JUDGMENT OF THE COURT (Second Chamber)

7 October 2004 *

In Case C-153/01,

ACTION for partial annulment under Article 230 EC, brought on 9 April 2001,

Kingdom of Spain, represented by S. Ortiz Vaamonde, acting as Agent, with an address for service in Luxembourg,

applicant,

v

Commission of the European Communities, represented by S. Pardo Quintillán, acting as Agent, with an address for service in Luxembourg,

defendant,

* Language of the case: Spanish.

THE COURT (Second Chamber),

composed of: C.W.A. Timmermans, President of the Chamber, C. Gulmann, J.N. Cunha Rodrigues, R. Schintgen and F. Macken (Rapporteur), Judges,

Advocate General: P. Léger,
Registrar: R. Grass,

after considering the observations submitted by the parties,

after hearing the Opinion of the Advocate General at the sitting on 6 May 2004,

gives the following

Judgment

1 By its application, the Kingdom of Spain is seeking partial annulment of Commission Decision 2001/137/EC of 5 February 2001 excluding from Community financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF) (OJ 2001 L 50, p. 9, 'the contested decision') in so far as it concerns the Kingdom of Spain.

Legal background

Financing of expenditure under the EAGGF

2 Articles 1(2)(b) and 3(1) of 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), as amended by Council Regulation (EC) No 1287/95 of 22 May 1995 (OJ 1995 L 125, p. 1, 'Regulation No 729/70') provide that the Guarantee Section is to finance intervention intended to stabilise the agricultural markets, granted in accordance with the Community rules within the framework of the common organisation of agricultural markets.

3 Article 5(2)(c) of Regulation No 729/70 provides:

'The Commission ...

...

(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. ...'

4 Under the first subparagraph of Article 8(1) of Regulation No 729/70:

'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.'

5 It is provided in the first subparagraph of Article 8(2) of the same regulation that, in the absence of full recovery, the financial consequences of irregularities or negligence attributable to administrative authorities or other bodies of the Member States are not borne by the Community.

6 Under Article 9 of Regulation No 729/70, the Commission may take a number of measures to verify and supplement the information and documents furnished by the Member State authorities. It may, therefore, carry out inspections on the spot and authorised representatives appointed by the Commission to carry out such inspections are entitled to have access to all books and documents relating to expenditure financed by the EAGGF.

7 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) establishes, among other things, the duties of the coordinating bodies, which are to act as the sole representatives of the Member State before the Commission. Those bodies must make available to the Commission all accounting information required in an appropriate form for Commission officials to carry out the necessary checks.

8 The annex to Regulation No 1663/95 lays down the administrative and accounting procedure which must be followed by the payment agencies of the Member States in order for effective checks to be made on whether aid claims are eligible and whether the corresponding payments comply with the Community regulations.

9 The first subparagraph of Article 8(1) of that regulation provides:

'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. ...'

10 Commission Document No VI/5330/97 of 23 December 1997 ('Document No VI/5330/97') sets out the guidelines which the Commission intends to follow when applying financial adjustments in the context of the clearance of EAGGF Guarantee accounts. According to those guidelines, when it is not possible to determine the actual amount of the incorrect payments, and hence to quantify the financial loss suffered by the Community, the Commission will apply flat-rate financial adjustments, usually equal to 2%, 5%, 10% or 25% of the declared expenditure, depending on the extent of the impending loss.

11 The document states that the guidelines distinguish between the following two categories of checks:

— 'Key controls, which are the 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 observance 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 the administrative operations required to process claims correctly, such as verification that they were submitted in time, identification of duplicate claims for the same subject, risk analysis, application of sanctions and appropriate supervision of the procedures.'

12 In that regard, Annex 2 to Document No VI/5330/97 provides:

'When one or more key controls are not applied or are applied so poorly or so infrequently that they are ineffective in determining whether claims are eligible or preventing irregularities, an adjustment of 10% is justified as it can reasonably be concluded that there is 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 legislation, an adjustment of 5% is justified as it can reasonably be concluded both that they do not provide the expected degree of assurance that claims are regular and that the risk to the Fund is significant.

When a Member State has adequately performed the key controls but completely failed to carry out one or more ancillary controls, an adjustment of 2% is justified since there is less risk of loss to the Fund and the infringement is less serious.

...

However, where implementation of the checking system has been non-existent or seriously inadequate and there are indications of very frequent irregularities and negligence in combating irregular or fraudulent practices, an adjustment of 25% is justified since the fact that claims may be submitted with impunity where there is no entitlement may reasonably be assumed to involve extremely high losses for the Fund.'

Olive oil production

13 In order to obtain the information needed to determine the Community's potential production of olives and olive oil and to improve the operation of the Community aid system for the latter product, the Council adopted Regulation (EEC) No 154/75 of 21 January 1975 on the establishment of a register of olive cultivation in the Member States producing olive oil (OJ 1975 L 19, p. 1), as amended by Council Regulation (EEC) No 3788/85 of 20 December 1985 amending, on account of the accession of Spain and Portugal, certain regulations in the oils and fats sector (OJ 1985 L 367, p. 1, 'Regulation No 154/75').

14 Article 1(1) of Regulation No 154/75 provides that the Member States producing olive oil are to establish a register of olive cultivation to cover all olive-growing holdings within their territory.

15 The second indent of the third subparagraph of Article 1(2) of that regulation provides that the time-limit for the establishment of that register is 1 November 1988 for the Kingdom of Spain.

16 The Council also adopted Regulation (EEC) No 2261/84 of 17 July 1984 laying down general rules on the granting of aid for the production of olive oil and of aid to olive oil producer organisations (OJ 1984 L 208, p. 3). Article 16(1) of that regulation provides that each producer Member State is to draw up and keep up to date permanent computerised files of olive and olive-oil production data, which must contain certain information listed in that provision.

17 Article 11(1) of Commission Regulation (EEC) No 3061/84 of 31 October 1984 laying down detailed rules for the application of the system of production aid for olive oil (OJ 1984 L 288, p. 52), as amended by Commission Regulation (EEC) No 98/89 of 17 January 1989 (OJ 1989 L 14, p. 14, 'Regulation No 3061/84'), provides that the Member States are to enter in the databases the data contained in the register of olive cultivation as soon as such data becomes available.

18 Article 11(2) of Regulation No 3061/84 provides that the computerised databases must be operational by 31 October 1990.

Olive oil consumption

19 The general rules relating to consumption aid for olive oil were laid down in Council Regulation (EEC) No 3089/78 of 19 December 1978 (OJ 1978 L 369, p. 12), as amended by Council Regulation (EEC) No 3461/87 of 17 November 1987 (OJ 1987 L 329, p. 1) ('Regulation No 3089/78'). Article 4 of that regulation provides that such aid will be granted in respect of olive oil produced in the Community which complies with certain requirements, as provided in that regulation.

20 The first paragraph of Article 7 of Regulation No 3089/78 requires Member States to institute an inspection system to ensure that the product for which aid has been applied qualifies for such aid.

21 Commission Regulation (EEC) No 2677/85 of 24 September 1985 (OJ 1985 L 254, p. 5) lays down the rules for implementing the system of consumption aid for olive oil. Article 12 of Regulation No 2677/85, as amended by Commission Regulation (EEC) No 571/91 of 8 March 1991 (OJ 1991 L 63, p. 19, 'Regulation No 2677/85'), concerns the content of the on-the-spot checks. The first subparagraph of Article 12(1) provides that for the purposes of the checks referred to in Article 7 of Regulation No 3089/78, the Member States must inspect the stock records of all approved undertakings.

22 Article 12(6) of Regulation No 2677/85 provides that where it has been found by the competent authority that an application for aid related to a quantity greater than that for which the entitlement to aid was recognised the Member State is immediately to withdraw approval, without prejudice to any other penalties.

Milk and milk products

23 Article 1 of Council Regulation (EEC) No 3950/92 of 28 December 1992 establishing an additional levy in the milk and milk products sector (OJ 1992 L 405, p. 1) provides:

'For seven new consecutive periods of twelve months commencing on 1 April 1993, an additional levy shall be payable by producers of cow's milk on quantities of milk

or milk equivalent delivered to a purchaser or sold directly for consumption during the 12-month period in question in excess of a quantity to be determined.

The levy shall be 115% of the target price for milk.'

24 Article 2(1) to (3) of Regulation No 3950/92 provides:

'1. The levy shall be payable on all quantities of milk or milk equivalent marketed during the 12-month period in question in excess of the relevant quantity referred to in Article 3. It shall be shared between the producers who contributed to the overrun.

In accordance with a decision of the Member State, the contribution of producers towards the levy payable shall be established, after the unused reference quantities have been reallocated or not, either at the level of the purchaser, in the light of the overrun remaining after unused reference quantities have been allocated in proportion to the reference quantities of each producer, or at national level, in the light of the overrun in the reference quantity of each individual producer.

2. As regards deliveries, before a date and in accordance with detailed rules to be laid down, the purchaser liable for the levy shall pay to the competent body of the Member State the amount payable, which he shall deduct from the price of milk paid to producers who owe the levy or, failing this, collect by any appropriate means.

...

3. As regards direct sales, the producer shall pay the levy payable to the competent body of the Member State before a date and in accordance with rules to be laid down.'

25 Article 10 of the same regulation provides:

'The levy shall be considered as intervention to stabilise agricultural markets and shall be used to finance expenditure in the milk sector.'

26 The fifth recital in the preamble to Commission Regulation (EEC) No 536/93 of 9 March 1993 laying down detailed rules on the application of the additional levy on milk and milk products (OJ 1993 L 57, p. 12) reads:

'... experience gained has shown that major delays in both the transmission of figures on collections or direct sales and payment of the levy have prevented the arrangements from being fully effective; ... therefore, lessons should be learned from the past and the necessary conclusions drawn by laying down strict requirements as regards notification and payment deadlines and providing for penalties where deadlines are not met.'

27 Article 3(4) of that regulation provides:

'Before 1 September each year, the purchaser liable for levies shall pay the competent body the amount due in accordance with rules laid down by the Member State.

Where the time-limit for payment is not met, the sums due shall bear interest at a rate per annum fixed by the Member State and which shall not be lower than the rate of interest which the latter applies for the recovery of wrongly paid amounts'.

28 Article 5(2) of Regulation No 536/93 provides:

'Member States shall take any additional measures necessary to ensure payment of levies due to the Community within the time-limit laid down.

Where the set of documents referred to in Article 3(5) of Commission Regulation (EEC) No 2776/88 ..., which the Member States must transmit to the Commission each month, shows that this time-limit has not been met, the Commission shall reduce advances on entry in the accounts of agricultural expenditure in proportion to the amount due or an estimate thereof.

Interest paid pursuant to Article 3(4) and Article 4(4) shall be deducted by the Member States from expenditure on milk and milk products.'

Arable crops and the consequences of not imposing the special set-aside

29 With regard to the system of aids applying to arable crops and set-aside, Article 2(1) of Council Regulation (EEC) No 1765/92 of 30 June 1992 establishing a support system for producers of certain arable crops (OJ 1992 L 181, p. 12), as amended by

Council Regulation (EC) No 231/94 of 24 January 1994 (OJ 1994 L 30, p. 2, 'Regulation No 1765/92'), provides that Community producers of arable crops may apply for a compensatory payment under the conditions set out in Articles 2 to 13 of that regulation.

30 The second subparagraph of Article 2(2) of Regulation No 1765/92 provides that that compensatory payment is granted for the area which is down to arable crops or subject to set-aside and which does not exceed a regional base area.

31 The same provision states that the regional base area is established as the average number of hectares within a region put down to arable crops or where appropriate fallowed in conformity with a publicly funded scheme during 1989, 1990 and 1991. It defines a 'region' as meaning a Member State or a region within the Member State, at the option of the Member State concerned.

32 The regional base areas are set out in the annex to Commission Regulation (EC) No 1098/94 of 11 May 1994 laying down the regional base areas applicable under the support system for producers of certain arable crops and repealing Regulation (EEC) No 845/93 (OJ 1994 L 121, p. 12). That annex lays down in the case of Spain, on the one hand, a regional base area for each autonomous community in respect of crops grown on unirrigated land ('secano') and, on the other hand, a regional base area at national level in respect of crops grown on irrigated land ('regadío').

33 The second subparagraph of Article 2(5) of Regulation No 1765/92 provides, lastly, that producers applying for the compensatory payment under the general scheme are required to set aside part of the land of their holding from production in return for compensation.

34 Under the first subparagraph of Article 7(1) of the same regulation that set-aside requirement is fixed in the case of a regional base area, as a proportion of the area down to the arable crops concerned and for which a claim is made, and left in set-aside.

35 Under the second subparagraph of Article 7(1) of that regulation, the set-aside requirement, which is subject to rotation, is to be 15% for the 1993/94 marketing year onwards.

36 A producer may transfer a set-aside requirement to another producer in the same Member State under Article 7(7) of Regulation No 1765/92. The set-aside rate referred to in the second subparagraph of Article 7(1) is to be increased by five percentage points in such circumstances.

37 Article 1(1) of Commission Regulation (EEC) No 2836/93 of 18 October 1993 on detailed rules for the application of Council Regulation No 1765/92 as regards the management of the regional base areas (OJ 1993 L 260, p. 3) provides that in determining the amount by which the regional base area may have been exceeded, the competent authority of the Member State is to take into account the regional base area which has been fixed and the sum of the areas for which applications for aid have been submitted in respect of the region in question.

38 With regard to the consequences of such overrun, Article 2(6) of Regulation No 1765/92 stated in the version applying to applications for aid for the 1994/95 marketing year:

'... when the sum of the individual areas for which aid is claimed under the arable producers' scheme ... is in excess of the regional base area, the following will be applied in the region in question:

— during the same marketing year, the eligible area per farmer will be reduced proportionately for all the aids granted under this Title,

— in the following marketing year, producers in the general scheme will be required to make, without compensation, a special set-aside. The percentage rate for special set-aside shall be equal to the percentage by which the regional base has been exceeded. This shall be additional to the set-aside requirement given in Article 7.

Areas which are the subject of a special set-aside in accordance with the second indent of the preceding subparagraph shall not be taken into account in applying this paragraph.'

39 Article 1 of Council Regulation (EC) No 1422/97 of 22 July 1997 amending Regulation No 1765/92 (OJ 1997 L 196, p. 18) added to Article 2(6) of that regulation a third subparagraph worded as follows:

'Should exceptional climatic conditions have affected production in a marketing year in which it is found that the regional base area has been exceeded, and should those conditions have had the effect of lowering yields to a level considerably below the normal and of causing the excess in question, then, provided that the budgetary

situation so allows, the Commission may ... totally or partially exempt producers in the regions affected from one or both measures applicable under this paragraph.'

40 Under the second paragraph of Article 2 of Regulation No 1422/97 that amendment was to apply from the 1995/96 marketing year.

41 Article 1 of Commission Regulation (EC) No 1040/95 of 10 May 1995 laying down further transitional measures for the management of base areas in Spain (OJ 1995 L 106, p. 4), which entered into force on 12 May 1995, provides:

'In the marketing year 1994/95, Article 2(6) of Regulation (EEC) No 1765/92 shall not apply in respect of the area planted with cereals, proteins, linseed, the related compulsory set-aside and all voluntary set-aside in the Spanish regional base area 'Regadío' as referred to in Commission Regulation (EC) No 1098/94.'

Arable crops and the Autonomous Community of Andalusia

42 The seventh recital in the preamble to 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) provides:

'Whereas compliance with the provisions on Community aid must be effectively monitored ...'.

43 The eighth recital in the preamble to the same regulation provides that the conditions for the use of remote sensing for on-the-spot checks should be laid down and provision should be made for physical checks to be required in doubtful cases.

44 Article 6(1) to (5) of that regulation provides:

'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 ... 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.

Should on-the-spot checks reveal significant irregularities in a region or part of a region the competent authority shall make additional checks during the current year in that area and shall increase the percentage of applications to be checked in the following 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 ... 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 ... 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.

...'

45 Lastly, Article 7(1) of that regulation provides:

'Should a Member State decide to use remote sensing on all or part of the sample referred to in Article 6(3) it shall:

— perform photo interpretation of satellite images or aerial photographs of all parcels to be checked with a view to recognising the ground cover and measuring the area,

— check on the spot all applications for which photo interpretation does not verify the accuracy of the declaration to the satisfaction of the competent authority.'

Facts and procedure

46 The reasons for which the transactions referred to in the contested decision are unlawful are set out briefly in the Commission's summary report of 16 October 2000 on the results of the checks for the clearance of the accounts of the EAGGF Guarantee Section for financial years 1996 to 1998 ('the Summary Report').

47 First, as regards production aid for olive oil, audits were carried out by Commission officials in Spain, in particular, in Extremadura in December 1998, Castilla-La Mancha in March 1999 and Madrid and Catalonia in June 1999. Those audits revealed first of all that the register of olive cultivation still had significant shortcomings, that the problem of reconciling the differences between that register and the crop declarations was far from resolved and, lastly, that that register was not operational for checking purposes.

48 Also, in January 2000, since the Spanish authorities had maintained their position that the register of olive cultivation and the computerised databases were operational in most of the regions, Commission officials carried out further inspections in Andalusia, the main production region, which accounts for over 80% of total production.

49 Those inspections revealed a number of shortcomings. For example, in over 50% of the cases analysed at least one parcel appearing in the corresponding crop declaration was not listed in the register of olive cultivation. Those results were worse than the results of the inspections carried out in 1999. They confirmed that the computerised databases were not operational. In those circumstances the Commission imposed a financial adjustment of 5% of the expenditure declared for the financial years 1997 and 1998, that is to say ESP 11 826 116 171.

50 Secondly, with regard to consumption aid for olive oil, the Commission, following an inspection visit by its officials from 18 to 22 November 1996, found failings in the Spanish management of payment and control systems and in the imposition of penalties in this sector. It therefore imposed a financial adjustment of 10% on the expenditure declared for the financial year 1996, amounting to ESP 832 182 856.

51 Thirdly, as regards milk and milk products, the financial adjustments were proposed following an inspection carried out by the Commission which showed that the milk quota was exceeded in Spain during the 1995/96 marketing year by 136 261 218 litres. Although the additional levy corresponding to that quantity was ESP 8 020 335 291, a total of ESP 7 193 208 113 had been credited to the EAGGF, so that the outstanding balance was ESP 827 127 178. The Commission considered that interest was also payable in respect of the late payment of that additional levy. Since the interest already credited to the EAGGF through the annual declarations for 1996, 1997, 1998 and 1999 and the monthly declarations for 2000 (up until August) totalled ESP 22 270 689, the additional adjustment made by the Commission in respect of interest for late payment was set at ESP 2 426 259 870.

52 Fourthly, with regard to arable crops, the documents before the Court show that the base areas laid down by Regulation No 1098/94 were exceeded in Spain during the 1994/95 marketing year. That overrun occurred, in the case of crops on unirrigated land, in the areas of three Autonomous Communities (Aragon, Castile and León and the Basque Country) and, in the case of crops on irrigated land, in the regional base area established at national level. In the event of such an overrun, the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92 provides that in the following marketing year producers in the general scheme will be required to make a special set-aside, without compensation. Since the Spanish authorities did not impose that special set-aside without compensation during the 1995/96 marketing year the Commission imposed a financial adjustment of ESP 27 823 775 209.

53 Lastly, so far as the Autonomous Community of Andalusia is concerned, the Commission imposed financial adjustments for failure to comply with Article 6 of Regulation No 3887/92 concerning on-the-spot checks in respect of the arable crops scheme. With regard to the 1995/96 marketing year, the Commission imposed a financial adjustment of 5% of the expenditure declared in respect of the arable crops scheme under Regulation No 1765/92 because of delays in carrying out those checks. As regards the 1996/97 marketing year, the Commission imposed a financial adjustment of 5% of applications that had been subjected to physical on-the-spot checks. That adjustment was imposed because there were still delays in carrying out checks in certain provinces and insufficient checks were carried out in collaboration with the Clearance of Accounts Unit. It also imposed a financial adjustment of 2% of the applications that had been subjected to on-the-spot checks by remote sensing. That adjustment was imposed because, although the requirements with regard to checking by remote sensing, which are integral to the techniques of physical checking, were generally complied with, those checks had been carried out late. Because of all those errors, it imposed a flat-rate adjustment of ESP 2 668 866 704.

54 By the contested decision, the Commission excluded from Community financing the amounts referred to in paragraphs 49 to 53 of this judgment because they did not comply with Community law.

55 By its action the Kingdom of Spain is seeking partial annulment, or at least amendment, of the contested decision in so far as it imposes those financial adjustments on it. It is also claiming that the Commission should be ordered to pay the costs.

56 The Commission contends that the application should be dismissed and that the Kingdom of Spain should be ordered to pay the costs.

The adjustment relating to aid for olive oil production

The first plea: infringement of the fourth subparagraph of Article 5(2)(c) of Regulation No 729/70

Arguments of the parties

57 The Spanish Government challenges the Commission's financial adjustment relating to failings the latter found, such as the payments made, the flat-rate yields attributed to producers and the lack of checks on the register of olive cultivation and the computerised databases.

58 First, it takes as its basis the position it adopted in Case C-130/99 *Spain* v *Commission* [2002] ECR I-3005 and Case C-349/97 *Spain* v *Commission* [2003] ECR I-3851, concerning each of the financial years 1993, 1995 and 1996. It adds that adjustments to the register of olive cultivation were made by putting into effect the mechanisms provided for by Royal Decree No 1972/1999 of 23 December 1999.

59 Secondly, it argues that the Community budget has not suffered any loss. It states that the total quantity of olive oil produced in Spain during the marketing years in question was equal to or in excess of the quantity of oil which received aid.

60 The Commission states that its audits in 1998, 1999 and 2000 confirmed that neither the register of olive cultivation nor the computerised databases were operational. It maintains that any aid wrongly paid necessarily causes loss to the Community budget. In the Commission's view the current shortcomings in the arrangements for checking the Spanish system of aid for olive oil production fail to provide any assurances that the Commission was justified in granting all that aid.

Findings of the Court

61 First, it is clear that the Kingdom of Spain was required, on the one hand, to establish the register of olive cultivation by 1 November 1988 at the latest, under Article 1(2) of Regulation No 154/75, and, on the other hand, to put into effect the computerised database of olive-oil production data by 31 October 1990, under Regulation No 2261/84 and Regulation No 3061/84.

62 However, the documents before the Court show that the time-limits laid down in those regulations were not met, and that there was still no register of olive cultivation or computerised database in financial years 1995 and 1996.

63 In those circumstances, the Commission is not required to submit, in respect of financial years 1997 and 1998 at issue in the present case, any other evidence of the absence of the register of olive cultivation and the computerised database apart from that which it gathered for that purpose in respect of financial years 1995 and 1996 (see Case C-130/99 *Spain* v *Commission*, cited above, paragraphs 137 to 139). It was incumbent upon the Member State concerned to establish that since those financial years it has indeed put in place the register of olive cultivation and the computerised database (see to that effect Case C-332/01 *Greece* v *Commission* [2004] ECR I-7699, paragraph 61).

64 Such evidence has not been adduced in this case by the Kingdom of Spain. On the contrary, as the Commission rightly stated as regards, in particular, the register of olive cultivation, the adjustments provided for by Royal Decree No 1972/1999 show that that register was not yet fully operational. A financial adjustment was therefore justified in that respect.

65 As regards the other failings of the checking system, in particular in respect of the payments made, the flat-rate yields allocated to producers and the absence of other checks, the Spanish Government merely refers to the position it adopted in Cases C-130/99 and C-349/97, cited above. In that regard, suffice it to say that the arguments put forward in those cases related only to financial years 1993, 1995 and 1996, whilst the present case relates to financial years 1997 and 1998. At any event, in both the judgments cited above the Court of Justice dismissed all the Spanish Government's arguments concerning those other failings.

66 Secondly, as regards the Spanish Government's argument that the Community budget suffered no loss, it should be noted that the EAGGF finances only intervention undertaken in accordance with the Community rules within the framework of the common organisation of agricultural markets. The Commission is not required to prove that there has been a loss but may simply adduce sound evidence of such loss. For those difficult cases where the extent of the losses cannot be ascertained precisely, the losses to the Community funds must be determined by an evaluation of the risk to which they are exposed by the deficiency in the controls (see to that effect Case C-349/97 *Spain* v *Commission*, cited above, paragraph 146).

67 Although it is for the Commission to prove that the rules of the common organisation of the agricultural markets have been infringed, once it has established such an infringement it is for the Member State to demonstrate, if appropriate, that

the Commission made an error as to the financial consequences to be attached to that infringement. The Member State must then adduce the most detailed and comprehensive evidence possible that its figures are accurate and, if appropriate, that the Commission's calculations are incorrect (Case C-349/97 *Spain* v *Commission*, paragraph 147).

68 In that connection, the Spanish Government bases its denial that there was any loss to the Community budget on the information contained in its letter to the Commission of 17 March 2000 and on the detailed information contained in the document from the Spanish Ministry of Agriculture of 16 December 1999 relating to marketing years 1995/96 and 1996/97. In its view that evidence shows that the total quantity of olive oil produced in Spain during those marketing years was the same as, or more than, the quantity of oil for which aid was received.

69 However, that evidence does not invalidate the Commission's conclusion that the Spanish authorities' checks were defective. In the absence of a computerised database, as was stated in paragraph 64 of the present judgment, that evidence does not show that the oil for which aid was received was the oil actually produced. Therefore, the documents relied on cannot undermine the finding that the failings in the checking system operated by the Spanish authorities with regard to aid for olive oil production establish that there was a significant risk of loss to the Community budget.

70 It follows, therefore, that the first plea concerning aid for olive oil production must be rejected as unfounded.

The second plea: the amount of the financial adjustment is unjustified

Arguments of the parties

71 The Spanish Government claims that when the Commission found there had been an improvement in the system of checking and paying aid for olive oil production in respect of the preceding financial years it should have reduced the percentage of the financial adjustment from 5% to 2%. It also maintains that the Commission failed to take into account the other activities involved in checking aid for olive oil production which made it possible to offset the inevitable under-use of the register of olive cultivation, namely the inspections and the monitoring which that Government carried out in respect of the oil mills.

72 According to the Commission, although some aspects of the checking system were satisfactory the improvements made still do not justify any reduction in the amount of the financial adjustment for financial years 1997 and 1998. It states that until the two main aspects of the checking, namely the register of olive cultivation and the computerised database, are in place the risk of loss to the Community will be high and the adjustments are therefore justified.

Findings of the Court

73 As regards the rate of 5% applied by the Commission in order to calculate the adjustment in respect of aid for olive oil production, it should be pointed out, on the one hand, that the register of olive cultivation and the computerised database are

fundamental aspects of the Community system for checking aid. Until those aspects are operational it is justified in principle to impose the 10% adjustment rate provided for by the Commission guidelines, as set out in its document No VI/5330/97 (see *Greece* v *Commission*, cited above, paragraph 70).

74 However, the Commission did acknowledge that some aspects of the checking system in Spain were satisfactory, although they were not as effective as the checking system required by the Community regulations. It therefore considered it appropriate to impose an adjustment of 5%.

75 It is not admissible, under the Commission guidelines, to reduce the adjustment rate to below 5% until the register of olive cultivation and the computerised database are in place, since these are key aspects of the Community checking system. The Spanish Government's arguments to the contrary must therefore be dismissed.

76 On the other hand, as to the assertion by the Spanish Government that a system of other forms of checking aid for olive oil production was put in place, in particular checks on the mills, it is sufficient to observe that the Court has consistently held that where a regulation lays down specific measures of supervision, the Member States must apply them and it is unnecessary to examine the merits of their view that another system of supervision is more effective (see Case C-54/91 *Germany* v *Commission* [1993] ECR I-3399, paragraph 38, and Case C-130/99 *Spain* v *Commission*, paragraph 87).

77 The second plea concerning aid for olive oil production must therefore be rejected as unfounded.

78 It is clear from the above considerations that the Spanish Government's claim with regard to the refusal to charge to the EAGGF certain costs in connection wtih aid for olive oil production must be rejected as unfounded.

The adjustment in respect of aid for olive oil consumption

The first plea: infringement of the fourth subparagraph of Article 5(2)(c) of Regulation No 729/70

Arguments of the parties

79 The Spanish Government states that the Commission made the financial adjustment at issue for the same reasons as it made its adjustments in respect of financial years 1994 and 1995. It therefore refers to the pleas raised in the context of the action it brought against those adjustments in Case C-374/99 *Spain* v *Commission* [2001] ECR I-5943.

80 The Commission states that in that case the Court rejected all the Spanish Government's arguments relating to the financial adjustment imposed by the Commission on the basis of the failings found in respect of financial years 1994 and 1995.

Findings of the Court

81 As regards the position taken by the Spanish Government in Case C-374/99 *Spain* v *Commission*, cited above, suffice it to say that the arguments raised by the Spanish Government in that case related only to financial years 1994 and 1995, whereas the present case relates to financial year 1996. At any event, in paragraph 36 of the judgment relied on the Court rejected all of the Spanish Government's arguments against the adjustments applied with regard to aid for the consumption of olive oil.

82 The first plea must therefore be rejected.

The second plea: infringement of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70

Arguments of the parties

83 In its second plea, the Spanish Government's first complaint is that the Commission's letter of 3 November 1997 cannot be regarded as 'written communication' of the results of the Commission's checks, within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70. It contends that when that letter mentions the possibility of making financial adjustments in respect of financial years 1994 and 1995 it is certainly not making an express notification in respect of financial year 1996. Moreover, in the Spanish Government's view, that letter makes no reference either to the results of the Commission's checks with regard to that financial year or to Regulation No 1663/95.

84 In the same plea, the Spanish Government makes a second complaint, alleging that the Commission's letter of 17 August 1998, received by the Spanish Government on 21 August 1998, did not constitute 'written communication', within the meaning of the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, either, since it makes no reference to Regulation No 1663/95. If that letter were to be considered to be such written communication it could only relate to the costs at issue in respect of financial year 1996 incurred in the 24 months before the date on which it was received, that is to say, those incurred after 21 August 1996.

85 The Commission replies, on the one hand, that its letter of 3 November 1997 constitutes written communication, within the meaning the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70, of the results of the checks carried out in November 1996. It contends that that letter makes reference to the final results of the inspection conducted from 18 to 22 November 1996 and to the financial adjustments which might be proposed. The same letter states that the results of the checks concerned financial year 1994 and following financial years. The letter expressly relates to financial year 1996. It is apparent from the correspondence subsequently exchanged between the Commission and the Spanish Government, and from bilateral meetings, that the letter in question was also interpreted in this way by the Spanish authorities.

86 The Commission states, on the other hand, that the letter of 17 August 1998 does not constitute written communication as referred to in that provision, but merely represents formal communication of the findings.

87 The Commission also asserts, with regard to the absence of any express reference to Regulation No 1663/95, that the Spanish Government is fully aware of the fact that, whilst the failings in question persist, the expenditure it incurs will continue to be subject to financial adjustments because of those failings. It cannot therefore rely on an alleged infringement of the principle of legal certainty, which that article seeks to protect.

Findings of the Court

88 The fifth subparagraph of Article 5(2)(c) of Regulation No 729/70 provides that '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 ...'.

89 The first subparagraph of Article 8(1) of Regulation No 1663/95, the regulation implementing Regulation No 729/70, sets out the content of that written communication. That provision states that the communication must include the corrective measures to be taken to ensure future compliance with the rules concerned, and an evaluation of any expenditure which it may propose to exclude, and must make reference to Regulation No 1663/95.

90 Consequently, it is necessary first of all to ascertain whether the letter of 3 November 1997 meets the requirements of Article 5(2)(c) of Regulation No 729/70, in conjunction with the first subparagraph of Article 8(1) of Regulation No 1663/95.

91 The letter states, first, that in connection with the clearance of accounts for financial year 1994 and following years in the sector of olive oil consumption Commission officials carried out an audit from 18 to 22 November 1996, the results of which, contained in the annex to the letter, had already been discussed by the Commission and the Spanish authorities. The letter goes on to disclose that those results convey the worrying situation in question which had led the Commission to request the Spanish authorities to adopt as a matter of urgency the measures needed in order to adapt to the Community provisions in force the management of payments and checks and the imposition of penalties. It states, lastly, that the Commission reserves

the right to submit at a later date financial adjustments to the expenditure declared by the Kingdom of Spain in respect of financial years 1994 and 1995 and that declared subsequently. The letter ends with a request to the national authorities to send their answers to the points made within six weeks, in particular with regard to the requests for information contained in the annex.

92 With regard to the complaint made by the Spanish Government that the letter of 3 November 1997 contained no express reference to Regulation No 1663/95, it is appropriate to consider whether that omission suffices in order to consider that the letter does not constitute written communication within the meaning of that regulation and of Article 5(2)(c) of Regulation No 729/70.

93 The Commission is bound, in its relations with the Member States, to respect the conditions it has imposed on itself by implementing regulations. However, the Member States cannot, in their relations with the Commission, adopt purely formalist positions, when it is clear from the circumstances that their rights were fully protected. Where the document in question, in the present case the letter of 3 November 1997, informs the government concerned fully about the Commission's reservations and the adjustments which will probably be made in relation to the sector in question, so that it can fulfil the warning function given to written communications by Article 5(2)(c) of Regulation No 729/70 and the first subparagraph of Article 8(1) of Regulation No 1663/95, the mere omission, in that document, of a reference to Regulation No 1663/95 cannot be regarded as a breach of an essential formal requirement (see to that effect Case C-170/00 *Finland* v *Commission* [2002] ECR I-1007, paragraph 34).

94 It is clear that the letter of 3 November 1997 informed the Spanish Government fully about the Commission's reservations and the adjustments which would probably be made in respect of financial year 1996 with regard to the sector of olive oil consumption. Therefore, even without a specific reference to Regulation No 1663/95, it fulfilled the warning function given to written communications by

Article 5(2)(c) of Regulation No 729/70 and the first subparagraph of Article 8(1) of Regulation No 1663/95.

95 The first complaint made in the second plea cannot therefore be accepted. Consequently, there is no need to consider the second complaint made in the same plea.

96 In the light of the above considerations, the claim of the Spanish Government with regard to the refusal to charge to the EAGGF certain expenditure relating to aid for olive oil consumption must be rejected as unfounded.

The adjustment relating to the additional levy in the milk sector

Arguments of the parties

97 The Spanish Government accepts that the Member States are required to recover promptly the additional levy for which purchasers or producers of milk are liable and, where appropriate, default interest. However, in its view, Community regulations do not allow the Commission to require such interest from the Member State.

98 The Commission, for its part, contends that the Member States are subject to two obligations: first, to take appropriate measures so that the persons liable to pay the levy pay it within the prescribed time-limit or else incur default interest and, second,

to pay to the Community the amount of the additional levy within the specified time-limit together with any default interest. The reduction in advances which relates to this last obligation does not put an end to the obligation incumbent upon Member States to charge persons liable to pay the levy both the levy and any default interest.

99 The Commission also points out that, contrary to the Spanish Government's contention, there is no legal basis that would justify default interest being paid to the national budget.

Findings of the Court

100 First of all, it should be noted that in order to ensure the proper functioning of the system of the additional levy Article 3(4) and Article 5(2) of Regulation No 536/93 seek to improve and expedite payment of the additional levy to the competent national body by the persons liable to pay it.

101 It is clear from reading those provisions together, in the light of Article 5(2) and Article 8 of Regulation No 729/70, Article 1(1) and Article 4 of Commission Regulation (EC) No 296/96 of 16 February 1996 on data to be forwarded by the Member States and the monthly booking of expenditure financed under the Guarantee Section of the Agricultural Guidance and Guarantee Fund (EAGGF) and repealing Regulation (EEC) No 2776/88 (OJ 1996 L 39, p. 5), and Article 13 of Council Decision 94/729/EC of 31 October 1994 on budgetary discipline (OJ 1994 L 293, p. 14), that where the deadline for payment of the additional levy by the purchaser or the producer who is liable to pay it is not met the Commission will impose on the Member State, by way of a penalty, a reduction in the advances intended to cover the expenditure on milk and milk products, as a proportion of the amount owing by way of the additional levy or of an estimate of that amount.

102 It should be pointed out that Article 3(4) of Regulation No 536/93 makes purchasers and producers liable to pay interest, as from 1 September of each year, to the competent body in case of late payment of the additional levy and also that Article 5(2) of that regulation makes Member States responsible for deducting interest paid from the applications for reimbursement of expenditure on milk and milk products submitted to the EAGGF (Case C-130/99 *Spain* v *Commission*, paragraph 101, and Case C-148/01 *Greece* v *Commission* [2003] ECR I-5883, paragraph 52).

103 In the present case, it is common ground that the Spanish authorities did not collect the default interest referred to in those provisions.

104 In paragraph 101 of Case C-130/99 *Spain* v *Commission*, the Court also held that the fact that certain sums due remain unpaid, or have been paid belatedly, does not of itself constitute failure to fulfil obligations placed on the Member States by Community law.

105 Article 5(2) of Regulation No 536/93 does not therefore apply in the present case.

106 However, according to the first subparagraph of Article 8(2) of Regulation No 729/70, the Commission may apply an adjustment where it is able to show that the EAGGF suffered a loss as a result of a negligent failure, attributable to the national authorities, to recover the disputed sums (see, to that effect, Case C-130/99 *Spain* v *Commission*, paragraph 102).

107 Even if the Commission, without making a specific reference to the first subparagraph of Article 8(2) of Regulation No 729/70, had based the contested adjustment on that provision, it did not specify how the Spanish authorities contributed through their alleged negligence to a loss for the Community funds, nor did it evaluate the risk to which they were exposed as a result of such negligence.

108 In the present case, it is common ground that by making express reference to Article 5(2) of Regulation No 536/93 the Commission based the contested adjustment exclusively on that provision.

109 As the Commission thus based the contested adjustment on an incorrect legal basis it is necessary to accept the Spanish Government's claim that the financial adjustment amounting to ESP 2 426 259 870 in respect of interest payable under the system of the additional levy on milk and milk products should be annulled.

The adjustment relating to aid in the arable crops sector and the consequences of not imposing the special set-aside

The first plea: infringement of the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92

Arguments of the parties

110 First of all, with regard to the financial year 1994/95, the Spanish Government acknowledges that it exceeded the guaranteed areas of arable crops in Spain as

regards both the area of crops on unirrigated land and the area of crops on irrigated land. However, that overrun was due to a serious drought in Spain in 1994, which led to a fall in yields. This in turn led to some crops being replaced by others.

111 In its first plea the Spanish Government makes an initial complaint alleging an obligation to make a special set-aside for crops on unirrigated land. It contends that in circumstances such as an exceptional drought the Commission should have applied the third subparagraph of Article 2(6) of Regulation No 1765/92, a subparagraph added by Article 1 of Regulation No 1422/97. It submits that, under that provision, should exceptional climatic conditions have affected production in a marketing year in which it is found that the regional base area has been exceeded, the Commission may exempt producers in the regions affected from the requirement to make a special set-aside without any compensation. That provision justifies the Kingdom of Spain's failure to comply with that requirement during the marketing year 1995/96.

112 In the same plea, the Spanish Government makes a second complaint alleging a requirement to make a special set-aside for crops on irrigated land, especially oilseed crops. It stresses the fact that the major drought made it necessary to impose restrictions on the use of water for irrigating crops. On irrigated land traditional crops such as rice, cotton and tomatoes were replaced by crops that required less water, in particular oilseed crops. The combination of those circumstances meant that the area that had been the subject of applications for compensatory payments, including set-aside, exceeded the base area for crops on irrigated land.

113 The Spanish Government acknowledges that Commission Regulation No 1040/95 provides that Article 2(6) of Regulation No 1765/92 gives rise to the imposition of

special set-aside without any compensation only in respect of oilseed producers and not in respect of producers of other crops on irrigated land. However, under a political agreement with the Commission that requirement did not even apply to oilseed producers either.

114 As regards the first complaint, the Commission contends that the third subparagraph of Article 2(6) of Regulation No 1765/92 applies to overruns from the 1995/96 marketing year onwards. It does not therefore apply in the present case, since the overrun which resulted in the contested adjustment occurred during the 1994/95 marketing year.

115 With regard to the second complaint, the Commission contends that Regulation No 1040/95 imposed on the Spanish authorities during the 1995/96 marketing year the requirement not to apply the special set-aside only to areas planted with cereals, proteins, linseed, the related set-aside and the voluntary set-aside in the regional base area for crops on irrigated land. It denies, and maintains that it has always denied, the existence of an unwritten agreement with the Spanish authorities under which it accepted that the requirement to make a special set-aside was not applied to oilseed crops either.

Findings of the Court

116 Article 2(1) and (2) of Regulation No 1765/92 provide that Community producers of arable crops may apply for a compensatory payment under certain conditions. That payment is granted for the area which is down to arable crops or subject to set-aside and which does not exceed a regional base area.

117 In that regard, the annex to Regulation No 1098/94 lays down in the case of Spain, on the one hand, a regional base area corresponding to each autonomous community in respect of crops on unirrigated land and, on the other hand, a regional base area at national level in respect of crops on irrigated land.

118 Article 1(1) of Regulation No 2836/93 provides that in determining the amount by which those regional base areas may have been exceeded, the competent authority of the Member State is to take into account the regional base area fixed and the sum of the areas for which applications for aid have been submitted in respect of the region in question.

119 Where the sum of the individual areas for which applications for aid have been submitted exceeds the regional base area, producers in the general scheme must, during the following marketing year, make a special set-aside of land, without any compensation, under the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92.

120 In that regard, the Spanish Government admits, in respect of the first complaint in the first plea, that in the case of crops on unirrigated land, the regional base area was exceeded in the 1994/95 marketing year and no requirement was imposed on the producers of those crops to make a special set-aside without compensation.

121 Contrary to what the Spanish Government contends, the third subparagraph of Article 2(6) of Regulation No 1765/92, which provides that should exceptional climatic conditions have affected production in a marketing year in which it is found that the regional base area has been exceeded, the Commission may exempt producers in the regions affected from the requirement to make a special set-aside

without any compensation, applies to such an overrun only from the 1995/96 marketing year onwards. It cannot therefore be relied upon in the present case, which concerns an overrun during the 1994/95 marketing year.

122 The first complaint in the first plea submitted by the Spanish Government must therefore be rejected as unfounded.

123 With regard to the second complaint in the first plea, it should be pointed out that the Spanish Government also admits that, in the case of crops on irrigated land, including oilseed crops, the regional base area was exceeded in the 1994/95 marketing year but no requirement was imposed on the producers of those crops to make a special set-aside without any compensation.

124 Moreover, it is clear from the sixth recital in the preamble to Regulation No 1040/95 that:

— the overrun in question was due to an exceptional increase in the area planted with oilseed crops;

— no significant increase was found in the area under other major crops;

— it therefore appeared appropriate to penalise oilseed producers alone for that overrun.

125 The Commission rightly argues the irrelevance in the present case of Article 1 of Regulation No 1040/95, which provides, following the overrun in the 1994/95 marketing year, that the requirement to make a special set-aside without any compensation should not apply in respect of the areas planted with cereals, proteins, linseed, the related set-aside and the voluntary set-aside in the regional base area for crops on irrigated land, and which therefore has no effect on areas planted with oilseed crops.

126 In those circumstances, the Spanish Government should therefore have required the producers of those oilseed crops to make a special set-aside without any compensation.

127 As for the Spanish Government's assertion that a political agreement was reached with the Commission, suffice it to say that the set-aside requirement on producers is laid down by a Community provision. It cannot therefore be amended by a political agreement between the Commission and a Member State.

128 The second complaint in the first plea must therefore be rejected as unfounded.

The second plea: the amount of the financial adjustment is unjustified

Arguments of the parties

129 In the second plea, the Spanish Government submits that even if the Commission had the right to apply the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92, the amount of the resulting financial adjustment is incorrect.

130 The Spanish Government acknowledges, first, that the Commission has the right to recover amounts wrongly paid in relation to the area planted with arable crops or allocated to set-aside, in respect of which the Kingdom of Spain should have imposed the requirement to make a special set-aside without payment. The Spanish Government also acknowledges that the Commission, when calculating the rate of set-aside which should have been achieved, but which was not, first of all added the rate of compulsory set-aside to that of special set-aside. Secondly, it took into account, as a reduction, the rate of voluntary set-aside during the 1995/96 marketing year, a reduction which was due to the fact that some producers who had made a voluntary set-aside could offset the fact that others had not made any set-aside.

131 However, the Spanish Government submits that the Commission should not have taken into account also in that calculation an increase of five percentage points in the rate of compulsory set-aside due partly to the fact that some parcels were not set aside on a rotational basis, as provided for in the third subparagraph of Article 7(1) of Regulation No 1765/92, and partly to the transfer of the set-aside requirement between producers, as provided in the second indent of the first subparagraph of Article 7(7) of that regulation.

132 The Commission, whilst acknowledging the complexity of the procedure for calculating the financial adjustment in question, contends that it is only applying the relevant Community legislation. It asserts, first of all, that it is necessary to recover the payments made in respect of the voluntary set-aside of land which should have been the subject of special set-aside without compensation. Secondly, since the rate of voluntary set-aside added to that of compulsory set-aside does not cover the total set-aside requirement, it is necessary to deduct in the same proportion from the set-aside deficit the payments made in respect of areas under cultivation. Lastly, since it is very unlikely that there would actually be the necessary correlation between the rate of voluntary set-aside of a producer and his corresponding rate of special set-aside, it should be considered that the set-aside of some parcels was not made on a rotational basis and that transfers of the set-aside requirement had taken place

between producers. The third subparagraph of Article 7(1) of Regulation No 1765/92 and the second indent of the first subparagraph of Article 7(7) of that regulation should therefore be applied.

Findings of the Court

133 It is appropriate to bear in mind, first, that the management of EAGGF financing is principally in the hands of the national administrative authorities responsible for ensuring that the Community rules are strictly observed. That system, based on trust between national and Community authorities, does not involve any systematic supervision by the Commission, which moreover would in practice be quite unable to carry it out. Only the Member State is in a position to know and determine precisely the information necessary for drawing up EAGGF accounts since the Commission is not close enough to obtain the information it needs from the economic operators (Case C-238/96 *Ireland* v *Commission* [1998] ECR I-5801, paragraph 30, and Case C-118/99 *France* v *Commission* [2002] ECR I-747, paragraph 37).

134 Articles 2 and 3 of Regulation No 729/70 allow the Commission to charge to the EAGGF only sums paid in accordance with the rules laid down in the different agricultural sectors (see, in particular, Case C-197/90 *Italy* v *Commission* [1992] ECR I-1, paragraph 38, and *France* v *Commission*, cited above, paragraph 38).

135 First of all, as regards direct loss to the Community budget, Article 2(1) of Regulation No 1765/92 provides, with regard to the system of aid applicable to arable crops and set-aside, that Community producers of arable crops may apply for a compensatory payment under the conditions set out in Articles 2 to 13 of that regulation.

136 In that regard, a compensatory payment granted to producers of arable crops for areas given over to such crops or to set-aside, which should, however, have been given over to special set-aside without compensation, is contrary to the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92. Under that provision, the percentage rate for special set-aside, and hence the percentage of wrongly paid amounts, is to equal the percentage by which the regional base has been exceeded.

137 In the light of the above, a Member State cannot apply to the Commission for reimbursement of sums paid in breach of that provision.

138 If the Member State subsequently applies for reimbursement of such sums the Commission is entitled to impose a financial adjustment equal to those sums.

139 That is so in the present case. So far as the 1995/96 marketing year is concerned, the Spanish Government admits that it did not impose on producers of arable crops the requirement to make a special set-aside without compensation and it made compensatory payments to those producers. The Commission was therefore entitled, under the second indent of the first subparagraph of Article 2(6) of Regulation No 1765/92, to impose a financial adjustment equivalent to the payments made in respect of the areas of arable crops which should have been the subject of a special set-aside without compensation.

140 The Commission's right in this respect cannot be called into question by the fact, apparent from the documents before the Court, that in the contested decision the Commission imposed a financial adjustment that was less than that amount.

141 The Spanish Government's second plea must therefore be rejected as unfounded.

142 Consequently, the Spanish Government's claim regarding aid in the sector of arable crops and the consequences of not imposing the special set-aside must be rejected as unfounded.

The adjustment relating to aid for arable crops in the Autonomous Community of Andalusia

The first plea: incorrect interpretation and application of Article 6(3) of Regulation No 3887/92

Arguments of the parties

143 First, the Spanish Government submits that Regulation No 3887/92 does not provide a time-limit for carrying out on-the-spot checks which, if exceeded, leads to financial adjustments. Even if such a time-limit existed, it would, according to that Government, apply only to initial checks.

144 Second, the Spanish Government asserts that the checks by remote sensing introduced for the 1996 and 1997 harvests were carried out on a sample of applications that was larger than the minimum sample of applications which should

have been subjected to on-the-spot checks under Article 6(3) of Regulation No 3887/92. The delays found in the on-the-spot checks were therefore irrelevant.

145 Third, the Spanish Government claims that even after the harvest the existence of crops and compliance with a set-aside requirement may be checked by means of another system that is equally reliable.

146 Fourth, as regards the Commission's allusion to the difficulty it encountered in obtaining the necessary information during its inspection visit from 8 to 12 September 1997, and regarding in particular applications for on-the-spot checks of the 1997 harvest, the Spanish Government contends that that difficulty stems from the system of checking put in place by the Consejería de Agricultura y Pesca de la Junta de Andalucía. It claims that because the competent provincial delegations examine essentially those files which are most likely to raise problems in the form of irregularities or incidents, in addition to the guided sampling files, it is not possible to draw any general conclusions or to extrapolate from the results of the files analysed during the inspection visit.

147 For its part, the Commission claims, first of all, that in order to check the aid effectively the competent authorities must carry out the checks during the current year and, in principle, before the harvest. Similarly, in its view, the set-aside files must be checked before 31 August, the date on which compliance with the set-aside requirement ends.

148 The Commission goes on to point out that, even if the inspectors arrive on site after the harvest or after the set-aside requirement has ended, the effectiveness of the alternative checks that could be put in place, such as the examination of invoices

relating to the harvest, fertilising or storage, and examination of alleged residues on site, cannot be comparable to the effectiveness of on-the-spot checks.

149 Lastly, it asserts that although, as the Spanish authorities themselves state, the on-site checks include on-the-spot checks, there is no doubt that the Consejería de Agricultura y Pesca de la Junta de Andalucía should have been in possession of that information in order to make it available in turn to the Community inspectors.

Findings of the Court

150 According to the seventh and ninth recitals in the preamble to Regulation No 3887/92, that regulation seeks to monitor compliance with the provisions on Community aid effectively and also to prevent and penalise irregularities and fraud effectively.

151 Article 6(1) of that regulation provides that on-the-spot checks are to be made in such a way as to ensure effective verification of compliance with the terms on which aids are granted, and the second indent of the first subparagraph of Article 6(3) provides that such checks, that is to say the initial checks, must cover at least a significant percentage of applications, and that percentage must represent 5% of 'area' aid applications. The second subparagraph of Article 6(3) provides that should on-the-spot checks reveal significant irregularities in a region or part of a region the competent authority must, in particular, make additional checks during the current year.

152 In accordance with the objective and the scheme of Regulation No 3887/92 it is therefore appropriate to interpret the second subparagraph of Article 6(3) of that regulation as meaning that both the initial and the additional checks must be carried out whilst there is still evidence of arable crops or of set-aside on the areas which have been the subject of payments under Regulation No 1765/92 and, at any event, during the current year.

153 For the sake of efficiency, it is appropriate to carry out checks on the areas down to arable crops before the harvest and on the areas subject to set-aside before that requirement ends, which is 31 August of the current year. At any event, the later the checks the more likely it is that the Commission may reasonably conclude that those checks do not offer the expected level of assurance that the applications are in order and the risk of losses for the EAGGF is significant.

154 In that regard, the Spanish Government's first argument that there is no time-limit for carrying out on-the-spot checks must be rejected as unfounded.

155 Since in its second argument the Spanish Government merely makes reference to the fact that the sample of 'area' aids subjected to checking was larger than that required under Article 6 of Regulation No 3887/92 it is not contradicting the Commission's evidence that some of the checks carried out were in fact too late to monitor compliance with the provisions on Community aid effectively. That argument must also be rejected as unfounded.

156 With regard to the Spanish Government's third argument, it should be pointed out that, as the Court has already noted in paragraph 76 above, the Court has consistently held that where a regulation lays down specific measures of supervision,

the Member States must apply them and it is unnecessary to examine the merits of their view that another system of supervision is more effective (see *Germany* v *Commission*, paragraph 38, and Case C-130/99 *Spain* v *Commission*, paragraph 87).

157 As regards that Government's fourth argument, concerning the problems encountered in supplying the Commission inspectors with the information requested, it should be pointed out, as the latter has done, that such problems cannot invalidate the findings reached by those inspectors. Moreover Article 6(4) of Regulation No 3887/92 provides that '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'. Therefore, since the Commission must make its findings on the basis of the sample selected and submitted by the Spanish Government, that Government cannot argue that the Commission was wrong to draw general conclusions or to extrapolate from the results of the files analysed during the inspection visit, files which according to that Government raised problems in the form of irregularities or incidents. The fourth argument must therefore be rejected as unfounded.

158 In the light of the above, the Spanish Government's first plea must be rejected as unfounded.

The second plea: a factual error

Arguments of the parties

159 With regard to the financial adjustment for the financial year relating to the 1996/97 marketing year, the Spanish Government submits that that adjustment is void due to

an error which the Commission made in evaluating that marketing year on the basis of data for the preceding year, namely the 1995/96 marketing year. It also maintains that it had always considered that the proposed adjustment related solely to the 1995/96 marketing year.

160 Although the Commission admits that some of its communications are incorrect in so far as they reproduce data for the 1995/96 marketing year as those for the 1996/97 marketing year, it contends that that simple error did not invalidate its assessment of that marketing year. According to the Commission, that assessment was logically based on the findings of the inspection visit of 8 to 12 September 1997, which found failings during those two marketing years, and on the arguments and data submitted subsequently by the Kingdom of Spain in its replies to communications from the Commission.

Findings of the Court

161 First of all, in respect of the 1996/97 marketing year, the reasons for which the Commission imposed the financial adjustments in question were the persistence of delays in carrying out checks in certain provinces and the poor quality of the checks carried out in collaboration with the Clearance of Accounts Unit. Secondly, those failings appeared in the report made by the Commission at the end of its inspection visit from 8 to 12 September 1997 and in its subsequent correspondence with the Spanish authorities. Third, it is apparent from the documents before the Court that in their letter to the Commission of 23 June 1999 the Spanish authorities had provided information on the rate of on-the-spot checks made using remote sensing or traditional methods during the 1996/97 marketing year and on the rate of checks which took place after 21 August 1997.

162 It follows from those considerations that the Commission, having concluded in the case of the 1996/97 marketing year that some of the checks did not provide the expected level of assurance that the applications were in order, and that the risk of loss to the EAGGF was significant, was entitled to impose a financial adjustment on all the expenditure in question. The fact that in some of its communications to the Spanish Government the Commission referred incorrectly to data for the 1995/96 marketing year, an error which the Commission has rectified, as the Spanish Government has acknowledged, does not justify annulment of the Commission's decision.

163 The Spanish Government's second plea must therefore be rejected as unfounded.

The third plea: infringement of the right to a fair hearing

Arguments of the parties

164 The Spanish Government complains that the Commission imposed the financial adjustment in respect of the 1996/97 marketing year without enabling it to put forward its arguments.

165 In the view of the Commission, the Spanish Government was aware that the proposed adjustment related both to the 1995/96 marketing year and to the 1996/97 marketing year. Therefore, the complaint alleging infringement of the right to be heard is unfounded. The Commission claims that the Spanish Government had the

opportunity to challenge the findings of its inspectors but merely made reference to the individual files mentioned in the report of the inspection visit of 8 to 12 September 1997 and to the checks by remote sensing without submitting any figures or data relating to other on-the-spot checks which the Commission could have used as a basis for altering the proposed adjustment for the 1996/97 marketing year.

Findings of the Court

166 The Spanish Government was informed in the report drawn up by the Commission following the inspection visit of 8 to 12 September 1997 that during the 1996/97 marketing year there were failings in the system of checking arable crops operating in the Autonomous Community of Andalusia. That Government itself provided the Commission with information on those checks. The Commission cannot therefore be said to have infringed the right to a fair hearing.

167 The Spanish Government's third plea must be rejected as unfounded.

The fourth plea: the amount of the financial adjustment is unjustified

Arguments of the parties

168 The Spanish Government claims that as that adjustment was based on the delay in carrying out the checks, the Commission should not have made a financial

adjustment of 5% of the expenditure declared in relation to areas down to arable crops or subject to set-aside in respect of the marketing years in question, but only in relation to those areas subject to set-aside which were checked late.

169 The Commission asserts that the checks carried out after the respective harvests of the marketing years in question were ineffective as regards not only the checking of compliance with the set-aside requirement but also the necessary checks on areas down to arable crops. In the Commission's view, therefore, the financial adjustment should apply to all those areas.

Findings of the Court

170 According to Document No VI/5330/97, when it is not possible to determine the actual amount of the incorrect payments, and hence to quantify the financial loss suffered by the Community, the Commission will apply flat-rate financial adjustments, usually equal to 2%, 5%, 10% or 25% of the declared expenditure, depending on the extent of the impending loss.

171 In the present case, therefore, the Commission, finding quite rightly that the on-the-spot checks for the areas of arable crops had not provided the expected level of assurance that the applications were in order, and that the risk of loss to the EAGGF was significant, was entitled to impose an adjustment of 5% of all the expenditure declared.

172 Moreover, as the Court held in paragraph 135 above, the compensatory payments which were the subject of the expenditure declared are granted under the conditions set out in Articles 2 to 13 of Regulation No 1765/92 for both areas down to arable crops and those subject to set-aside. In circumstances such as those in the present case, a financial adjustment cannot therefore be imposed solely on areas subject to set-aside.

173 The Spanish Government's fourth plea must therefore be rejected as unfounded.

174 Consequently, the Spanish Government's claim relating to aid for arable crops in the Autonomous Community of Andalusia must be rejected as unfounded.

175 It follows from all the above considerations that the contested decision should be annulled in so far as it excludes from Community financing the sum of ESP 2 426 259 870 representing the interest due under the scheme of the additional levy on milk and milk products and that the remainder of the application should be dismissed.

Costs

176 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for in the successful party's pleadings. However, under the first subparagraph of 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. In the present case,

since each of the parties has applied for costs and the Commission has been unsuccessful in respect of just one of the financial adjustments challenged by the Kingdom of Spain, the latter must be ordered to pay four fifths of the costs and the Commission must be ordered to pay one fifth of the costs.

On those grounds, the Court (Second Chamber) hereby:

1. **Annuls Commission Decision 2001/137/EC of 5 February 2001 excluding from Community financing certain expenditure incurred by the Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF) in so far as it imposes on the Kingdom of Spain a financial adjustment amounting to ESP 2 426 259 870 representing the interest payable under the scheme of the additional levy on milk and milk products;**

2. **Dismisses the remainder of the application;**

3. **Orders the Kingdom of Spain to pay four fifths of the costs;**

4. **Orders the Commission of the European Communities to pay one fifth of the costs.**

Signatures.