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## Information and Notices

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## I

*(Information)*

## COURT OF AUDITORS

## SPECIAL REPORT No 1/94

concerning

follow up to the Court's Special Report No 2/92 and continuation of the Court's audit of major beneficiaries of export refunds accompanied by the replies of the Commission

*(94/C 75/01)**(Observations pursuant to Article 188c (4) 2nd alinea of the EC Treaty)*

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## 0. INTRODUCTION

0.1. Special Report No 2/92 <sup>(1)</sup> on the audit of export refunds paid to selected major traders in the milk products sector was based on audits carried out in the period from January 1990 to March 1991. The preliminary audit findings had been communicated to the Member States concerned between June 1990 and April 1991.

0.2. The Special Report (Para 3.2) outlined 14 audit findings and said: 'The Court will keep these cases under review and will present further observations to the discharge authority if it is not satisfied with the measures adopted by the Commission and the Member States.' Chapter 1 deals with the follow-up of this Special Report by the Commission and the Member States.

0.3. In its reply to chapter 1 of this report the Commission has called for additional information from the Court in spite of the fact that the Court has already provided all the

relevant information at its disposal. Furthermore, in the event of receiving specific enquiries from the Commission, the Court is always prepared to give any possible assistance. The Commission should obviously also seek its information at the level of the Member States where it should be most complete. Indeed, the Court is surprised that a call for further information should be made at this stage— three years after the relevant matters were brought to the attention of the Commission.

0.4. The Commission's estimate (reply to para. 3.1) of a 65.22 % rate of recovery is based upon the limited amount which the Commission so far provisionally accepts as recoverable i.e. 610 189 ECU and bears little relation to the total export refunds involved, which are of the order of five million ECU. That such large sums of Community budgetary resources should remain in contention for so long underlines the Court's conclusions in paragraphs 1.27, 3.1, 3.2, 3.3 and 3.4 of this report.

0.5. Chapter 2 reports on the work carried out by the Court in continuation of its investigation of selected recipients of export refunds as promised in paragraph 4.8 of the Special Report. It also describes cases which have come to the Court's notice during audits of the role of the Commission and the Member States in the implementation

<sup>(1)</sup> Special Report No 2/92, OJ C 101 of 22.4.1992.

of Council Regulation (EEC) No 4045/89 <sup>(1)</sup> concerning the scrutiny by Member States of EAGGF transactions <sup>(2)</sup>.

0.6. The Court is surprised to note that the Commission's only reply to Chapter 2, which describes problems which have come to light since the earlier report, is a general request for information. See 0.3 above.

## 1. FOLLOW UP OF SPECIAL REPORT No 2/92

### *Follow-up of specific audit findings*

1.1. The information herein is presented in the same order as the findings in Special Report No 2/92 and is cross referenced to the relevant paragraphs of that report in the headings below.

#### Misdescription of a cheese as Provolone — 3.1 (a)

1.2. The Court's audit finding in Ireland that this cheese was described as Provolone on export refund claims, thereby obtaining a higher rate of refund than actually due, was based on three elements:

- (a) the cheese was not marketed under the commercial description of Provolone;
- (b) according to the producer's quality control tests there was a significant incidence of failure to meet the export refund criteria for Provolone in respect of water content(W/C) and
- (c) there was a significant incidence of failure to meet the minimum requirement for fat content in dry matter(FCDM).

According to the Court's estimate the total of export refunds unduly paid was  $\pm 500\ 000$  ECU.

<sup>(1)</sup> Council Regulation (EEC) No 4045/89 of 21st December 1989 (OJ L 388 of 30.12.1989).

<sup>(2)</sup> Special Report No 7/93 on the Controls of Irregularities and Frauds in the Agricultural Area.

1.3. In respect of the export refund classification based upon commercial description (1.2 (a) above), the Commission has not communicated its position to the Court. However, in respect of failure to meet the W/C and FCDM criteria, following a request from the Commission, Ireland has repaid IRL£ 58 828,87 ( $\pm 68\ 000$  ECU).

#### Edam misdescribed as Steppenkäse — 3.1 (b)

1.4. This case involved the description of Edam as Steppenkäse in order to use a prefixation certificate specifying Steppenkäse. The Member State, Germany, has refused to recover the refunds paid but, as the two cheeses are identical, the Commission does not propose to pursue the matter. The Special Report said the 'possible overclaim' was  $\pm 105\ 000$  ECU but, in the light of evidence received subsequent to publication, the Court now calculates the amount involved as  $\pm 60\ 000$  ECU. The Court has requested the Commission to pursue a definitive single classification for this cheese.

#### Cheese misdescribed as Gouda — 3.1 (c)

1.5. This case concerned a consignment of cheese for processing sold to a third country customer. Such cheese attracts no export refund. However, it was declared as Gouda on exportation thereby obtaining  $\pm 30\ 000$  ECU in refunds.

1.6. In its reply to the Court of 31st July 1991, the Member State concerned, Germany, indicated agreement with the Court's findings but in its reply to the Commission on 19th October 1992, Germany contested the Court's position. The Commission, on 4th November 1992, asked Germany to recover the sum unduly paid and to initiate a special investigation to establish the extent of similar misdeclarations. The Court has not yet been notified of the result.

#### Buttermilk powder (BMP) misdescribed as Semi-fat milk powder (SFMP) — 3.1 (d)

1.7. There is no dispute concerning the fact that BMP was misdescribed as SFMP thus involving the irregular payment of refunds amounting to  $\pm 1,15$  Mio ECU.

1.8. In regard to an amount of 190 000 ECU, the Commission requested one of the Member States concerned, Ireland, to recover the refunds unduly paid. Accordingly, Ireland issued a recovery order for 190 000 ECU against the export refund claimant. However, he failed to repay. Legal proceedings have, therefore, been initiated against him.

1.9. In respect of some 1.0 Mio ECU of export refunds, a second Member State, the Netherlands, requested the Commission to find a solution which would not have adverse financial consequences for the parties involved. By letter of 11th August 1992, the Commission replied that it was unable to provide such a solution firstly, because of doubts over the good faith of the parties when they made the export declarations and secondly, because of the risk of unequal treatment of exporters. However, in its last communication to the Court, on 9th June 1993, the Commission argued that the equivalent rate should have been applied to both products. The Court believes that during the period in question different rates applied.

1.10. Since the publication of Special Report No 2/92, the Court has identified other export refund claimants who have misdeclared BMP as SFMP. In the Netherlands a further seven undertakings with possible overclaims of more than 1,3 Mio ECU in one year, were identified. In a third Member State, France, the Court audited another firm with possible overclaims in one year totalling more than 340 000 ECU. The facts in these cases have been communicated both to the Member States concerned and to the Commission. The French authorities have replied to the Court on 30th June 1993, to the effect that they are awaiting the Commission's decision before considering recovery action. The Court urges the Commission to take all necessary steps to bring this matter to a satisfactory conclusion.

#### Skimmed milk powder (SMP) wrongly declared as not containing added whey — 3.1 (e)

1.11. A food aid consignment produced by an undertaking in France, was the subject of an export refund claim by an undertaking in Germany. The SMP was delivered for export in 14 lorries but only one was examined by the customs authorities and a sample taken for analysis. This sample revealed 'the presence of added undeclared whey' which does not qualify for export refunds. However, the results of the analysis were not extrapolated to the

complete consignment nor was the Commission informed so that the export refunds and the food aid payments could be adjusted.

1.12. The Court's audit uncovered evidence that the SMP was produced at one dairy over a period of 10 days and that the dairy had even accepted the financial consequences in respect of the refunds lost as a result of the addition of undeclared whey. However, France, Germany and the Commission consider that the elements of genuine proof at hand do not permit the extrapolation of the analysis results to the loads in the thirteen lorries not examined. The Court does not share this view. Special Report No 2/92 estimated the total of overpayments involved was  $\pm 500\,000$  ECU.

#### Cheddar cheese failing to meet minimum fat content in dry matter (FCDM) requirements — 3.1 (f)

1.13. The Commission has requested and the Member State, Ireland, has agreed to the recovery of refunds unduly paid in this case. The Court has not been advised by the Commission of the amounts involved but the Court's estimate was 40 000 ECU.

#### Maximum water content for Cheddar cheese — 3.1 (g)

1.14. As neither the Common Customs Tariff nor the Export Refund Nomenclature gives a specific maximum water content for Cheddar cheese Member States interpret the rules differently. The Court requested the Commission to ensure that all Member States interpreted the rules in the same way. The Commission is examining the matter in a wider context. The Court has requested the Commission to keep it informed.

#### Failure to meet minimum fat content (F/C) requirements for whole milk powder (WMP) — 3.1 (h)

1.15. The Member State, Ireland, concerned does not agree with the Court's findings. In December 1992 the Commission informed the Court that it was continuing its enquiries but the Court is not yet aware of the outcome of the follow-up action.

**Cheese unfit for human consumption on arrival in Poland — 3.1 (i) (i)**

1.16. The Member State concerned, Germany, has recovered some 330 000 ECU of the 450 000 ECU identified as recoverable by the Court. The balance of 120 000 ECU related to cheese suspected of having unacceptable high nitrate levels.

**Cheese returned from USA because of non compliance with health standards and reexported from the EC with the benefit of refunds 3.1 (i) (ii)**

1.17. The authorities in the Member State in which the cheese was produced and from which the cheese was originally exported, Ireland, tested samples of the returned cheese and confirmed the results of the tests carried out by the US Customs services. The related export refunds were reimbursed. However, the authorities in the Netherlands and Denmark where refunds were claimed again on reexportation of the cheese in question have argued to the Commission that the results of the US Customs tests are not binding on them. Further, one of these Member States, the Netherlands, was still investigating in November 1992 whether or not the returned cheese was reexported although as early as July 1990 it had been furnished with the Court's evidence of this. The authorities in the fourth Member State, the United Kingdom (UK) involved were still investigating the case in June 1993. The Commission is awaiting the outcome of these investigations before taking a position. The amount of possible refunds involved was estimated at  $\pm$  150 000 ECU.

**Butter to Egypt unfit for human consumption — 3.1 (i) (iii)**

1.18. 1 700 cases of butter, were according to the insurance survey report, 'completely and severely damaged' in transit. Some of the damaged goods were destroyed and the remainder, not being fit for human consumption, was sold for industrial use. Copies of the survey report were passed to the Member States concerned, Ireland and the Netherlands, in June and July 1990 by the Court. Although the shipping company confirmed the damage and the insurance company paid compensation, the Member State in which the export refunds were paid, the Netherlands, wrote to the Court on 16 April 1993 to the effect that there was no conclusive proof that there had been a shortfall in the delivery of the butter in a state fit for human consumption. The refunds involved total some 90 000 ECU.

1.19. This case was one of many where the Court established, from an examination of insurance claims and credit notes, that goods either were not placed on the market in a non member country in accordance with Article 5 of Commission Regulation (EEC) No 3665/87 <sup>(1)</sup>, for example because of short shipment, or were found to be unfit for human consumption contrary to the refund requirement in Article 13 of the same Regulation. The Court has requested the Member States concerned, Ireland and Germany, to establish the full extent of such cases.

1.20. Ireland has quantified the amounts involved for one undertaking, covered by its own paying agency and by those in Germany, the Netherlands and the UK, at 436 000 ECU but recoveries only amount to 12 189 ECU. The Netherlands has refused to recover in any of the cases identified. Germany is in discussion with the Commission to clarify the legal position. The Commission has not commented on the UK position in its reply to the Court.

1.21. The Commission in its first follow up report adopted the position that the full refund should be recovered in cases where the refund was differentiated by destination but in its second report it adopted a different approach. In that report it indicated that it had commenced an in depth study of the general principle, taking account of the economic objectives of export refunds and the risks to the exporters. In fact, both of the undertakings concerned in the above cases had insurance cover based on a value inclusive of export refunds.

**Cheese declared as taken into customs control before the production date — 3.1 (j)**

1.22. The Court's findings were not contested but the Member State involved, Ireland, has satisfied itself that there was a genuine misunderstanding and no intent to defraud and that the full quantity of declared cheese was exported. The Commission proposes no further action as no financial advantage accrued to the trader.

<sup>(1)</sup> Commission Regulation (EEC) No 3665/87 of 27 November 1987 (OJ L 351 of 14.12.87).

**Plastic wrapping included in the weight for refund purposes — 3.1 (k)**

1.23. The Member State, Germany, in its reply of 31st July 1991 to the post audit letter, agreed with the audit findings. In a later communication to the Commission, the German authorities argued that the wrapping was to be considered as part of the net weight in accordance with the Commission's interpretive note. As the wrapping was a heavy duty plastic bag and not a film adhering to the surface of the cheese the Commission has requested the recovery of the 40 000 ECU involved.

**Irregular use of a prefixation certificate issued in the framework of a third country call for tender 3.1 (l)**

1.24. The facts as presented by the Court have not been disputed. However, the Member State in which the prefixation certificate was issued, France, has rejected any responsibility concerning the export in question. The Member State in which the payment was made, Germany, maintains, by letter of 12 October 1992, that the Court's findings in other Member States, which their authorities cannot verify, is not adequate justification for seeking recovery of refunds from their exporters. The Commission at first asked Germany to recover the  $\pm$  2 Mio ECU unduly paid stating that 'the certificate states expressly and without possible misinterpretation the sole conditions on which it can be used'. Subsequently, it changed its position basing its new stance on two elements: firstly, that the export refund claimants who had used this certificate in good faith, faced the problem of reimbursing the refunds some four or five years after the event, and, secondly, that the case illustrates the difficulties in launching recovery action when the undertakings involved are in different Member States. By letter to Germany of 20 August 1993 the Commission withdrew its request for recovery of the sums involved.

1.25. These cannot be considered as valid reasons for non-recovery. Moreover, the export refund claimants, when making their refund claims, declared that the consignments in question were delivered within the framework of the call for tender quoted on the prefixation certificate. This they also presented to the national authorities at the time of export in the full knowledge that they did not have a contract within the framework of that call for tender.

1.26. The Court, during another audit, has uncovered a further instance involving France and the UK, of the irregular use of a certificate issued to the same undertaking. The refunds involved amount to 238 000 ECU. This was brought to the attention of the Commission on 21st October 1992.

### *Conclusion*

1.27. The observations in Special Report No 2/92, based on the audit of two undertakings, were all communicated to the Member States concerned in June and July 1990 in respect of the first undertaking and in April 1991 in respect of the second. The Commission was informed on 16th October 1991. It is a matter of serious concern that so many findings brought to the notice of the Commission and the Member States up to three years ago remain unresolved. According to the information available to the Court no more than 7 % of the amount which the Court considers as recoverable following Special Report No 2/92, has been recovered.

## **2. CONTINUATION OF THE COURT'S AUDIT OF MAJOR BENEFICIARIES OF EXPORT REFUNDS**

### *General*

2.1. In Special Report No 2/92 the Court indicated its intention to continue its investigation of selected recipients of export refunds. Since the completion of the audits which gave rise to that report, the Court has continued the audit of beneficiaries and has also audited the role of the Commission and Member States in the implementation of Regulation (EEC) No 4045/89 concerning the scrutiny by Member States of EAGGF transactions. The findings on the continuing audit of beneficiaries are described in the following paragraphs.

### *Classification*

#### **Maximum water content**

2.2. During 1990/91, a Regulation (EEC) No 4045/89 scrutiny was carried out by the French authorities at a company manufacturing certain brand name cheeses. The

scrutiny report examined by the Court referred to a Customs laboratory analysis on one of the cheeses. The cheese, declared at export as St. Paulin, was classified by the Customs laboratory under the ERN heading appropriate to non denominated 'other cheeses' on the basis that it did not comply with the definition of St. Paulin as laid down in French law.

2.3. Although there is no difference in the refund rates between the heading for 'other cheeses' and that for St. Paulin, there is a considerable difference in the maximum permissible water content calculated by weight on the non-fatty matter. St. Paulin cannot benefit from export refunds if the W/C exceeds 72 %, whereas the limit for non denominated cheeses is much stricter being 62 %.

2.4. The French Customs authority has chosen to ignore the findings of the Customs laboratory by arguing that the laboratory findings were based on a French legal text without any reference to EC law.

2.5. The French authorities have maintained this argument in a reply to the Court's query. The position is similar in respect of the other brand name cheeses involved in the audit by the Court of the implementation of Regulation (EEC) No 4045/89. The value of refunds involved in the EAGGF year 1991 is  $\pm$  1,1 Mio ECU.

#### Milk mixture misclassified

2.6. The use of a prefixation certificate is restricted to products conforming to the combined nomenclature (CN) description and ERN code defined therein.

2.7. During the period from June to September 1990, an export refund claimant in the Netherlands declared a milk product containing 71.5 % whole milk powder (WMP), 9 % lactose, 18.5 % whey powder and 1 % sugar for export to the former DDR under a heading within ERN code 0402 which is proper to full cream milk or partially or fully skimmed milk. The product should, however, be classified under code 0404 being a mixture of natural milk constituents.

2.8. Export refunds were paid on the milk product in question on the basis of a prefixation certificate for code 0402 products. The refunds involved amounted to 260 000 ECU. As the prefixation certificate was not valid for 0404 products the export took place, in fact, without any prefixation certificate cover. Moreover, during the period in question no refunds were payable, in any event, on exports to the former DDR without a valid prefixation certificate. The refunds paid should accordingly be recovered.

#### Unsatisfactory follow up of Customs laboratory reports by Member State Authorities

2.9. Examination by the Court of Regulation (EEC) No 4045/89 scrutiny reports in Denmark revealed instances of Customs laboratory tests on Feta and Mozzarella cheeses which had not been satisfactorily followed up. The tests had shown that these cheeses had exceeded the maximum water content expressed as a percentage of the fat free matter (WCFFM) requirement to qualify for export refunds. The refunds on the consignments in question were recovered, but no attempt was made to verify whether or not the problem was restricted to these consignments.

2.10. The Court's audit at one of the producers of the cheeses in question, revealed more instances of WCFFM failures and also failures in minimum levels of fat content in dry matter. The evidence was available from the producers' own quality control laboratory analyses and from independent tests which had been carried out. It also became apparent that this problem was not confined to that producer. On 23rd March 1993 the Court requested Denmark to quantify the refunds overpaid and suggested that the recovery of the relevant amount be undertaken. To date this information has not been received.

#### Ash content (impurities) of flour

2.11. Flour declared as having an ash content not exceeding 600mg/100g was found on analysis by the German Customs laboratory to have an ash content exceeding that maximum and consequently should have attracted a lower rate of refund. At the time of the Court's audit, not only had there been no attempt to ascertain the full extent of failures of this kind, but there had been no

adjustment of the refunds overpaid on the then known failures. At the Court's request, Germany has since quantified the refunds involved at some 410 000 ECU and the necessary adjustment to the refunds is being carried out.

#### Grated cheese declared as non grated

2.12. The rate of refund for Pecorino cheese when grated and exported to the USA was approximately 40 % of the rate of refund for the non-grated variety. Examination by the Court of the US import entries showed that in certain cases parts of consignments of the cheese declared for export refund purposes in Italy as being not grated, were declared on the US import entry as grated. The rate of US import duty for grated cheese was 15 % as opposed to 9 % for whole cheeses. It was not, therefore, in the importer's interest to declare whole cheeses as grated. Export controls in Italy had not revealed the discrepancies.

2.13. The Court informed the Italian authorities. Legal proceedings followed for alleged fraudulent misdeclaration of the grated cheese as non grated. The total export refunds involved were in excess of 1 Mio ECU. The Judge dismissed the case on the grounds inter alia that although the US import code could not apply to whole cheeses it could apply to both grated cheese and cheese in segments. He concluded that even if 100 000 ECU of export refunds were wrongly claimed where the US import code was accompanied by the text 'grated cheese', the amount involved would not be sufficient to qualify as aggravating circumstances and therefore would not be excluded from amnesty under national law.

#### *Sound and fair marketable quality*

#### Non marketable processed cheese

2.14. A Regulation (EEC) No 4045/89 scrutiny in France revealed a case of 76 tonnes of processed cheese, on which

some 126 000 ECU had been paid in export refunds, which was found to be faulty on arrival in Saudi Arabia. After a quality control enquiry by the producer, it was established that the fault was attributable to the manufacturing process. The product was withdrawn from the market and destroyed. However, the French authorities decided not to recover the refunds and in response to the Court's query, justified their decision by stating that at the point of export there was no indication that the product was not of sound and fair marketable quality.

#### Whole Milk Powder (WMP) unfit for human consumption

2.15. An audit by the Court revealed a case involving the export from the UK of 85 tonnes of WMP which was destroyed by the Public Health authorities in the third country on the grounds that it was unfit for human consumption. An enquiry by the exporter revealed that the cans have been inadequately sealed during the manufacturing process. However, the UK authorities say that they have been unable to find any evidence that at the date of export the products were not of sound and fair marketable quality. The refunds involved total some 120 000 ECU.

2.16. Similar cases involving export refund claims by the same company in Germany, Denmark, France, the Netherlands and the UK are to be found in Special Report No 7/93. In each case the Member State involved has refused to recover the refunds, giving similar justifications.

#### Cheese unfit for human consumption

2.17. The following case was found by the Court during the audit of another undertaking. Several consignments of Mozzarella cheese, manufactured between August and October 1991, were rejected by the buyer in Japan because of an excessive nitrate level and contamination by foreign matter. The cheese in question was returned to Denmark and replaced without further claim to refunds. The returned cheese was then, however, exported to Jordan with the benefit of refunds. There the Ministry of Health found the cheese to be unfit for human consumption both in respect of germ and chemical tests. The cheese was again returned to Denmark and placed in a Customs warehouse without repayment of refunds where it was found at the

time of the Court's audit in 1993. Further tests carried out by the Danish authorities at the Court's request confirmed that the cheese was unfit for human consumption. As a result of the Court's findings refunds of 37 000 ECU have been recovered.

### *Placing of goods on third country market*

#### False evidence of arrival and other irregularities

2.18. Customs authorities in Ireland were alerted to information that two containers of a butter spread destined for Cyprus with the benefit of export refunds were in fact awaiting clearance into Greece. The subsequent investigation by Customs into these and other consignments revealed that:

- (a) false evidence of arrival had been lodged in respect of three containers of the spread destined for Lebanon when in fact one containerload had been destroyed and the other two loads were still in their containers in the port of Haifa, Israel, more than 12 months after export;
- (b) the total quantity exported exceeded underlying purchases by some 26 tonnes;
- (c) the product concerned was a downgraded one, being shop returns or having exceeded the producer's recommended date of retail sale, and
- (d) there was evidence of payment by the customer for only one container load.

2.19. Furthermore, the economics of the operations allowed a reasonable return to the trader, without any payment from the customer, with costs ranging between 500 and 600 ECU per tonne and export refunds being for the most part around 800 to 900 ECU per tonne.

2.20. The Irish authorities decided to recover the refunds in respect of the quantities involved in paragraphs 2.18 (a) and (b) above and to request more information on one consignment where there were doubts as to quality. No action was proposed for the remaining consignments even though there was no evidence that the goods had been

placed on the market in a third country. When the Court queried the latter decision Ireland replied that disallowance was not sustainable having regard to:

- (a) the fact that entitlement to export refunds is not dependent on the vendor receiving payment for the product;
- (b) the feasibility of the company's statement that they did not make a charge for the product on the grounds that they were attempting to open up markets for future operations.

#### Butter not placed on 3rd country market

2.21. On 15 August 1990, a consignment of 2 000 tonnes of butter was shipped from the Netherlands to the former DDR with the benefit of 4 Mio ECU of export refunds. On 17 August 1990, the consignment was cleared through customs in Wismar, in the former DDR, but the butter was then immediately transferred to five coldstores in West Germany. The Dutch investigation authorities were alerted to the affair by their German counterparts and an investigation ensued in both countries which confirmed that the butter was in the coldstores in West Germany.

2.22. On 23 July 1992, the paying agency in the Netherlands having received reports from their fraud investigation service, and having contacted the Commission, commenced action to recover the export refunds in respect of 1 100 tonnes being that part of the consignment for which the guarantee had not been released. The exporter appealed to the Dutch Commercial Tribunal. At the time of the Court's audit, action had not been initiated by the Dutch authorities in respect of the two claims for the balance of 900 tonnes for which the guarantees had been released.

2.23. The Court, concerned by the lack of recovery action on these two claims, began enquiries to ascertain the final disposal of the butter in question which, according to the German reports at the close of their investigation, was still in the coldstores in West Germany. The Court's enquiries revealed that:

- (a) 343 tonnes had been sold directly to retail outlets in West Germany;

- (b) 162 tonnes had been sold to a trader in France;
- (c) 1 197 tonnes had been sold to German traders or processors;
- (d) 100 tonnes had been sold to a German trader who had resold the consignment to the Russian forces in Germany, and had been paid export refunds of 213 000 ECU on the transaction, the butter thereby benefitting a second time from export refunds and
- (e) 199 tonnes had been sold to a German butter factory. The German butter factory also claimed export refunds on exports of butteroil.

2.24. At the time of writing this report, none of the refunds of  $\pm 4$  Mio ECU have been recovered. However, litigation is continuing in respect of the 1 100 tonnes ( $\pm 2.2$  Mio ECU) referred to paragraph 2.22 above.

### *Origin*

#### **Importation of cheese from Switzerland**

2.25. In late 1992, the Court obtained information involving Emmental, imported into a Member State from Switzerland at a falsely overinvoiced price in order to meet the GATT minimum price and benefit from the reduced rate of import levy of 9.07 ECU per 100 kgs instead of the appropriate rate of 172,1 ECU per 100 kgs. The same cheese was re-exported, after removal of all traces of Swiss origin, with the benefit of export refunds of 159 ECU per 100 kgs.

2.26. The Court's examination of the trade statistics confirmed an unusual increase in importations of Emmental from Switzerland, the total quantity involved in the period in question being in excess of 2 000 tonnes. Examination of import documentation confirmed the identity of an importer allegedly involved and aroused suspicions concerning other importers. The details of the suspect transactions have been communicated directly by the Court to the investigation authorities in the importing Member State for appropriate action.

2.27. Their enquiries confirmed false declaration of value in order to evade import levies. The invoice value of the goods was later reduced by a promotional discount which was not declared to Customs.

2.28. Enquiries into the possible re-export of the cheese with refunds, which involves other Member States, are continuing as is the investigation into the possibility of similar practices in two other Member states. For this reason the names of the Member States involved are not divulged in this report.

#### **Obligations of Member States**

2.29. While most of the Member States have cooperated with the Court in its export refund audits, the Court has been unable to pursue its enquiries in France in a manner similar to audits conducted in other Member States. Until recently France has maintained that national law inhibited it from giving the Court on magnetic tape the registration numbers and names of beneficiaries of export refunds. France still maintains that in the absence of a specific provision in Council Regulation (EEC) No 4045/89, it could not be required to provide copies of reports of scrutinies carried out under that Regulation. Problems have also arisen in relation to the exercise by the Court of its right to audit beneficiaries of export refunds in France.

2.30. As explained in Special Report No 2/92, the non-fulfilment by France of its obligations to facilitate the Court's audits jeopardised the satisfactory performance of audits not only in France but in other Member States, given the transnational character of the export refund arrangements.

2.31. Without prejudice to the Court's view that national legislation may not restrict the Court's right to audit and report upon all revenue and expenditure of the Community, the Court has continued its consultations with the French authorities in the hope of overcoming their objections. While some progress has been made practical working solutions to all difficulties have yet to be agreed upon. In order that the Court may have similar audit access in all Member States, the Court hopes that the French authorities will remove any remaining obstacles to the work of the Court where records relating to Community revenue and expenditure are kept in France.

### 3. CONCLUSION

3.1. Action on the part of both the Commission and the Member States to recover EAGGF monies irregularly paid out lacks the rigour and urgency required to recover such funds with the minimum of delay. To overcome the apparent lethargy of national authorities to recover and the reluctance of beneficiaries of irregular receipts to repay, steps should be taken to subject all debts to penal interest rates from the time of irregular payment until ultimate recovery by the Community, as provided for in the case of superlevies under Commission Regulation (EEC) No 536/93 of 9th March 1993 <sup>(1)</sup>.

3.2. Member States tend to adopt a minimal approach in the supervision of EAGGF expenditure. They frequently fail to sufficiently extend or deepen their examinations even when irregularities are discovered in situations which

would indicate a wider occurrence of such irregularities than in the specific case under examination. When an irregularity or fraud is found or suspected, the national authorities should undertake a wide search in analogous activities with a view to detecting any other irregular or fraudulent incidents.

3.3. Member States are reluctant to question the validity of export refund payments already made when post export evidence establishes that the products concerned could not have been at the time of export fit for human consumption or were not placed on the market in a third country. Such evidence clearly proves that the goods failed to qualify for export refunds and any decision that they did, was erroneous. Therefore, export refunds should be recovered.

3.4. The Court is of the opinion that the Commission should expedite the review of the regulatory provisions concerning the water content of cheeses with a view to achieving a harmonised application by the Member States of the related rules.

<sup>(1)</sup> Commission Regulation (EEC) No 536/93 of 9th March 1993 (OJ L 57 of 10.3.1993).

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 27 January 1994.

*For the Court of Auditors*

André J. MIDDELHOEK  
*President*

## COMMISSION REPLY

### 1. FOLLOW-UP TO SPECIAL REPORT No 2/92

#### Misdescription of a cheese as Provolone

##### 1.2 and 1.3.

- (i) As regards the classification of products, in 1993 the Commission took a number of steps to produce a simplified product nomenclature.

On 22 June 1993 a draft regulation was put to the vote. There were 54 votes against and it was therefore rejected.

On 6 September 1993, as the Member States were clearly reluctant to pursue this course, the Commission judged it better to halt this work and to adopt a different approach.

It accordingly tabled for discussion a new products nomenclature for the milk sector, together with implementing rules. Discussions began on 11 November between national experts and Commission staff. At the centre of the work is the question of the objective classification criteria and related controls. The Commission's plan is to try and see the regulation adopted in 1994.

- (ii) As regards the failure to meet the quality criteria, undue payments have been recovered, IRL 58 828,87 was transferred to the EAGGF on 29 September 1993.

It should be pointed out that the figure of ECU 500 000 given by the Court is an overall estimate with no detailed breakdown for each separate observation. It is therefore impossible to compare the Member State's figure with that of the Court.

#### Edam misdescribed as Steppenkäse

1.4. The Commission notes that the amount of the 'possible overclaim' has been reduced by 43%. As regards the 'classification aspects', see the reply to paragraph 1.3.

#### Cheese misdescribed as Gouda

1.5 and 1.6. EAGGF letter 27972 was sent to Germany on 20 August 1993 confirming the view that sums should be recovered. This was also the Commission's position at a bilateral meeting on 16 December 1993. Germany has been requested to make known its definitive position on the matter.

#### Buttermilk powder misdescribed as semi-fat milk powder

1.7 to 1.10. The Commission is trying to find a fair solution. As stated in follow-up No 2 sent to Mr Ryan on 9 June 1993, this is essentially a problem deriving from the introduction of the new refunds nomenclature which caused a certain amount of confusion to begin with, until Regulation (EEC) No 2659/90 was adopted.

#### Skimmed milk powder wrongly declared as not containing added whey

1.11 and 1.12. Extrapolation of the results of the analysis of a single batch to the entire consignment is not as obvious as the Court seems to imply. There were 14 separate import entries, only one of which was controlled. There is therefore no proof that the products in the other lorries did not satisfy the requirements.

The Commission would none the less ask the Court to let it have all the information in its possession.

#### Cheddar cheese failing to meet minimum fat content in dry matter requirements

1.13. The amount of the repayments is being calculated.

**Maximum water content for Cheddar cheese**

1.14. Reference should be made to the reply to paragraph 1.3. The maximum water content will be specified in the new rules.

**Failure to meet minimum fat content requirements for whole milk powder**

1.15. By letter 27154 of 9 August 1993 the Commission repeated that it cannot accept Ireland's arguments and maintains its view that amounts should be repaid.

**Cheese unfit for human consumption on arrival in Poland**

1.16. The EAGGF initially obtained from the Court proof that the cheese, which had an excessively high nitrate content, was not intended by the Polish authorities for human consumption. However, in annex to its letter of 10 December 1993, Germany has supplied a document produced by its Health Inspection Service confirming that the cheese had been admitted for human consumption and thus cancelling the earlier decisions. In view of this evidence no recovery operation can be undertaken.

**Cheese returned from USA because of non-compliance with health standards and reexported from the EC with the benefit of refunds**

1.17. The four Member States concerned refute the analyses carried out by the US authorities, the results of which were based on factors other than purely scientific ones. The Commission notes that the cheese returned from the United States was exchanged for other consignments of the same product before it had been marketed in the Community. The cheese refused by the United States, and subsequently exported to Canada, Finland, the United Arab Emirates and Sweden, was sold at normal prices and did not give rise to any commercial disputes or comments by the importing countries. The Commission can therefore see no reason for not accepting the opinion of the four Member States concerned.

**Butter to Egypt unfit for human consumption**

1.18. By letter 26740 of 3 August 1993 the Member State was informed of the Commission's opinion that the amount involved should be recovered. A reminder was sent on 18 November 1993.

1.19 to 1.21. As the Court was told when its staff visited the EAGGF departments on 12 October 1993, this whole issue of missing or defective quantities goes to the very heart of the question of the right to refunds which is at present under discussion. The situation has since been explained to the Member States concerned. A new Article 5 (Regulation 3665/87) is also to be drafted in order to make matters clearer.

**Cheese declared as taken into customs control before the customs date**

1.22. Correct.

**Plastic wrapping included in the weight for refund purposes**

1.23. By letter 27972 of 20 August 1993 the Commission confirmed that the amount involved should be recovered. This was restated at the bilateral talks on 16 December.

**Irregular use of a prefixation certificate issued in the framework of a third country call for tender**

1.24. The case reported by the Court of Auditors highlights the risks involved in such operations both for exporters and for the EAGGF. Even though the certificate fixing the refund was issued by the competent French service in accordance with the rules, it is difficult to imagine that the request for this certificate complied with the spirit of the rules. As the certificate (and extracts) was transferred to other operators who, in good faith, used it for exports to Algeria, these operators now face the possibility of claims for the repayment of refunds they received four or five years ago.

This case raises the following problems:

- the recovery operation is directed solely at the operators who received the refunds even though they were not responsible for what happened,

- the danger of the Community subsequently refusing to finance operations is transferred to a Member State which was not in a position to check in what circumstances an export licence was issued (in another Member State),
- the complexity of the case, which has political aspects linked to the relations between companies of a given nationality and Algeria, makes it impossible to foresee the outcome of what will be very lengthy court proceedings,
- it is difficult for the Community rules to cover all conceivable types of cases without becoming unwieldy through their complexity, in which case they would remain a dead letter and no form of control would be possible. Such rules must remain general in scope.

For Commission departments this is a textbook case illustrating the inadequacies of the present situation for undertaking recovery measures where a number of operators from different countries are involved.

These departments are now conducting a detailed analysis of the situation to find a coherent and fair solution: pending the findings, the terms on which advance fixing certificates are issued following an open invitation to tender by a non-member country have been clarified by the amendment of Article 44 of Regulation (EEC) No 3719/88 (Annex I). The arrangement now is that certificates will not be issued unless the applicant has produced a contract concluded after such an invitation to tender. In addition the collaboration of Member States' departments must be developed and become standard practice. The light shed on this specific case is a first step in that direction.

1.27. As already stated in the EAGGF Director's reply to the Court of 28 October 1993, it should be pointed out that:

- recovery is a matter for the Member States alone and not until all the available means have been exhausted can the Commission assess the position [Article 8 of Regulation (EEC) No 729/70],
- individual cases have been taken up with the Member States and the Commission departments have made known their views,
- while giving figures for the amounts involved in the cases reported, the Court has been unable to provide sufficient details, even when the EAGGF visited the Court, to allow a proper quantification,

- in its conclusions the Court ignores the steps taken to improve the existing rules.

These steps were on the following points:

- redefinition of the milk products refund nomenclature,
- redefinition of the conditions for the issue and use of advance fixing certificates following an open invitation to tender by a non-member country,
- consideration of the adoption of reference analysis methods,
- consideration of the redrafting of the conditions of entitlement to refunds.

## 2. FOLLOW UP TO THE COURT'S AUDIT OF MAJOR BENEFICIARIES OF EXPORT REFUNDS

The Court reports on new cases which will be given the Commission's careful attention. The Commission would, however, ask the Court to provide it with all the evidence relating to the cases it mentions so that the inquiries can be followed up in all aspects, including financial.

## 3. CONCLUSIONS

3.1. As the Court will be able to see, the Commission has always been at pains to recover undisputed sums obtained by irregular procedures. The Commission has no powers to recover amounts which are challenged, Article 8 of Regulation (EEC) No 729/70 referring explicitly to measures taken by Member States in accordance with their national provisions laid down by law, regulation or administrative action. The present situation as regards amounts recovered or which might be recovered is set out in Annex II. The Commission's rate of recovery to date is 65,22%.

3.4. The Commission would refer to its reply to paragraphs 1.2 and 1.3.

## ANNEX I

## 3. Article 44(6) is replaced by the following:

'6. Applications for certificates shall not be accepted where, during the period of issue to which applications for certificates for certain products are subject, a special measure has been taken which prevents the issue of certificates.

No special measure taken subsequent to the expiry of the said period may prevent the issue of a certificate where the applicant has fulfilled the conditions referred to in the third subparagraph.

Where the applicant has:

- (a) provided, by means of the appropriate documents, the information referred to in the first subparagraph of paragraph 3;
- (b) furnished proof of his having been awarded a contract;
- (c) submitted the contract, or;
- (d) where absence of the contract is justified, submitted all documentation proving the obligations entered into with the other contracting party/parties, including confirmation from his bank of the opening of an irrevocable letter of credit by the purchaser's financial institution relating to the agreed delivery;
- (e) lodged the total amount of the security required for the issue of the certificate.

One or more certificates shall be issued in respect of the invitation to tender in question.

The certificate or certificates shall be issued only for the country referred to in the first indent of the first subparagraph of paragraph 3. The invitation to tender shall be mentioned thereon.

The total quantity for which the certificates or certificates are issued shall be the total quantity for which the applicant was awarded the contract and has submitted the contract or documentation referred to at (d): such quantity may not exceed the quantity applied for.

Moreover, where several certificates are applied for, the quantity for which the certificate or certificates are issued may not exceed the quantity initially applied for in respect of each certificate.

For the purposes of determining the period of validity of the certificate, Article 21(1) shall apply.

No certificate may be issued in respect of a quantity for which the applicant has not been awarded a contract or has not complied with the conditions stipulated at (a), (b), (c) and (e) or (a), (b), (d) and (e).

The holder of the certificate or certificate(s) shall be principally liable for the repayment of any refund wrongly paid where it is established that the certificate or certificates was or were issued on the basis of a contract or one of the obligations provided for in (d) which does not correspond to the invitation to tender issued by the non-member country.'

*Article 2*

This Regulation shall enter into force on the day of its publication in the *Official Journal of the European Communities*.

The provisions of Article 33(5)(a) of Regulation (EEC) No 3719/88 shall also apply to dossiers still outstanding at the time of the entry into force of this Regulation.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels.

*For the Commission*  
R. STEICHEN  
*Member of the Commission*

## ANNEX II

## Amounts recovered at 21 december 1993

(ECU)

	Court estimate	Commission estimate	Amounts already recovered
Provolone – classification	432 000	—	
– quality – water content	} 68 000 (*)	68 000	68 000
– ECDM			
Steppenkäse – Edam	60 000	—	
Cheese misdescribed as Gouda	30 000	30 000 (**)	
Buttermilk powder	1 150 000	(***)	
Milk powder with added whey	500 000	—	
Cheddar – FCDM	40 000	40 000 (**)	
Cheddar – water content	—	—	
Milk powder – fat content	?	(***)	
Cheese exported to Poland	450 000	330 000	330 000
Cheese returned from US	150 000	—	
Butter exported to Egypt	90 000	90 000 (**)	
Insurance credit notes	?	12 189 + ? (***)	
Refund granted on packaging	40 000	40 000 (**)	
Certificate 'third country call for tender'	2 238 000	(***)	
<b>Total</b>	<b>5 248 000</b>	<b>610 189 (****)</b>	<b>398 000</b>

(\*) For Provolone the Court gives an overall figure of ECU 500 000. It is assumed that the amount relating specifically to quality shortcomings corresponds to the amount repaid by the Member State.

(\*\*) To be recovered.

(\*\*\*) Under examination.

(\*\*\*\*) Provisional figure.

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