# OPINION OF ADVOCATE GENERAL SHARPSTON

delivered on 16 March 2006 [1]

## Introduction

1. By this action under Article 230 EC Spain challenges the new Community support system for cotton adopted by Council Regulation (EC) No 864/2004 [2] ('the contested Regulation') and inserted into the principal 'horizontal' regulation, Council Regulation No (EC) 1782/2003, [3] encapsulating the so-called MacSharry reforms to the common agricultural policy ('CAP').

2. In essence Spain claims that the new support system will produce effects that run directly counter to the avowed aims of supporting cotton production and ensuring that cotton is not driven out by other crops in those regions where cotton is important for the agricultural economy — aims enshrined in Protocol No 4 to the Act of Accession of Greece to the European Community ('Protocol No 4'), [4] subsequently extended to Spain and Portugal when those two countries became Member States in 1986, [5] and in the preamble to the contested Regulation. Spain claims that the new system is likely, on the contrary, to encourage farmers to abandon cotton production in favour of competing crops, with deeply prejudicial consequences for cotton-dependent agricultural regions.

3. The contested Regulation is challenged on four grounds: (1) infringement of the provisions of Protocol No 4, (2) infringement of

1 — Original language: English.

2 — Of 29 April 2004 amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, and adapting it by reason of the accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia to the European Union (OJ 2004 L 161, p. 48).

3 — Of 29 September 2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers and amending Regulations (EEC) No 2019/93, (EC) No 1452/2001, (EC) No 1453/2001, (EC) No 1454/2001, (EC) 1868/94, (EC) No 1251/1999, (EC) No 1254/1999, (EC) No 1673/2000, (EEC) No 2358/71 and (EC) No 2529/2001 (OJ 2003 L 270, p. 1).

4 — Documents concerning the accession of the Hellenic Republic to the European Communities, Act concerning the conditions of accession of the Hellenic Republic and the adjustments to the treaties, Protocol 4 on cotton (OJ 1979 L 291, p. 174).

5 — Documents concerning the accession of the Kingdom of Spain and the Portuguese Republic to the European Communities, Act concerning the conditions of accession of the Kingdom of Spain and the Portuguese Republic and the adjustments to the Treaties, Protocol 14 on cotton (OJ 1985 L 302, p. 436).

essential procedural requirements due to lack or inadequacy of reasoning, (3) misuse of powers and (4) breach of fundamental principles — specifically, the principles of proportionality and legitimate expectations.

## Background

### *Initial Community support system for cotton*

4. Recognising the great importance that cotton production represented for the Greek economy, when Greece joined the European Community in 1980 Protocol No 4 established a Community support system for cotton.

5. According to paragraph 2 of Protocol No 4, the support system is intended 'particularly to support the production of cotton in regions of the Community where it is important for the agricultural economy, to permit the producers concerned to earn a fair income and to stabilise the market by structural improvements at the level of supply and marketing'.

6. Paragraph 3 of Protocol No 4 provides that such a system 'shall include the grant of an aid to production'.

7. Paragraph 11 of Protocol No 4, in its original version, both required the Council to review the operation of the support system for cotton and provided it with the *vires* to modify that system. On the basis of that paragraph, the Council modified the system on a number of occasions.

8. The sixth amendment to the system was effected in 2001 by Council Regulation (EC) No 1050/2001.[6] By then the Commission considered that the legislative arrangements concerning the Community cotton system had become 'exceptionally complex and, in order to simplify [the system], the provisions of the Protocol should be reduced to essentials and all other legislative measures should be brought together in a single Council Regulation'.[7] Regulation No 1050/2001 thus repealed, inter alia, paragraph 11 of Protocol No 4 and replaced it with a new enabling provision (now paragraph 6 of Protocol No 4), stating that 'the Council, acting by a qualified majority on a proposal from the Commission and

6 — Of 22 May 2001, adjusting, for the sixth time, the system of aid for cotton introduced by Protocol No 4 annexed to the Act of Accession of Greece (OJ 2001 L 148, p. 1).

7 — Proposal for a Council regulation adjusting, for the sixth time, the system of aid introduced by Protocol No 4 annexed to the Act of Accession of Greece, COM(1999) 492 final, at p. 2. That rationale was also reflected in recital 2 of the preamble to Council Regulation No 1050/2001.

after consulting the European Parliament, shall decide on the adjustments necessary to the system introduced pursuant to this Protocol and shall adopt the general rules necessary for implementing the provisions of this Protocol'.

*The 2001 support system*

9. On the same day and on the basis of the new paragraph 6 of Protocol No 4, Council Regulation (EC) No 1051/2001 [8] ('Regulation No 1051/2001') was adopted. That regulation put into place the support system for cotton that operated from 2001 until it was replaced by the contested system with effect from 1 January 2006. For convenience I shall refer to this support system as 'the 2001 support system'.

10. Under the 2001 support system, the aid to cotton production consisted entirely of 'coupled aid' — that is, aid linked to the actual production of unginned cotton of a (specified) standard quality. The aid was not, however, paid directly to cotton farmers. Rather, the central role in the support system was played by the ginning undertakings. The ginning undertakings were the direct recipients of the Community aid. [9]

11. Ginning undertakings apply the first industrial processing to harvested cotton by separating cotton fibres from the seedpods and seeds. Cotton farmers obtained a fixed amount of aid per tonne of unginned cotton sold to ginning undertakings, since the latter were required to pay a minimum price laid down in the regulation. Ginning undertakings in turn received a variable amount of aid per tonne, depending on the fluctuations in world market prices. When world prices were low, the price subsidy would increase, and vice-versa. In either event, however, ginning undertakings would be able to match world prices. The system thus insulated Community cotton producers from fluctuations in world market prices whilst enabling Community ginning undertakings to produce cotton fibres at competitive prices and still make a profit.

12. The 2001 support system therefore was intended to protect both cotton farmers and

8 — Of 22 May on production aid for cotton (OJ 2001 L 148, p. 3).

9 — Articles 10 to 12 of Regulation No 1051/2001.

ginning undertakings. That intention was reflected in recital 4 of Regulation No 1051/2001 which required the price support system to be such as 'to enable "operators" to run medium-term production *and processing* programmes'. [10]

*The 2003 CAP reforms*

13. The MacSharry reforms, agreed by the EU agriculture ministers at the meeting of the Council in Luxembourg on 26 June 2003, provided for a far-reaching general reform of the CAP. The guiding principle was to move from a policy of price and production support for specific crops to a policy of direct support for farmers' incomes.

14. Regulation No 1782/2003 duly implemented the CAP reform for a variety of agricultural products. As from October 2003 most aid to farmers under the CAP became 'decoupled': that is, farmers receive a single farm payment *not* linked to the production of defined crops. The rationale behind the change in policy is to grant farmers greater freedom to decide the most effective use for their agricultural land, while at the same time guaranteeing them a minimum income. [11] The reforms also sought to enhance competitiveness, strengthen market orientation, improve environmental respect, stabilise incomes and reflect a higher regard for the situation of producers in less favoured areas. [12]

15. By way of exception to that general principle, in the case of certain crops (of which cotton was one) decoupled aid was to be complemented by a certain amount of 'coupled aid' (i.e., aid linked to the actual production of that crop). The specific rules governing the Community support system for those crops, including cotton, were introduced as amendments to Regulation No 1782/2003 by the contested Regulation.

10 — Emphasis added.

11 — Recital 28 in preamble to Regulation No 1782/2003.

12 — See Communication to the Council and the European Parliament 'Accomplishing a sustainable agricultural model for Europe through the reformed CAP — the tobacco, olive oil, cotton and sugar sectors', COM(2003) 554 final, at p. 2.

*Regulation No 1782/2003, as amended by the contested Regulation*

Legislative history

16. In order to appreciate Spain's challenge properly, it is necessary briefly to trace the legislative history of the contested Regulation, adopted pursuant to Article 37(2) EC and paragraph 6 of Protocol No 4, which requires the consultation procedure to be followed.

17. The Commission's proposal [13] was intended to give effect to the CAP reforms in, inter alia, the cotton sector. Priority was therefore given 'to producer income and not to production support, through the transfer of a significant part of the current production-linked expenditure to the single payment mechanism established by the new horizontal [Regulation No 1782/2003]'. [14] However, the proposal took into account the potential impact of full de-coupling in the cotton sector, in particular the risk that cotton production would be abandoned. For that reason, the Commission proposed that part of the aid should continue to be coupled. [15]

18. The Commission calculated that the Community production-linked expenditure during the 2000-2002 reference period, to be divided between the single payment and the new production aid, amounted to EUR 695.8 million. [16] In order to ensure that economic conditions enabled activity in the cotton sector to continue and to make cotton attractive in relation to other competing arable crops, the Commission proposed that 40% of the budget should go towards the new (coupled) production aid per hectare. [17] The proposal also defined the maximum eligible area per Member State. That produced, for Spain, a direct production (coupled) aid of EUR 898 per eligible hectare. The balance of the budget, 60%, would go to the single payment scheme in line with Regulation No 1782/2003.

19. Finally, in order to compensate for any consequential restructuring that the reform might require, the Commission proposed that approximately EUR 103 million be

13 — Proposal for a Council Regulation amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers, COM(2003) 698 final.

14 — COM(2003) 698 final, p. 2.

15 — Ibid.

16 — For a detailed account of how the Commission calculated that figure, see COM(2003) 698 final, pp. 2 to 4.

17 — Idem, p. 3.

transferred towards sectoral restructuring in the context of rural development measures under the European Agricultural Guidance and Guarantee Fund ('EAGGF)'. [18]

20. In its legislative resolution on the Commission's proposal, the European Parliament suggested substantial amendments to the proposed split between coupled and decoupled aid. It proposed that 'each Member State [could] allocate up to 80%' of the national share of the aid that went directly to the producers as a crop specific payment, that is, as coupled aid. The remaining '20%' should be available for the single payment scheme. [19]

21. The opinion delivered by the European Economic and Social Committee ('EESC') was also highly critical of the Commission's proposal, both in general and as regards the proposed support system for cotton. It called for 'a series of specific analyses' to 'be carried out by sector and region on the possible effects of the various degrees of de-coupling of aid (market, territorial, employment, environmental effects, etc.) before any decisions are taken on changing the existing mechanisms' [20] and pointed out that the Commission proposal was not 'accompanied by an impact study as was the case for other sectors reviewed in June 2003 and the tobacco sector'. [21]

22. The Commission did not accept the proposed amendments. Nor did it carry out an impact study. The Council adjusted the percentages for the split between decoupled and coupled aid from 60%: 40% to 65%: 35%. It cut the overall rural development support for restructuring under the EAGGF from EUR 103 million to EUR 22 million and altered the eligible areas per Member State. [22] It then adopted the contested Regulation.

## The contested Regulation as adopted

23. The preamble to the contested Regulation initially echoes the overriding principle

18 — Idem, at p. 5. The EUR 103 million additional support should be used as provided for in Council Regulation (EC) No 1257/1999 of 17 May 1999 on support for rural development from the EAGGF and amending and repealing certain Regulations, OJ 1999 L 160, p. 80.

19 — European Parliament Legislative Resolution on the proposal for a Council Regulation amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers (OJ 2004 C 102 E, p. 601, at pp. 604 and 605).

20 — Opinion of the EESC on the 'proposal for a Council Regulation amending Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers' (OJ 2004 C 110, p. 116, at point 2.10).

21 — Idem, at point 5.8. For convenience, like the EESC, I will refer to these preliminary studies as 'impact studies'.

22 — In the case of Spain, the total eligible area was reduced from 85 000 to 70 000 hectares.

of the CAP reforms, namely that aid to cotton, olive oil, raw tobacco and hops should, like aid to other products, in principle be decoupled and transformed into a single payment to support farmers' incomes. [23]

24. However, the recitals go on to state, in respect of cotton, that since 'a complete integration in the single payment scheme of the current support scheme in the cotton sector would bring a significant risk of production disruption to the cotton producing regions of the Community[, a] part of the support should therefore continue to be linked to the cultivation of cotton through a crop specific payment per eligible hectare. Its amount should be calculated in such a way so as to ensure economic conditions which, in regions which lend themselves to that crop, enable activity in the cotton sector to continue and prevent cotton from being driven out by other crops.' [24]

25. The preamble states that, in order to achieve that goal, 65% of the national share of the aid that cotton farmers received indirectly under the previous support system would now be decoupled and be turned into a single farm payment, payable to any eligible farmer. [25] The remaining 35% would still be coupled, that is, linked to the farming of cotton, but calculated as a sum per hectare of eligible land. [26]

26. Article 1(20) of the contested Regulation introduced a new Chapter 10a, entitled 'Crop specific payment for cotton', within Title IV of Regulation No 1782/2003. Articles 110a to 110f in that Chapter lay down the main provisions concerning the new support system for cotton.

27. In addition to the amount of decoupled aid to which any eligible farmer is entitled under Title III of Regulation No 1782/2003, Article 110b thus lays down the conditions for payment of the support that is 'coupled aid', paid by reference to hectares of eligible land. Eligibility is based upon the land being 'agricultural land authorised by the Member State for cotton production, sown under

23 — Recitals 1 and 2 in the preamble.

24 — Recital 5.

25 — Recital 6. The eligibility criteria and the mechanism for the implementation of the single farm payment are governed by Title III of Regulation No 1782/2003.

26 — Recital 5. That percentage gave as a result the amount of aid per eligible hectare laid down in new Article 110c of Regulation No 1782/2003 as introduced by Article 1(20) of the contested Regulation.

authorised varieties and maintained at least until the boll opening [27] under normal growing conditions'.

28. Article 110c(1) fixes the total area eligible for aid for each of the producing Member States (for Spain, a total of 70 000 hectares). Article 110c(2) fixes the amount of aid payable per eligible hectare (in the case of Spain, EUR 1 039).

29. All payments are moreover to be made directly to cotton farmers. They are no longer paid via the intermediary of the ginning undertakings. [28]

30. Finally, Article 1(22) of the contested Regulation added a new Title IVb to Regulation No 1782/2003, under the heading 'Financial transfers'. That Title contains a new Article 143d pursuant to which 'as from budget year 2007, an amount of EUR 22 million' is made available per calendar year as additional Community support for measures in cotton producing regions in order to compensate for any restructuring that the new support system may entail in those regions. [29]

## Assessment

*The first ground: alleged infringement of Protocol No 4*

31. Spain claims that by setting boll opening, rather than harvest, as the qualifying point at which agricultural land sown to cotton becomes eligible for aid, the new Article 110b of Regulation No 1782/2003 breaches the requirements of paragraph 3 of Protocol No 4. In essence, Spain argues that both a literal and a systematic interpretation of Protocol No 4 lead to the conclusion that, for a support system to qualify as 'aid to cotton production' within the meaning of paragraph 3, the cotton must be harvested.

27 — Boll opening refers to the moment when the capsule (or boll) containing the cotton seeds opens and the cotton fibres that grow around the seeds, called lint, become apparent.

28 — New Articles 110a and 110f of Regulation No 1782/2003 as introduced by Article 1(20) of the contested Regulation.

29 — See recital 22 to the contested Regulation. This additional support should be used as provided for in Regulation No 1257/1999, cited in footnote 18 above.

32. Spain's arguments under this head may be summarised as follows. The key requirement of paragraph 3 of Protocol No 4 is that the Community system of support for cotton must include 'an aid to production'. 'Production' implicitly means that the cotton must not merely reach boll opening. It must also actually be harvested. Otherwise, cotton 'production' *strictu senso* does not take place.

33. That analysis is supported by the fact that the preamble to Protocol No 4 refers to the importance of cotton as a raw material. Only harvested cotton can be subject to industrial processing. Therefore, only harvested cotton can qualify as a raw material.

34. Furthermore, paragraph 1 of Protocol No 4[30] states that the Protocol 'concerns cotton, not carded or combed, falling within heading No 5201 00 of the combined nomenclature'. That only makes sense if the Protocol refers to harvested cotton.

35. Spain further argues that it constitutes a general principle of civil law common to various Member States[31] that natural fruits cannot be considered as 'products' until they are separated from the plant in which they grow: that is, until they are harvested. The same applies to cotton.

36. Finally, Spain adduces a linguistic argument based on the Spanish text of the contested Regulation. Recital 5 requires that 'a part of the support should therefore continue to be linked to the *cultivation* of cotton' (underlined in the original Spanish application); and chapter 10a of Title IV is entitled (in its Spanish version) 'specific aid to cultivation' (rather than to 'production') of cotton. Spain submits that production and cultivation are not synonyms. Whereas production may be assimilated to harvest, it can never be assimilated to cultivation. The contested Regulation therefore breaches Protocol No 4.

37. I do not share Spain's interpretation of Protocol No 4.

38. As the Council correctly points out, paragraph 3 of the current version of

30 — As amended by Commission Regulation (EEC) No 4006/87 of 23 December 1987 amending Protocol No 4 on cotton (OJ 1987 L 377, p. 49) in order to harmonise the descriptions of goods and tariff heading numbers which appear in Protocol No 4 with the combined goods nomenclature based on the Harmonised System introduced by Council Regulation (EEC) No 2658/87 (OJ 1987 L 256, p. 1), as amended by Regulation (EEC) No 3985/87 (OJ 1987 L 376, p. 1).

31 — Spain refers to the Spanish, Italian, Belgian and French civil codes.

Protocol No 4 merely states, without further qualification, that the system of support 'shall include the grant of an aid to production'. Protocol No 4 contains no express requirement from which one can deduce that the support system and the corresponding aid to production are dependent on the cotton actually being harvested. Furthermore, the new paragraph 6 of Protocol No 4 introduced by Regulation No 1050/2001 empowered the Council to decide on necessary adjustments and to adopt the *general* rules for implementing the provisions of the protocol. The Council was thus explicitly granted a wide margin of discretion as to how to organise the aid to 'production of cotton'. The only restriction upon the exercise of that power arising from Protocol No 4 is the obvious one: the rules adopted must be adequate to achieve the aims laid down in paragraph 2.

39. In the absence of any stipulation in Protocol No 4 to the effect that production of cotton means harvested cotton, I do not find Spain's restrictive interpretation of the concept of 'production' convincing. In economic terms, 'production' refers both to the final outcome of a production process, be it industrial, manufacturing or agricultural, and to the production process itself. [32] As Spain itself acknowledges, the process of production is composed of several interrelated stages. In my view, aid to production may consist of aid granted to support any of those stages including 'cultivation', even if the grant of that aid is not made dependent on obtaining a raw material for sale in the market.

40. Since the notion of aid to production in Protocol No 4 encompasses aid granted to support any of the stages of growing, and hence producing, cotton, the fact that for civil law purposes a 'fruit' does not reach legal existence until separated from its plant does not undermine that reasoning.

41. Nor do I accept that the reference in the preamble of Protocol No 4 to the 'importance of cotton as a raw material' necessarily implies that Protocol No 4 only concerns harvested cotton. The recital relied upon by Spain, quoted in full, reads, 'recognising that by reason of the importance of cotton as a raw material, the system of trade with third countries ought not to be affected'. Taken in context, the reference to the importance of cotton as a raw material seems to me to emphasise that, whatever support system is chosen, there must not be an (adverse) impact upon trade with third countries. I

32 — According to the *Shorter Oxford English Dictionary*, 'production' means both the 'action or an act of producing, making or causing something' and 'something which is produced by an action, process'. The same is true in Spanish. Pursuant to the *Diccionario de la Real Academia de la Lengua*, 'producción' means both 'acción de producir' and 'la cosa producida'.

cannot see how it can plausibly be taken to imply that only harvested cotton is covered by Protocol No 4. [33]

42. In the same vein, Spain's reliance on a strict textual interpretation of the reference to 'cotton, not carded or combed, falling within heading No 5201 00 of the Combined Nomenclature' in paragraph 1 of Protocol No 4 does not take its argument much further. That reference does not necessarily exclude cotton that has not been harvested from the scope of application of Protocol No 4. Combing and carding are the processes that are applied to harvested cotton in order to clean the impurities and smaller threads of the cotton fibres emerging from the seed. Cotton at the stage of boll opening is (by definition) 'not combed or carded'. It thus falls within the scope of paragraph 1.

43. It is worth stressing here that the contested system does not prevent farmers from harvesting. Rather, it leaves them the choice whether or not to do so. The underlying assumption is that it will make economic sense for them to harvest if the crop has reached the boll opening stage 'under normal growing' and good agricultural and environmental conditions. I will examine whether that simple assumption is acceptable when discussing the fourth ground of annulment.

44. Spain's argument relating to recital 5 of the contested Regulation can be disposed of briefly. If cultivation can be regarded as a stage of the production process, as I have accepted earlier, an aid to 'cultivation' may be equated to an aid to production.

45. The linguistic argument based upon the fact that in the Spanish version of the contested Regulation Chapter 10a is entitled 'specific aid to cultivation' is misconceived for a different reason. It is sufficient to note that the terminology of the Spanish text is contradicted by a number of other language versions. The same Chapter is, for example, variously entitled 'Crop specific payment for cotton' (English), 'Pagamento específico para o algodão' (Portuguese), 'Kulturspezifische Zahlung für Baumwolle' (German), 'Aide spécifique au cotton' (French) and 'Pagamento specifico per il cotone' (Italian). The Court has in the past given preference to the language versions forming the majority whenever the interpretation resulting there-

33 — Indeed, it seems to me that the 2001 system which operated through the ginning undertakings, in essence amounted to a price subsidy enabling EU-produced cotton to be competitive at world prices in the global market. That may well have had a significantly greater potential effect on trade with third countries than the new support system introduced by the contested Regulation.

from is more in line with the objectives sought by the regulation. [34] Such is the case here. Since in my view aid to cultivation qualifies as aid to production, the term 'cultivation' in the Spanish text does not show that the new scheme breaches Protocol No 4.

46. More fundamentally, it seems to me that the Community legislature intended it to be possible to implement the MacSharry reforms to the CAP within the structure of the existing Treaty provisions and protocols, including Protocol No 4. The whole thrust of those reforms, with their emphasis on the use of decoupled (rather than coupled) aid, militates against construing Protocol No 4 in such a restrictive way that *any* decoupling breaks the required link between the aid given and the 'production' of cotton. [35]

47. The first ground for annulment advanced by Spain is therefore unfounded.

34 — Case 55/87 *Moksel* [1988] ECR 3845, paragraph 16 et seq., and Case C-64/95 *Lubella* [1996] ECR I-5105, paragraph 18. For an analysis of the case-law on the interpretation of divergent linguistic versions, see Opinion of Advocate General Stix-Hackl in Case C-265/03 *Simutenkov* [2005] ECR I-2579.

35 — To be fair, Spain's argument at the hearing was not that *any* decoupling is unlawful. Rather, Spain argued that decoupled aid might be introduced provided that the system as a whole, and, in particular, the amount of coupled aid still provided, enabled cotton production to continue in those regions where it was important for local economies, something which Spain claimed the new support system failed to achieve.

*The second ground: infringement of essential procedural requirements (absence or inadequacy of reasoning)*

48. Spain contends that the Council has failed to state the reasons on which the contested Regulation is based. In particular, the Council has not adequately explained why the new system abandons indirect payment of aid to producers via the ginning undertakings in favour of direct payment of aid to producers. Nor has the Council justified the selection of the boll opening stage, rather than another stage in the production process, as the trigger point for determining when producers become eligible for coupled aid.

49. It is settled case-law that 'the extent of the requirement to state reasons depends on the nature of the measure in question and ... in the case of measures intended to have general application the preamble may be limited to indicating the general situation which led to its adoption, on the one hand, and the general objectives which it is intended to achieve, on the other'. [36] Moreover, 'if the contested measure clearly discloses the essential objective pursued by the

36 — Case C-284/94 *Spain* v *Council* [1998] ECR I-7309, paragraph 28; and Case 5/67 *Beus* [1968] ECR 83, at p. 95. More recently, see Case C-372/96 *Pontillo* [1998] ECR I-5091, paragraph 36.

institution, it would be excessive to require a specific statement of reasons for the various technical choices made'. [37]

50. The Court has also held that 'whether the statement of reasons meets the requirements of [Article 235] of the Treaty must be assessed with regard not only to its wording but also to its context and to all the legal rules governing the matter in question'. [38]

51. In my view, read in its context and by reference to all the legal rules governing the matter, the contested Regulation complies sufficiently with those conditions.

52. The extensive preamble to Regulation No 1782/2003 clearly explains the policy reasons for changing the overall system of support to farmers under the CAP. Recitals 24 and 28 state clearly and unequivocally that the aim of the modifications is to implement the shift from a production support system to a direct support system for farmers' incomes. That policy choice is intended to enhance the competitiveness of the European agricultural sector, and enhance food and environmental standards and market-oriented production. Those aims are to be seen in the light of the Community's medium to long-term policy of decreasing Community support to the agricultural sector. In the light of those objectives, the preamble also makes clear that the new system seeks to allow greater freedom to farmers when choosing their crops, while guaranteeing them a fair income.

53. As regards specific support for cotton production, recitals 4 to 6 of the preamble to the contested Regulation clearly and unequivocally explain why cotton production, together with certain other crops, is still to benefit from coupled aid as a complement to decoupled aid in the context of the CAP reform. [39]

54. It is true that the preamble to the contested Regulation does not give any detailed explanation as to why the ratio between coupled and decoupled aid is set at 35%: 65%. However, I do not consider that that amounts to a failure to state reasons.

55. The determination of the ratio between coupled and uncoupled aid is a technical choice, and the Community institutions are not required to give detailed reasons for the

37 — *Spain* v *Council*, cited above, paragraph 30 and the case-law cited therein.

38 — See, in particular, Case C-367/95 P *Sytraval* [1998] ECR I-1719, paragraph 63.

39 — See points 24 and 25 above.

technical choices that they make in order to achieve their stated objectives. Recitals 5 and 6 of the preamble to the contested Regulation show that, in the Council's view, the two levels of aid retained are appropriate to 'enable activity in the cotton sector to continue and prevent cotton from being driven out by other crops'. It may be that the Council's view turns out to be wrong. In that event, however, the error would not be an inadequacy in the statement of reasons, but an error of assessment to be examined in the present case under the proportionality principle. [40]

56. The position in respect of the reasoning behind the choice of the boll opening stage (rather than, e.g., harvesting) as the trigger for eligibility for aid is rather different. Nowhere does the contested Regulation offer an explanation for this choice. That is clearly unsatisfactory.

57. On balance, I doubt that that omission taken in isolation is sufficiently serious for the Court to strike down the contested Regulation for lack of reasoning, and hence infringement of an essential procedural requirement. That choice is, like the ratio between coupled and uncoupled aid, a technical choice. [41] It is not a wholly implausible choice as the trigger for the payment of coupled aid. The Community legislature is not bound to explain all technical choices in the preamble of a general act such as a regulation. On balance, it seems to me to be more pertinent to re-examine this issue in the context of whether the system put in place by the contested Regulation satisfies the proportionality principle.

58. The second ground for annulment advanced by Spain is therefore not made out.

*The third ground: alleged misuse of powers*

59. Spain claims that by adopting the contested Regulation on the basis of paragraph 6

40 — See, for instance, the distinction drawn by the Court in Case C-265/97 P *VBA* [2000] ECR I-2061, paragraphs 110 to 122.

41 — There is, indeed, an argument that requiring cotton to reach the boll opening stage to trigger eligibility for aid, but not necessarily requiring it to be harvested, may be more efficient in economic terms. If world prices for harvested and ginned cotton are too low to justify harvesting the cotton crop, it would be unreasonable to force cotton producers nevertheless to incur the (additional) harvesting costs in order to become eligible for Community aid. By choosing boll opening as the trigger point, agricultural land devoted to cotton is maintained in conditions apt for cotton production even in years when harvesting the cotton crop does not make economic sense.

of Protocol No 4 the Council has misused its powers. The Council's modification of the 2001 system was not limited to the introduction of mere adjustments, as provided for in paragraph 6. Rather, it amounted to a substantive reform of the system of production aid to cotton. In using paragraph 6 of Protocol No 4 to introduce such reform, the Council intended to avoid the procedures specifically provided for the amendment of primary rules of Community law, such as those contained in Protocol No 4.

60. The Court has consistently held that 'a decision may amount to a misuse of powers only if it appears, on the basis of objective, relevant and consistent factors, to have been taken with the exclusive purpose, or at any rate the main purpose, of achieving an end other than that stated or evading a procedure specifically prescribed by the Treaty for dealing with the circumstances of the case'. [42]

61. Those conditions are manifestly not met here.

62. First, paragraph 6 of Protocol No 4 provides for a specific procedure, involving a proposal from the Commission and an opinion from both the European Parliament and the EESC, for modifying the support system for cotton. The Commission and the Council followed that procedure to the letter for the purposes of adapting the support system for cotton to the principles inspiring the MacSharry reforms of the CAP. It is hard to see how that can be described as a misuse of powers.

63. Secondly, paragraph 6, and its predecessor paragraph 11, has been used by the Council in the past to make substantial modifications to Protocol No 4 itself. [43] Indeed, since the adoption of Regulations Nos 1050/2001 and 1051/2001, the system of indirect aid to cotton production via the ginning undertakings has been governed *not* by the provisions of Protocol No 4, but by Community regulations adopted on the basis of Protocol No 4. Strictly speaking, the contested Regulation does not modify Protocol No 4 at all. Rather, it modifies Regulation No 1782/2003 with respect to the cotton sector.

64. In those circumstances, reliance on paragraph 6 to modify the Community

42 — Case C-331/88 *FEDESA* [1990] ECR I-4023, paragraph 24, and case-law cited therein.

43 — See for instance, Council Regulation (EC) No 1553/95 of 29 June 1995 adjusting, for the fifth time, the system of aid for cotton introduced by Protocol No 4 annexed to the Act of Accession of Greece, (OJ 1995 L 148, p. 45), adopted on the basis of the earlier version of paragraph 11 of Protocol No 4; or Regulation No 1050/2001, which was adopted on the basis of paragraph 6; see point 8 above.

support system for cotton appeared the most obvious choice. Spain has adduced no evidence to show that, by doing so, the Council pursued purposes other than those stated in the contested Regulation.

65. There are therefore no 'objective, relevant and consistent factors' to conclude that the Council has deliberately used the procedure in paragraph 6 of Protocol No 4 for the exclusive or main purpose of achieving an end other than that stated or evading a procedure specifically provided for in the Treaty.

66. Consequently, the third ground for annulment is unfounded.

*The fourth ground: breach of fundamental principles*

67. For convenience, I deal first with the arguments relating to legitimate expectations, and then with Spain's case on proportionality.

Legitimate expectations

68. Spain argues that economic operators in the sector were justified in expecting to continue benefiting from a Community aid system that would not harm the continuance of the crop. The adoption of the contested provisions was, however, unpredictable and was not justified either from a socio-economic point of view or on the basis of the European Union's international commitments.

69. These contentions do not stand up to scrutiny.

70. First, the contested measures can scarcely be described as unforeseeable, as required by the case-law.[44] Reform of the CAP had been on the political agenda since 1992. In 2003, the Council finally agreed on the central principle of the MacSharry reforms, namely the shift from a support system based on production and prices to a system that supported farmers' incomes. Regulation No 1782/2003 was adopted to implement those principles and clearly reflects them. Moreover, at the Council's

44 — See Case 78/77 *Luhrs* [1978] ECR 169, paragraph 6; Case 265/85 *Van den Bergh en Jurgens* v *Commission* [1987] ECR 1155, paragraph 44.

request, the Commission issued a Communication in 2003 [45] in which it explained how it intended to modify the cotton support system in the light of the new principles inspiring the CAP. The new support system for cotton introduced by the contested Regulation was therefore far from unforeseeable or unpredictable.

71. Furthermore, the Commission's original proposal had envisaged that the 2001 support system would cease to apply after the 2004/05 campaign, and that the new support system would be in place with effect from 1 September 2005, but would apply to cotton sown in spring 2005. [46] In fact, the new support system was adopted in 2004 but only entered into force together with other CAP reforms in 2006. The Community legislator was entitled to consider this to be sufficient time for those economic operators affected by the change to adapt to the new system. In those circumstances, economic operators cannot avail themselves of arguments based on a breach of their legitimate expectation when a measure is then adopted. [47]

72. Secondly, the Court has consistently held that, 'whilst the protection of legitimate expectations is one of the fundamental principles of the Community, traders cannot have a legitimate expectation that an existing situation which is capable of being altered by the Community institutions in the exercise of their discretionary power will be maintained; this is particularly true in an area such as the common organisation of the markets whose purpose involves constant adjustments to meet changes in the economic situation'. [48]

73. The Council was expressly empowered to make adjustments to the support system for cotton (initially under paragraph 11, and subsequently under paragraph 6, of Protocol No 4) in the light of economic, social or policy developments. It had already exercised those powers on several occasions. Where the Community institutions enjoy such a margin of discretion in the choice of means, undertakings active in the cotton sector cannot therefore claim a vested right to the maintenance of the original situation or to the advantages which they derived from it and which they enjoyed at a given time. [49]

74. Spain's reliance upon the principle of legitimate expectations is therefore unfounded.

45 — See footnote 12 above.

46 — COM(2003) 698 final, at paragraph 2.5.

47 — See, inter alia, *Lührs*, cited in footnote 44 above, at paragraph 6; Case T-336/94 *Efisol* [1996] ECR II-1343, paragraph 31.

48 — See, inter alia, Joined Cases C-133/93, C-300/93 and C-362/93 *Crispoltoni* [1994] ECR I-4863, paragraph 56, and the case-law cited therein. In this context it is worthwhile noting that recital 22 of Regulation No 1782/2003 already pointed out that 'beneficiaries could not rely on support conditions remaining unchanged and should be prepared for a possible review of schemes in the light of market developments'.

49 — See, for instance, Case C-353/92 *Greece* v *Council* [1994] ECR I-3411, paragraph 45, and the case-law cited therein.

Breach of the principle of proportionality

75. Community institutions enjoy a large margin of appreciation as to the appropriate means to achieve the objectives pursued by a Community measure, particularly where management of agricultural markets is concerned. [50] Equally clearly, there must be limits to the institutions' margin of appreciation if judicial control over legislation in the agricultural sector is to be retained.

76. Thus, the Court has also stated that 'the principle of proportionality ... requires that measures adopted by Community institutions do not exceed the limits of what is appropriate and necessary in order to attain the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued'. [51]

77. The Court's case-law clearly establishes that, in such cases, judicial review must be limited to examining whether the measures are 'manifestly inappropriate' to the aims pursued, and not whether the chosen means are the only means or the means best suited to achieve those aims. [52] Where the Community institutions have committed a manifest error of assessment, the resulting measure will be manifestly inappropriate and therefore contrary to the principle of proportionality. [53] Indeed, by its nature such an error invalidates the chain of reasoning that leads to the chosen measure; and vitiates the Community institutions' exercise of their discretion. As a matter of logic, that case-law cannot be interpreted as exempting Community institutions from carrying out *any* examination of the adequacy of the contested measures to the set objectives.

78. The principle of proportionality sometimes requires national authorities 'to examine carefully the possibility of using measures less restrictive of freedom of movement, and discount them only if their inadequacy, in relation to the objective pursued, was clearly established'. [54]

79. I do not think that that strict obligation can automatically be transposed to the assessment of Community measures, and

50 — Case C-189/01 *Jippes* [2001] ECR I-5689, paragraph 80, and the case-law cited therein.

51 — Idem, at paragraph 81, and the case-law cited therein.

52 — Idem, at paragraphs 82 and 83, and the case-law cited therein.

53 — Case C-84/94 *United Kingdom* v *Council* [1996] ECR I-5755, paragraphs 50 to 67, in particular at paragraph 58.

54 — Case C-320/03 *Commission* v *Austria* [2005] ECR I-9871, paragraph 87. The case concerned a national measure promoting environmental protection at the expense of the free movement of goods.

that, in consequence, the same degree of diligence may be required from both national and Community authorities when adopting legislative measures. The fact that a less rigorous proportionality standard is applied with respect to Community measures may be subject to criticism. However, it is (at least in part) justified by the fact that whereas Community measures are adopted through the Community decision-making process and seek the general interest of the Community, national measures generally pursue national interests that may conflict with those of the Community. [55]

80. Nevertheless, I read the principle of proportionality as imposing an obligation on Community institutions at least to satisfy themselves that the proposed measures are prima facie adequate to attain the legitimate aims pursued by the legislation, and to be aware of how onerous those proposed measures are likely to be. Otherwise, the Court cannot review whether the Community institutions have 'exceeded what is appropriate and necessary in order to attain the objectives legitimately pursued', and whether (when, as here, there was a choice between several appropriate measures) 'the least onerous' option has been chosen such that 'the disadvantages caused' are not 'disproportionate to the aims pursued'. The Community institutions must, in any event, be in a position to justify their legislative choices if these are challenged before the Court under the proportionality principle.

81. Against that background, I consider that Spain's argument relating to breach of the principle of proportionality is partly founded in two respects.

— Absence of an impact study

82. It is common ground that the Commission did not carry out any preliminary study to examine the likely socio-economic impact of its proposal for a new support system for cotton. It was not in terms obliged to do so by any specific provision of Community law. Nevertheless, as Spain argued before the Court without being contradicted, equivalent impact studies had duly been carried out before reforms to other agricultural sectors were proposed. [56]

55 — This view was defended by Advocate General Jacobs in the first *Journal of Environmental Law* lecture delivered at the University College London on 24 November 2005. The text of his lecture is to be published shortly in that journal.

56 — See also the statements of the EESC, at point 21 above.

83. At the hearing, the Commission expressed the view that, because the support system for cotton is simple when compared with other common market organisations (i.e., a simple mechanism links internal support price and external world market price), an impact study was unnecessary. To my mind, that is an over-simplification which is not borne out by the facts. The rural economy is an inter-dependent whole, and primary processing of agricultural products, where the characteristics of the product necessarily require this to be carried out locally, is an important component in local employment and income generation. The Community legislator had, indeed, earlier recognised the connexity that exists between cotton production and the first stage of cotton processing (ginning) by creating a support system that explicitly supported both cotton farmers and ginning enterprises.

84. At the hearing, the Council similarly maintained that it was under no obligation to consider the impact of the reforms upon ginning enterprises. I am sure that, in general terms, the Council is correct to say that Article 37 EC and measures taken thereunder are concerned with agriculture, not industry.

85. However, in the present case, there are particular features. Pursuant to Article 32, agricultural products are defined for the purposes of the CAP as 'products of the soil, of stockfarming and of fisheries and products of first-stage processing directly related to these products'. The 'first stage processing' concept was broadly defined by the Court in *König* as 'implying a clear economic interdependence between basic products and products resulting from a productive process, irrespective of the number of operations involved therein'. [57]

86. Ginning is the first process in transforming raw cotton into a product that can be marketed for further processing and/or incorporation into other products such as textiles. As such, it is not obvious that ginned cotton cannot qualify as an agricultural product for the purposes of the CAP. Furthermore, the 2001 support system had expressly supported both cotton farmers and ginning undertakings. [58]

87. Be that as it may, the Court was told — without this being contradicted by the Council or the Commission — that cotton has to be ginned close to its place of production and cannot be transported long distances. It is therefore clear that, within an agricultural community heavily dependent

57 — Case 185/73 [1974] ECR 607, paragraph 13.

58 — See points 10 to 12.

on the production of cotton, local cotton-related employment will comprise both farm labour and workers employed within the ginning undertakings.

88. In contrast, the new support system, by granting aid directly to farmers and not requiring the cotton to be sold to the ginning undertakings in order to be eligible for aid, may render the local ginning industry economically non-viable. The disappearance of local ginning capacity could, in turn, lead to a reduction of cotton production in the areas affected. In those circumstances, whilst I agree that the fate of the ginning undertakings should not have occupied centre stage when designing the new support system, I am not satisfied that it could lawfully be left out of the equation altogether without casting some doubt on the proportionality of the measures put in place.

89. The failure to carry out an impact study leads to a number of obvious questions. Was there any basis (other than simple arithmetic) for deciding upon a 65%: 35% split between decoupled and coupled aid, and considering that the two components would operate correctly so as to maintain the necessary economic conditions to ensure the survival of cotton production in the affected regions? Why and how were the Commission and the Council satisfied that, if the global level of support remained the same but the structure of the aid and the method of payment were radically altered, there would not be side effects whose possible impact would need to be evaluated, because they might be excessively onerous?

90. Both the European Parliament [59] and the EESC [60] had drawn attention to aspects of the proposed scheme that, in their view, were likely to lead to significant negative effects upon, e.g. regional rural employment. They had suggested substantial changes. The European Parliament had, for example, suggested that the split between decoupled and coupled aid should be 20%: 80%. [61] Under the consultation procedure by which the contested Regulation was adopted, the Commission and the Council were under no legal obligation to respond formally or publicly to the criticisms the European Parliament and the EESC had made. Nevertheless, given that those objections went to the heart of the proposed new support scheme, one might have expected that the Commission would then proceed to examine more carefully the likely socio-economic impact of its proposal (perhaps, by carrying out an impact study at that stage), and/or that the recitals to the contested Regulation as adopted would give a more detailed explanation of why the Council deemed the new scheme to be the appropriate legislative choice. None of that happened.

59 — See point 20 above.
60 — See point 21 above.
61 — See point 20 above.

91. The absence of a specific impact study, undertaken at the moment when radical changes were about to be proposed, does not of course mean that the Commission (and through it the Council) were necessarily insufficiently informed about the likely impact of the proposed changes to be able to put in place a new scheme that satisfied the proportionality test, and that they had to go through the formality of carrying out a specific impact study at that point. From the material before the Court and the oral submissions at the hearing, that was not the case here.

92. Moreover, it was clear from the Commission's and the Council's submissions at the hearing that the institutions' main concern when adopting the contested Regulation was to ensure that the new system respected the principle of budgetary neutrality. Both the Commission and the Council appear to have assumed that, because they perceived the Community support system for the cotton sector to be simple, the aims of Protocol No 4 and the contested Regulation would automatically be achieved if they merely ensured that the total amount of Community aid devoted to the cotton sector remained the same under the new system as it had been under the old.

93. Spain has cast serious doubt on that assumption. Crucially, it has shown that the institutions paid no regard to the possibility that budget-neutral changes might nevertheless, through the new structure and mechanisms for paying aid, have effects within the regional rural economy that ran counter to achieving the stated objectives of Protocol No 4 and the contested Regulation.

94. In the absence of any impact study, certain choices made by the Commission and the Council appear arbitrary. In the course of these proceedings, those institutions have not been able to justify them convincingly. Two aspects are particularly noteworthy: the failure to take into account the impact of the new scheme on the locally-based downstream processing industry in the cotton sector (i.e., the ginning industry), and the setting of the specific split between coupled and decoupled aid.

95. In reaching that conclusion, I should make it clear that I am *not* necessarily accepting at face value the two studies submitted by Spain to the Court. It is not the Court's function to effect an economic adjudication between Spain's position and that of the Council and Commission. It is clear that there are sharp divergences between the two assessments. The place and time for those differences to be examined was *before* a radically different new support scheme was put in place, not after-

wards. A comparative table showing the relative profitability of wheat, maize and cotton at particular levels of world prices, such as that annexed by the Commission to its intervention, is — with respect — no substitute for such an examination.

96. I am therefore not satisfied that the Council and Commission had sufficiently considered the likely impact of the proposed new scheme on cotton farmers and the associated rural communities to formulate a scheme whose parameters were not tainted with arbitrariness, and/or whose effects were not potentially disproportionate. In the absence of an impact study, it is hard to see how the Council and the Commission could conclude that the new support system constitutes the most appropriate measure to 'ensure economic conditions which, in regions which lend themselves to that crop, enable activity in the cotton sector to continue and prevent cotton from being driven out by other crops' as required by the contested Regulation.

— Failure to include direct labour costs in the calculations

97. The Council starts from the premiss that the total amount of both coupled and decoupled aid needs to be considered when examining whether farmers will decide to grow cotton or switch to other crops. That approach is, in my view, incorrect. As Spain rightly contends, since farmers are entitled to receive *decoupled* aid regardless of whether they grow cotton or not, they will only grow cotton if the amount of *coupled* aid together with the revenues from the sale at market prices makes it economically worthwhile to do so given the costs of production.

98. Relying on the data supplied by the Commission, the Council argues that the costs per hectare of growing cotton are inferior to the coupled aid per hectare made available, together with the revenue from sales, even after harvesting costs. The Council submits that the production costs of cotton amount to EUR 1 045 per hectare. The Council concludes that it will always make economic sense for Spanish farmers to grow and harvest their cotton crop under the new support system, since coupled aid under the contested Regulation is set at EUR 1 039 per hectare, to which the revenues of the sale of the cotton — estimated at approximately EUR 744 per hectare — need to be added.

99. However, the Council (following the Commission) does not include fixed labour

costs [62] in calculating the costs of growing and harvesting cotton. At the hearing the Commission suggested that there were methodological difficulties in including fixed labour costs. Spain strongly objects to that approach, claiming, without being contradicted, that labour costs not taken into consideration by the Council amount to approximately EUR 630 per hectare. Once these costs are taken into account, the gross margin farmers obtain for growing and selling their cotton production is reduced to a point where it may no longer be economically attractive for them to grow cotton.

100. Without entering in the detailed analysis of the figures supplied by all parties, it seems to me that, if cotton is indeed a labour-intensive crop (as Spain claims, without being contradicted by the Council), total labour costs, i.e. both seasonal and fixed costs, must necessarily constitute an important element of overall costs. Labour costs must therefore affect farmers' decisions whether or not to grow and harvest cotton.

101. In the course of the proceedings, neither the Council nor the Commission have produced evidence contradicting Spain's estimates for labour costs. Nor have they shown that fixed labour costs are a negligible part of total labour costs in cotton production and that, in consequence, they can reasonably be disregarded. It follows that, in not taking into account those labour costs and their possible effect on farmers' decisions whether to grow cotton or to switch to other crops, the Council has committed a manifest error of assessment when adopting the contested Regulation. It has thus breached the principle of proportionality.

— Conclusion on proportionality

102. The stated aims of the contested Regulation are to ensure continuation of the economic conditions that will enable cotton production to survive in the areas concerned and prevent it being driven out by competing crops. [63] By introducing the new support system without carrying out a previous examination of the likely impact of the modification in the cotton sector as a whole (and in particular without having considered the effects that the new system might have on the ginning industry and, as a consequence, on the production of cotton,

62 — As opposed to seasonal labour costs which are included

63 — See point 24 above.

and without justifying the chosen 65%: 35% split between decoupled and coupled aid), the Council has made choices whose arbitrariness violates the principle of proportionality. By not taking fixed labour costs into account in its calculations to determine the level of coupled aid, the Council has committed a manifest error of assessment. On both these grounds the Council has thus failed to show that the new support system comprises 'appropriate and necessary' measures to attain the objectives pursued. The contested Regulation fails to respect the principle of proportionality in these respects. Spain's action is accordingly well founded.

104. Clearly that has serious implications. The new regime entered into force in January 2006. Farmers are likely to have adapted their production strategies on the assumption that the conditions under the new support system would apply. Affected Member States may have already taken measures to give effect to the new support system. The Council and Commission will also need a non-negligible amount of time in order to put in place a replacement support system.

— Scope of the annulment

103. Spain correctly argues that the annulment of Article 110b would render all the other provisions governing the new cotton support system otiose. It therefore seems to me that, as Spain has requested, the Court would also have to annul, in consequence, Chapter 10a of Title IV of Regulation No 1782/2003 ('Crop specific payment for cotton'). In effect, that amounts to annulling the new support system for cotton.

105. Should the Court decide to annul those parts of the contested Regulation, it therefore appears convenient for reasons of legal certainty and in order to avoid a legal lacuna that would have obvious negative consequences for both public and private interests at stake for the Court to exercise its powers under Article 231(2) EC, and to rule that the effects of the annuled provisions are to be maintained pending the adoption and entry into force, within a reasonable period of time, of a new Community measure to give effect to its judgment. [64]

64 — See a series of cases starting with Case 81/72 *Commission* v *Council* [1973] ECR 575 and ending with Case C-178/03 *Commission* v *Parliament and Council* [2006] ECR I-107, paragraphs 61 to 65.

## Conclusion

106. I accordingly suggest that the Court should:

— annul Chapter 10a of Title IV of Regulation No 1782/2003 as introduced by Regulation No 864/2004 as contrary to the principle of proportionality;

— maintain the effects of Chapter 10a of Title IV of Regulation No 1782/2003 as introduced by Regulation No 864/2004 until the adoption, within a reasonable period and in accordance with the principle of proportionality, of new provisions replacing it;

— order the Council to bear both its own and Spain's costs;

— order the Commission to bear its own costs.