Luxembourg. As regards the conclusions of the Conciliation Body, it merely suggested that the Commission re-examine the application of financial corrections at 5% without thereby claiming that the approach of the Commission was legally incorrect. Concerning the alleged disproportion of the flat-rate correction factor, the Commission objects that this type of correction is necessary specifically when it is not possible to quantify the loss sustained by the Community because of the irregularities found.

58. I do not think I need discuss these arguments further, for the obvious reason that they repeat almost entirely the arguments examined under the second plea in law. I shall therefore merely refer to my previous remarks, particularly concerning the choice of the Commission to apply the same flat-rate correction factor to three consecutive financial years despite the fact that in the period under consideration some improvements in the Luxembourg system of control were noted.

59. The third plea in law cannot therefore be upheld.

IV — Costs

60. Under Article 69(2) of the Rules of Procedure, the unsuccessful party must be ordered to pay the costs if they have been applied for in the successful party's pleadings. However, under Article 69(3) of those Rules, where each party succeeds on some and fails on other heads, the Court may order that the costs be shared or that the parties bear their own costs. Since, as stated above, I consider that Luxembourg and the Commission are each partially unsuccessful, I think it is fair to propose that each party should bear its own costs.

V — Conclusion

61. In view of the foregoing I therefore propose that the Court declare that:

(1) Commission Decision 2000/216/EC of 1 March 2000, excluding certain expenses by Member States from Community financing under the European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee section [notified by number C(2000) 488], should be annulled to the extent to which it excludes from Community financing certain expenses relating to the arable crops sector incurred by the Grand Duchy of Luxembourg prior to 26 May 1996.

(2) The remainder of the application is dismissed.

(3) The parties shall each bear their own costs.