JUDGMENT OF THE COURT (Fifth Chamber)

13 June 2002 *

In Case C-158/00,

Grand Duchy of Luxembourg, represented by F. Hoffstetter, acting as Agent, and by R. Nothar, avocat,

applicant,

v

Commission of the European Communities, represented by P. Oliver and G. Berscheid, acting as Agents, with an address for service in Luxembourg,

defendant,

APPLICATION for partial annulment of Commission Decision 2000/216/EC of 1 March 2000 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 2000 L 67, p. 37), in so far as it excluded from Community financing, for the 1996 to 1998 financial years, expenditure of LUF 56 106 800 incurred by the Grand Duchy of Luxembourg in the arable crops sector,

* Language of the case: French.

THE COURT (Fifth Chamber),

composed of: P. Jann, President of the Chamber, S. von Bahr (Rapporteur), D.A.O. Edward, A. La Pergola and M. Wathelet, Judges,

Advocate General: A. Tizzano,
Registrar: R. Grass,

having regard to the report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 21 February 2002,

gives the following

Judgment

1 By application lodged at the Court Registry on 27 April 2000, the Grand Duchy of Luxembourg sought, pursuant to the first subparagraph of Article 230 EC, partial annulment of Commission Decision 2000/216/EC of 1 March 2000 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 2000 L 67, p. 37), in so far as it excluded from Community financing, for the 1996 to 1998 financial years, expenditure of LUF 56 106 800 incurred by the Grand Duchy of Luxembourg in the arable crops sector.

Legal background

2 Article 5(2)(c) and (3) 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, hereinafter 'Regulation No 729/70'), provide:

'2. 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 24 months preceding the Commission's written communication of the results of those checks to the Member State concerned. ...

3. Detailed rules for the application of this Article shall be adopted in accordance with the procedure laid down in Article 13. Those rules shall cover in particular the attestation of the accounts referred to in paragraph 1 and the procedures relating to the decisions referred to in paragraph 2.'

3 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) provide:

'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 Directive 94/442/EC.'

4 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), set up a Conciliation Body which acts within the framework of the clearance of the accounts of the EAGGF. Under Article 1(2)(a) of that decision, 'the position of the Body shall be without prejudice to the Commission's final decision on the clearance of the accounts.'

5 The Commission's Guidelines in respect of flat-rate corrections are set out in Document VI/5330/97 of 23 December 1997 (hereinafter 'Document VI/5330/97').

6 The Commission therein distinguishes two categories of checks:

'— 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.'

7 Under the terms of Document VI/5330/97, the Commission shall apply the following flat rates of correction:

'When one or more key controls are not applied or applied so poorly or so infrequently 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.'

The clearance procedure in question

8 From 5 to 7 December 1995, the Commission's services carried out an audit in Luxembourg concerning payments under the support regime to producers of certain arable crops. That audit dealt with the marketing years 1993/1994 and 1994/1995.

9 By letter of 13 February 1996, the Commission notified the Luxembourg authorities of the results of that inspection and requested them to submit their replies and any comments they might have within a period of six weeks.

10 A further audit was carried out by the Commission's services from 24 to 26 June 1997. Its purpose was to examine the payments made under the arable crops regime for the marketing years 1995/1996 and 1996/1997.

11 By letter of 26 May 1998, the Commission notified the Luxembourg authorities of the result of that audit referring expressly to Regulation No 1663/95 and requesting those authorities to submit their reply within a period of two months.

12 By letter of 3 August 1999, the Grand Duchy of Luxembourg requested that the conciliation procedure provided for by Decision 94/442 be initiated. The Conciliation Body defined its position on 12 January 2000. It pointed out that the deficiencies in the Luxembourg control system found by the Commission's

services were obvious. It noted however that progress had been made since the first audit carried out in 1995 and requested the Commission to review whether the flat-rate correction of 5% proposed by the Commission should be applied to the whole of the period.

13 On 1 March 2000 the Commission adopted Decision 2000/216, which is the subject-matter of this action. By that decision the Commission confirmed the application of a flat-rate correction of 5% to all the expenditure under consideration.

The first plea in law alleging infringement of Regulation No 729/70

14 By the first plea in law in support of its claim for partial annulment of Decision 2000/216, the Luxembourg Government claims that the refusal of financing for the expenditure disbursed before 26 May 1996, in other words more than 24 months prior to the letter of 26 May 1998, is contrary to the provisions of Article 5(2)(c) of Regulation No 729/70. The expenditure which it claims should not have been disallowed in this respect amounts to LUF 17 939 235.

15 The Luxembourg Government asserts that the letter of 26 May 1998 constitutes the reference date for calculating the period of 24 months provided for in the said provision, because that letter alone makes reference to Regulation No 1663/95 in accordance with Article 8 thereof.

16 The Luxembourg Government submits that the letter of 13 February 1996 contains no reference to Regulation No 1663/95 nor any evaluation of the expenditure which the Commission was proposing to exclude from financing and

gives the Luxembourg authorities only six weeks to submit their observations. It follows that that letter cannot constitute a letter sent under Article 8 of Regulation No 1663/95. By failing to follow the procedural rules laid down by that regulation, the Commission ignored certain significant formalities and prejudiced the rights of the defence.

17 The Commission disputes the first plea in law relied upon by the Luxembourg Government. It acknowledges that the letter of 13 February 1996 does not expressly refer to Regulation No 1663/95, but submits that that letter, like the letter of 26 May 1998, was sent under Article 8 of Regulation No 1663/95 and did not therefore infringe the rule relating to the period of 24 months laid down by that article.

18 An express reference to Regulation No 1663/95 in such a notification does not constitute an essential guarantee to the Member State to which it is addressed and is not therefore an essential formality.

19 The Commission also maintains that the nature of the procedure in issue is set out clearly in the heading of the letter of 13 February 1996 and that the report attached as an annex to that letter contains a precise description of the deficiencies established by the Commission's services concerning the checks carried out in Luxembourg in the course of the relevant period. It follows, according to the Commission, that the Grand Duchy of Luxembourg could not have been mistaken as to the procedure being followed. It adds that it is apparent from the course of that procedure that the Member State had fully understood the consequences involved and that rights of the defence were not prejudiced.

20 In relation to the absence, in the letter of 13 February 1996, of a precise assessment of the expenditure covered, the Commission submits that indications of amounts are not required by Regulation No 1663/95 and that too precise an

assessment would not only be technically difficult but also inappropriate at that stage of the procedure. Further, the Luxembourg Government could have worked out for itself, by reading the audit report, the expenditure concerned and the risk involved, since it should have known the applicable rates of correction.

21 Regarding the period of six weeks given for replying to that letter, instead of the two months provided for by Article 8 of Regulation No 1663/95, the Commission submits that this was a mere administrative error which cannot invalidate that letter with regard to the said article. Furthermore, that period cannot give the Luxembourg Government any ground for complaint since it had, in the event, two months to reply.

Findings of the Court

22 It is appropriate to recall that 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 24 months preceding the Commission's written notification to the Member State concerned of the results of the checks which it has carried out.

23 The detailed rules for the application of Regulation No 729/70, and, in particular, the procedures for decisions refusing financing mentioned in Article 5(2)(c) thereof, are set out in Regulation No 1663/95. The Court has noted that the first subparagraph of Article 8(1) of Regulation No 1663/95 specifies what the written communication by which the Commission notifies the results of its checks to Member States must contain (see Case C-170/00 *Finland* v *Commission* [2002] ECR I-1007, paragraph 26). Under that article, that

communication is to state the corrective measures to be taken to ensure future compliance, to include an evaluation of any expenditure which the Commission may propose to exclude and to make reference to Regulation No 1663/95. The Member State must be given two months to reply to it.

24 In accordance with the Court's case-law, the Commission is bound, in its relations with the Member States, to respect the conditions it has imposed on itself by implementing regulations (see Case C-170/00 *Finland* v *Commission*, cited above, paragraph 34). A failure to observe those conditions may, depending on its significance, deprive of its efficacy the procedural guarantee accorded to Member States by Article 5(2)(c) of Regulation No 729/70, which limits the period for which expenditure can be refused financing by the EAGGF.

25 The Court must therefore investigate the extent to which the letter of 13 February 1996 meets the conditions set out in Article 8(1) of Regulation No 1663/95.

26 It is apparent from the file that three of the conditions laid down in Article 8(1) of Regulation No 1663/95 are not met by the letter of 13 February 1996, that is to say, a reference to that regulation, an evaluation of the expenditure to be refused Community financing and the giving of two months to reply. That letter contains no reference to the regulation nor any evaluation of the expenses which might be refused financing and provides for a period of six weeks for a reply.

27 It must be held that by those three irregularities the Commission has infringed, in a significant way, the rules laid down in Article 8(1) of Regulation No 1663/95 and prejudiced the procedural guarantee accorded to Member States by the fifth subparagraph of Article 5(2)(c) of Regulation No 729/70. The letter of 13 Feb-

ruary 1996 cannot therefore constitute a communication for the purposes of the said Article 8 and therefore the reference point for the period of 24 months referred to in Regulation No 729/70.

28 The first plea in law relied upon by the Luxembourg Government must therefore be upheld.

The second plea in law alleging erroneous statement of reasons and manifest error of assessment

29 By its second plea in law, the Luxembourg Government maintains that the statement of reasons for Decision 2000/216 is erroneous in that it did not take into account the evidence put forward by the Luxembourg Government in assessing the true extent of the financial consequences of the irregularities found. The Commission thus committed a manifest error of assessment. In particular, the Government rejects the conclusions drawn by the Commission from various findings relating to irregularities committed by the Luxembourg authorities in the administrative checks of files and on-the-spot inspections.

30 In relation to the administrative checks, the Luxembourg Government admits that some mistakes were made in two files. It acknowledges also that, for the marketing year 1995/1996, it did not have, at the outset, the necessary computer resources to carry out the cross-checks required by the Community legislation and that there were also some problems for the following marketing years. It also admits that exchange of information with neighbouring countries has only taken place since 1998 and that penalties with retrospective effect have only been applied since 1999. It argues, none the less, that those gaps have not had a significant financial impact and rejects the Commission's conclusion that the administrative checks were not always reliable.

31 In relation to on-the-spot checks, the Luxembourg Government maintains that, contrary to the Commission's contention, the competent national authorities carry out a risk analysis when selecting the farms to be made the subject of checks. It acknowledges that there were deficiencies in some on-the-spot checks, but asserts that most of them, that is more than 95%, were correctly carried out. The Commission based its conclusions on two audits, in 1995 and 1997, which concerned only two of the four regional offices operating in the Grand Duchy.

32 The Luxembourg Government also maintains that the number of on-the-spot checks was increased appropriately. The alleged lack of clarity of the check reports caused no problems in practice, because the staff responsible for the administrative checks were able to request explanations from the staff carrying out checks on the ground.

33 The Luxembourg Government further submits that cases of lack of on-the-spot checks were very few and that in only two cases did those checks cover less than 30% of the plots of land.

34 Generally the Luxembourg Government points to the progress achieved in the quality of its checks and to the efforts which the competent authorities continue to make.

35 The Commission maintains that it follows from the arguments of the Luxembourg Government that there is no dispute as to most of the facts alleged against it. The Government seeks essentially to minimise the impact of the complaints made against it.

36 As for the administrative checks, the Commission points out that they showed some gaps, due to computer problems, during the marketing year 1995/1996, and that, in spite of some improvements, not all the anomalies had been eliminated for the marketing year 1997/1998.

37 As for on-the-spot checks, the Commission submits, referring to the system of flat-rate corrections provided for in Document VI/5330/97, that these are key controls and any insufficiency is enough, in itself, to warrant application of the flat-rate correction of 5%.

38 The Commission disputes the Luxembourg Government's assertion that the competent authorities carried out an adequate risk analysis for the purposes of deciding which plots of land to check. As for the quality of the on-the-spot-checks, the Commission maintains that the audit carried out in 1995 revealed weaknesses in the Luxembourg system of checks and that the deficiencies that came to light were also found during the audit of 1997. It considers that overall those findings contradict the Luxembourg Government's arguments that most of the checks, that is, more than 95%, were correctly performed.

39 The Commission maintains that, in breach of Article 6(3) 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), the number of checks was not sufficiently increased following the significant irregularities noted. The argument of the Luxembourg Government relating to ways of glossing over the

lack of clarity of the check reports, that is to say informal contacts between staff, should be rejected.

40 The Commission rejects the Luxembourg Government's statement that the two offices covered by the Commission's audits were not representative, pointing out, in particular, that they covered half of the country.

41 The Commission also notes that the Luxembourg Government mentions various improvements made to its system of checks, but claims that these were insufficient during the financial years in issue.

Findings of the Court

42 It must be held that the Luxembourg Government does not dispute most of the failures revealed by the Commission's services concerning both the administrative and on-the-spot checks. Further, examination of the file has not revealed any manifest error of assessment committed by the Commission in the adoption of Decision 2000/216 and the reasons relied upon by the Commission to justify it therefore appear sufficient.

43 The second plea in law must therefore be dismissed.

The third plea in law alleging breach of the guidelines mentioned in Document VI/5330/97 and of the principle of proportionality

44 By its third plea in law, the Grand Duchy of Luxembourg complains that the Commission, when fixing the rate of correction, failed to take into account as a mitigating circumstance the fact that the Luxembourg authorities had made considerable efforts to improve the situation since 1996, a fact which the Conciliation Body also recognised.

45 The Commission's approach is contrary to the guidelines set out in Document VI/5330/97 and the application of a rate of correction of 5% is completely disproportionate in relation to the risk of losses for the EAGGF, which is in reality non-existent.

46 The Commission maintains that the audits carried out in December 1995 and in June 1997 revealed serious deficiencies which were still apparent in mid-1997, so that the improvement noted was insufficient to justify a reduction of the correction relating to the latter year.

47 The Commission also submits that, when the checks carried out by national authorities are defective, the risk of losses for the EAGGF is obvious. If the number of irregularities committed by operators cannot be established with precision, it is appropriate to apply a flat-rate correction. As for the argument according to which the EAGGF has suffered no loss because of the corrective measures supposedly taken by the Luxembourg authorities, the Commission maintains that it is sufficient to recall that those measures were incomplete and they were taken after the time-limit had passed.

48 The Commission adds that the conclusions of the Conciliation Body confirmed the deficiencies of the Luxembourg control system. That body confined itself to suggesting to the Commission that it review application of the 5% rate over the entire period. The Commission points out that it is not bound by suggestions of the Conciliation Body.

Findings of the Court

49 By that plea in law, the Luxembourg Government disputes the rate, equal to 5%, of the flat-rate correction applied by Decision 2000/216 to the expenditure incurred by the Grand Duchy of Luxembourg in the arable crops sector.

50 It is apparent from examination of the file that a large number of the anomalies found by the Commission are not disputed by the Luxembourg Government. Further, as the Commission states, the Conciliation Body confirmed the deficiencies established by the Commission's services concerning the checks carried out by the Luxembourg authorities. In relation to the suggestion made by the Conciliation Body to the Commission that it review application of the 5% correction rate, it must be pointed out that, under Article 1(2)(a) of Decision 94/442, the Conciliation Body's position does not bind the Commission.

51 In view of the extent of the anomalies found, in particular those concerning on-the-spot checks, it is right to decide that they could justify a correction of 5%.

52 It follows that the third plea in law must be dismissed.

53 Having regard to the foregoing considerations, Decision 2000/216 must be annulled in so far as it excludes from Community financing expenditure incurred by the Grand Duchy of Luxembourg in the arable crops sector prior to 26 May 1996. The remainder of the application must be dismissed.

Costs

54 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 Article 69(3) of those Rules, the Court may order that the costs be shared or that the parties bear their own costs where each party succeeds on some and fails on other heads. In this case, since the parties have each been partially unsuccessful, each must be ordered to bear its own costs.

On those grounds,

THE COURT (Fifth Chamber)

hereby:

1. **Annuls Commission Decision 2000/216/EC of 1 March 2000 excluding from Community financing certain expenditure incurred by the Member**

States under the Guarantee Section of the European Agricultural Guidance Fund (EAGGF), in so far as it excludes from Community financing expenditure incurred by the Grand Duchy of Luxembourg in the arable crops sector prior to 26 May 1996;

2. Dismisses the remainder of the application;

3. Orders each of the parties to bear its own costs.

Jann von Bahr Edward

La Pergola Wathelet

Delivered in open court in Luxembourg on 13 June 2002.

R. Grass P. Jann

Registrar President of the Fifth Chamber