

I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 4/98

on importation at reduced rate of levy into the Community and disposal of New Zealand milk products and Swiss cheese accompanied by the Commission's replies

(submitted pursuant to Article 188c (4) (2) of the EC Treaty)

(98/C 127/01)

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1. INTRODUCTION

General

1.1. This report deals with the importation and disposal of dairy products from New Zealand (NZ) imported in the period 1990 to 1996 at the reduced rates of levy ⁽¹⁾ authorised by Commission Regulation (EC) No 1600/95 ⁽²⁾ and preceding legislation. The objectives of the audit were to examine whether or not the conditions of eligibility for the reduced rates of levy prescribed by the abovementioned legislation and the rules relating to disposal contained in Council Regulation (EC) No 3290/94 ⁽³⁾ have been respected. The report also contains a chapter on imports of Swiss Emmental at reduced rates of levy covered by similar legislation.

Annual quotas and financial impact

1.2. Both the full rates of levy and the rates of export refund are much higher than the reduced rates of levy

applicable to the imports in question. If the conditions of eligibility for the reduced levy are not met then the full levy is due. If the products are re-exported the rate of refund is restricted to the levy collected at import, the normal refund rate being much higher. There are therefore significant amounts at risk if the import or disposal conditions are not respected. For example in 1996 the reduced rate of levy for butter was ECU 868,8 per tonne whereas the full rate of levy was ECU 2 784 per tonne ⁽⁴⁾ and the full export refund rate for equivalent Community butter was ECU 1 561 per tonne. On the annual quota quantity for that year of 76 667 tonnes the difference between the full and reduced rate of levy amounts to some ECU 146,8 million and between the reduced levy and export refunds the difference is ECU 53 million. Tables 1 to 3 summarise the annual volumes and values. The subjects were selected for audit because, as described above, the amounts involved were significant.

⁽¹⁾ The term 'levy' was replaced by 'duty' under Regulation (EC) No 1600/95 but the term 'levy' is used throughout this report.

⁽²⁾ OJ L 151, 1.7.1995, p.12.

⁽³⁾ OJ L 349, 31.12.1994, p.105.

⁽⁴⁾ From 1 July 1995 to 30 June 1996; from 1 July 1996 to 31 December 1996, the rate was ECU 2 607/tonne.

TABLE 1

NZ butter quota quantities, levy and refund rates, risk amounts

Calendar year unless otherwise stated	Quota quantity (tonnes)	Reduced levy (ECU per tonne)	Full levy (ECU per tonne)	Risk amount (ECU million)	Export refund (ECU per tonne for Community butter)	Risk amount (ECU million)
(a)	(b)	(c)	(d)	(b) × ((d)-(c))	(e)	(b) × ((e)-(c))
1990	61 340	440,2	2 715,5	139,5	1 658,5	74,7
1991	58 170	428,5	2 535,2	122,5	1 580,5	67,0
1992	55 000	428,5	2 378,9	107,2	1 639,0	66,5
1993	51 830	342,8	2 317,1	102,3	1 639,0	67,1
1994	51 830	342,8	2 280,0	100,4	1 561,0	63,1
1995 (to 30.6)	25 915	342,8	2 257,4	49,6	1 561,0	31,5
1995/96	76 667	868,8	2 784,0	146,8	1 561,0	53,0

TABLE 2

NZ Cheddar for direct consumption

Year	Quota quantity (tonnes)	Reduced levy (ECU per tonne)	Full levy (ECU per tonne)	Risk amount (ECU million)	Export refund (ECU per tonne applicable to Community origin Cheddar only)	Risk amount (ECU million)
(a)	(b)	(c)	(d)	(b) × ((d)-(c))	(e)	(b) × ((e)-(c))
1990	6 500	150,0	2 138,6	12,9	1 516,8	8,9
1991	6 500	150,0	2 255,9	13,7	1 516,8	8,9
1992	6 500	150,0	2 211,7	13,4	1 516,8	8,9
1993	6 500	150,0	2 244,4	13,6	1 369,0	7,9
1994	6 500	150,0	2 141,5	12,9	1 300,6	7,5
1995	6 500	181,1	2 537,8	15,3	1 374,8	7,8

TABLE 3

Swiss Emmenthal, Gruyère and Sbrinz

Year	Quantity imported (tonnes)	Reduced levy (ECU per tonne)	Full levy (ECU per tonne)	Risk amount (ECU million)	Export refund per tonne applicable to cheese of Community origin only	Risk amount (ECU million)
(a)	(b)	(c)	(d)	(b) × ((d)-(c))	(e)	(b) × ((e)-(c))
1990	28 365	90,7	1 905,6	51,5	1 593,4	42,6
1991	33 411	90,7	1 818,7	57,7	1 593,4	50,2
1992	38 720	90,7	1 721,0	63,1	1 593,4	58,1
1993	35 570	90,7	1 654,0	55,6	1 438,0	47,9
1994	32 009	90,7	1 432,3	42,9	1 366,1	40,8
1995	32 111	96,6	1 954,2	59,6	1 444,1	43,2

Origin of the New Zealand quota and reduced levy rates for butter

1.3. Prior to the accession of the United Kingdom (UK) to the EEC in 1973, the traditional market for New Zealand (NZ) butter had been the UK. To allow NZ to maintain access to this market and to diversify its economy, Protocol 18 to the Act of Accession of Denmark, Ireland and the United Kingdom introduced, initially for a five-year period, quotas for the import of butter and cheese from New Zealand. The imports under these quotas were subject to the application of special levies. Under Protocol 18, these levies were set at a level such as to allow the quantities of butter and cheese to be effectively marketed without prejudicing the marketing of Community butter and cheese. However, when compared with the rates applicable on imports of butter and cheese of non-Community origin, the special levies applicable to New Zealand butter and cheese were set at levels which were lower, in effect being reduced rates of levy. They are hereinafter referred to in this report as reduced rates of levy.

1.4. From 1978 to 30 June 1995 imports of NZ butter continued under Protocol 18. From 1 July 1995 the tariff quotas for milk and dairy products were provided for under the Agreement on Agriculture concluded during the Uruguay Round multilateral trade negotiations held under the auspices of the General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO). The tariff quota for NZ butter, which was part of this Agreement, was incorporated into Commission Regulation (EC) No 1600/95 and the quantities eligible for quota import were increased from 51 830 tonnes to 76 667 tonnes per annum. Butter exported by NZ to the Community still accounts for some 32 % of all NZ butter production.

Commercial background

1.5. For the most part butter is imported under the NZ quota by subsidiary companies of the New Zealand Dairy Board (NZDB) in the Community who purchase the butter from NZDB. NZDB is wholly owned by the dairy farmers of New Zealand.

Imports of New Zealand whole Cheddar cheese

1.6. In addition to NZ butter, the Protocol 18 arrangements and subsequently GATT/WTO Agreements also established quotas for the import of NZ whole Cheddar cheese. Protocol 18 authorised the quotas and reduced rates of levy from 1973 to 1977. In 1978 and 1979 there was no quota for New Zealand. From 1980 to 30 June 1995 imports were covered by the GATT tariff quota as detailed in Council Decision 80/271/EEC⁽⁵⁾ and succeeding legislation. From 1 July

1995 the quota was included in Annex I to Regulation (EC) No 1600/95. The annual quota for the import of NZ whole Cheddar cheese was at the level of 6 500 tonnes up to 31 December 1995 when it was increased to 7 000 tonnes by Commission Regulation (EC) No 694/96⁽⁶⁾, following GATT Article XXIV.6 negotiations consequent on the accession of Austria, Finland and Sweden.

1.7. The Community also imports NZ Cheddar and other cheeses for processing at a reduced rate of levy of ECU 17,06 per 100 kg instead of the full rate of ECU 253,78 per 100 kg. The quota authorised under Annex I to Regulation (EC) No 1600/95 specifically for New Zealand cheese was 3 000 tonnes per annum up to 31 December 1995 when it was increased to 4 000 tonnes by Regulation (EC) No 694/96.

2. ADMINISTRATIVE AND CONTROL PROCEDURES

Conditions for eligibility for the New Zealand quota for butter

2.1. In contrast to the butter traditionally supplied to the UK market by New Zealand, most butter manufactured and consumed in the rest of the Community is unsalted with a fat content normally between 82 % and 85 %. To ensure that the quota arrangements achieved their objectives of maintaining NZ's access to its traditional market for butter in the UK and of protecting producers in other Member States, a definition of eligible NZ butter, corresponding to the type traditionally imported into the UK, was introduced by Council Regulation (EEC) No 858/81⁽⁷⁾. The conditions imposed were that the butter concerned:

- (a) was of New Zealand origin;
- (b) was at least 6 weeks old;
- (c) had a fat content by weight of not less than 80 % but less than 82 %;
- (d) had been manufactured directly from milk or cream.

Certification of butter for quota purposes

2.2. The key document evidencing entitlement to the quota and reduced levies from 1981 to June 1995 was the Protocol 18 certificate. This document was certified by the New Zealand High Commission, the agreed NZ certifying body, to the effect that the quantity of butter cited thereon met the conditions of eligibility for the quota and was within the limits of the quota for the

⁽⁵⁾ OJ L 71, 17.3.1980, p.1.

⁽⁶⁾ OJ L 97, 18.4.1996, p.18.

⁽⁷⁾ OJ L 90, 4.4.1981, p.18.

period in question. It was presented at the time of importation as a supporting document to the import declaration. Protocol 18 arrangements did not require importers to enter the conditions of eligibility on the import declaration, a fact which did not facilitate customs documentary controls.

2.3. From July 1995 the Protocol 18 certificate was replaced by the IMA 1 (inward monitoring arrangements) document⁽⁸⁾ which certifies that the conditions of eligibility for quota are being met, and the NZDB was approved as the IMA 1 issuing agency.

2.4. Article 28 of Regulation (EC) No 1600/95 stipulates that an issuing agency of such certificates may be accepted only if:

- (a) it is recognised as such by the exporter country;
- (b) it undertakes to verify the particulars set out in the certificates;
- (c) it undertakes to supply the Commission and the Member States, on request, with any information that may be required to assess the particulars set out in the certificates.

Article 28 further states that Annex VII⁽⁹⁾ shall be revised when the condition referred to in (a) is no longer fulfilled or when an issuing agency fails to fulfil one of the obligations it has undertaken.

2.5. Finally, Article 29 requires Member States to take the measures necessary to check that the system of certificates established by Title IV is operating correctly.

Licences

2.6. Article 13(1) of Council Regulation (EEC) No 804/68⁽¹⁰⁾ requires that imports into the Community of any of the products listed in Article 1 (which includes butter) shall be conditional on the presentation of an import licence. Import licences fix the rate of levy to be applied and enable the Commission to monitor quantities imported.

⁽⁸⁾ *Background to the system of IMA 1 certificates*

IMA 1 (inward monitoring arrangements) certificates were introduced by Commission Regulation (EEC) No 1767/82 particularly for Swiss cheese to be imported into the Community at reduced rates of levy. Their use has since been extended to other dairy products from other third countries. Their purpose is to certify that the conditions of entitlement to the reduced rates of levy have been met. They are issued by approved agencies in the third countries.

⁽⁹⁾ Annex VII to Regulation (EC) No 1600/95 lists the agencies approved for the issue of IMA 1 certificates.

⁽¹⁰⁾ OJ L 148, 28.6.1968, p.13.

Restrictions on marketing

2.7. Protocol 18 and succeeding supplementary legislation specified that NZ butter should not become the subject of intra-Community trade or of re-exportation to third countries. On 1 January 1993, the restriction on intra-Community trade was withdrawn when Council Regulation (EEC) No 3841/92⁽¹¹⁾ became applicable.

2.8. The restriction on re-exportation to third countries was also removed in the same Regulation. However, Article 7(2) of Council Regulation (EEC) No 876/68⁽¹²⁾ stipulated that the rate of refund on re-export of milk products should be equal to the lower of either the rate of levy assessed at the date of importation or the rate of refund applicable on the date of exportation. This rule has been perpetuated in subsequent legislation.

2.9. Article 10 of Regulation (EC) No 1600/95 requires that at all stages of marketing NZ butter shall bear an indication of its New Zealand origin. Although they are not specified, the Article further requires the UK to inform the Commission of measures taken to that end.

Restrictions on use within the Community

2.10. Under Article 7 of Council Regulation (EEC) No 858/81, the United Kingdom was required, among other things, to take the measures necessary to ensure that NZ butter imported under that Regulation was not used for processing but only for direct consumption on the territory of the United Kingdom. Council Regulation (EEC) No 1269/79⁽¹³⁾ provided a definition of 'direct consumption' used in the application of Article 7. This restriction was removed by Article 4(2) of Council Regulation (EEC) No 3667/83⁽¹⁴⁾.

2.11. Article 10(2) of Regulation (EC) No 1600/95 stipulates that the blending of NZ butter with Community butter for direct consumption may only take place in the United Kingdom.

⁽¹¹⁾ OJ L 390, 31.12.1992, p.1.

⁽¹²⁾ OJ L 155, 3.7.1968, p.1.

⁽¹³⁾ Article 1(A) of Council Regulation (EEC) No 1269/79 defined 'butter for direct consumption' as being 'butter purchased by the final private consumer from retail outlets with a view to private consumption, including butter purchased from the retail trade by hotels, restaurants, hospitals, homes, boarding schools, prisons, and similar establishments in order to cater for persons fed in such establishments, and excluding butter purchased for sale to the public in the form of other products by cake shops, caterers, etc.'

⁽¹⁴⁾ OJ L 366, 28.12.1983, p.16.

Conditions of eligibility for the cheese quotas

2.12. In order to benefit from the reduced rate of levy appropriate for the New Zealand quota authorised by Regulation (EC) No 1600/95 and preceding legislation, NZ Cheddar cheese:

- must be of a fat content of 50 % or more by weight in the dry matter,
- must be matured for at least three months.

2.13. NZ cheese imported under the cheese for processing quota shall only be considered as processed when it has been processed into products falling within subheading 0406 30 of the Common Customs Tariff (i.e. processed cheese) as laid down in Article 2 of Commission Regulation (EEC) No 2967/79 ⁽¹⁵⁾.

2.14. Importations of NZ Cheddar cheese are also to be supported by IMA 1 certificates to the effect that the quantity of cheese cited thereon is within the quota and conforms to the quality conditions.

Control provisions

2.15. A weakness of both Protocol 18 legislation and Regulation (EC) No 1600/95 is that neither contains a specific requirement for Member States to control quota quantities or conditions of eligibility. The only control provisions in force are those of a general nature as laid down in Council Regulation (EEC) No 2913/92 ⁽¹⁶⁾ establishing the Customs Code. The Code, which applies to all types of importation, provides for the scrutiny of import declarations and supporting documents, the possibility for physical examination and sampling for laboratory analysis and the possibility of *ex-post* controls of commercial documentation. The responsibility for the execution of these controls rests with the national customs authorities.

2.16. Under Commission Regulation (EEC) No 3038/89 ⁽¹⁷⁾ and subsequently under Commission Regulation (EEC) No 3885/92 ⁽¹⁸⁾ and Commission Regulation (EC) No 3618/93 ⁽¹⁹⁾, the UK authorities were required, until 30 June 1995, to inform the Commission not later than the end of each week, *inter alia*, of:

- (a) the quantities of butter arriving in the United Kingdom in the previous week,

- (b) the quantities of butter in storage in the United Kingdom, as at the most recent date,
- (c) the quantities of butter sold on the United Kingdom market during the previous week,
- (d) the cumulative quantities of butter since 1 January each year,
- (e) the quantities of butter in course of consignment between New Zealand and the United Kingdom, with a statement of their probable arrival date; and
- (f) the sale price of butter at the first marketing stage.

These reporting requirements applied to NZ butter which was to qualify or had qualified under the special import (quota) arrangements.

3. RESULTS OF THE AUDIT

General

3.1. the audit revealed major weaknesses in the control arrangements to ensure compliance with the conditions of eligibility for the preferential rates of levy. The principal findings can be summarised as follows:

- (a) the UK authorities had not required licences for the importation of NZ butter in the entire period of operation of the Protocol 18 arrangements (22½ years), because, they argue, the legal basis for the legislation establishing the requirement for import licences (Council Regulation (EEC) No 804/68) was Articles 42 and 43 of the Treaty Establishing the European Economic Community; whereas the legal basis relating to NZ butter imports was determined by Protocol 18 and the various Council and Commission Regulations which have regard to it. In July 1997, the Commission indicated that in its view, the arrangements applicable under Protocol 18 and succeeding supplementary legislation, constituted a derogation from the general Community regime applicable to the import of agricultural products and that the New Zealand butter was therefore not subject to the provisions of Regulation (EEC) No 804/68. The Court's view is that Protocol 18 and the succeeding supplementary legislation are an exception to, and therefore derogate from the general rules on the import of butter, laid down in Regulation (EEC) No 804/68 and implementing legislation, only with

⁽¹⁵⁾ OJ L 336, 29.12.1979, p.23.

⁽¹⁶⁾ OJ L 302, 19.10.1992, p.1.

⁽¹⁷⁾ OJ L 291, 10.10.1989, p.45.

⁽¹⁸⁾ OJ L 391, 31.12.1992, p.18.

⁽¹⁹⁾ OJ L 328, 29.12.1993, p.23.

regard to the issues with which they specifically deal. Neither Protocol 18 nor the succeeding legislation specifically deal with, or contain a contrary provision concerning import licences as prescribed by Article 13 of Regulation (EEC) No 804/68. Moreover, in principle exceptions to general rules have to be interpreted restrictively. Since the general rules on import licences continued to apply to the importation of NZ butter, import licences should have been requested. The effect of not requiring an import licence was to withdraw a key element of control of the quota level over imports of New Zealand butter. The regularity of the totality of New Zealand imports is therefore questionable. The Commission's argument according to which the certificate under Regulation (EEC) No 858/81 (and subsequent Regulations) constituted a specific import procedure derogating from the general import procedure under Regulation (EEC) No 804/68, requiring import licences, does not take into account the fact that this specific procedure did not exist in the period between 1973 and 1981, a period during which import licences have not been requested either. Moreover, a similar certificate (IMA 1 certificate) and import licences have coexisted since 1995 under Regulation (EC) No 1600/95. This confirms the difference between the two procedures, making it legally impossible for one procedure to rule out the other;

- (b) the UK customs service had never examined whether the quota limits had been respected either when accepting declarations for clearance of the products into free circulation or *ex post*, on the basis of commercial documentation; this serious lacuna in controls was justified by the UK Customs authorities on the grounds that they had no reason to doubt the veracity of the Protocol 18 and IMA 1 certificates provided by the issuing bodies;
- (c) UK Customs had not carried out any checks to verify that the declared weights were correct;
- (d) UK Customs had not taken any samples for laboratory testing to verify the fat contents of the imported products;
- (e) despite the provisions of Article 78(2) of the Customs Code regarding post-clearance examination of declarations and despite the rights of access provided for by Article 28(1)(c) of Regulation (EC) No 1600/95 with effect from 1 July 1995, in the six months ending 31 December 1995 neither the Commission nor the UK authorities had requested information from NZDB (as the issuing agency) to assess the particulars set out in the IMA certificates;
- (f) the responsible services of the Commission had failed to monitor systematically the preferential import arrangements and had never undertaken an examination of these activities;
- (g) UK Customs had never carried out any *ex post* controls of the conditions of eligibility for the quotas.

3.2. As a result of these failings, there can be no assurance that the terms and conditions set out for the import of NZ butter and cheese at preferential rates of levy had ever been respected. In the following paragraphs the consequences of the principal weaknesses observed are developed further. In effect the UK Customs service placed total reliance on the certificates issued by the New Zealand bodies under Protocol 18 and Regulation (EC) No 1600/95.

Weekly returns of butter imports

3.3. The information which the United Kingdom authorities were required to provide under Commission Regulations (EEC) No 3038/89, (EEC) No 3885/92 and (EC) No 3618/93 was transmitted to the Commission by the UK Ministry of Agriculture, Fisheries and Food (MAFF). MAFF obtained this information from the New Zealand High Commission, in the form of weekly returns prepared on the basis of information provided by the importing company. Neither MAFF nor the Commission carried out systematic checks on the accuracy of the information on the returns. UK Customs were not provided with copies of these weekly returns.

Control of quantity limits

3.4. In late May 1995 the quota for NZ butter of 25 915 tonnes for the period 1 January to 30 June 1995 provided for under Council Regulation (EC) No 3232/94⁽²⁰⁾ had already been exhausted. Despite this in June 1995, 352,5 and 319,2 tonnes of NZ butter were cleared into free circulation at the reduced rate of levy appropriate to the NZ quota. The fact that these quantities were in excess of the quota for that period was not detected by UK Customs.

3.5. As at 23 November 1995 the United Kingdom authorities had not communicated to the Commission the information required under Article 4 of Regulation (EC) No 3618/93 for the weekly period ending 2 July 1995. This information should have contained the cumulative figures for NZ butter cleared against the quota for the six months ending 30 June 1995. On 20 December 1995, subsequent to a request by the Court to the Commission for a copy of this information, the importer made a voluntary declaration to UK Customs that the quota for the period ending 30 June 1995 had been exceeded and offered to pay at the rate of reduced levy of ECU 868,8 per tonne in force after 1 July 1995.

3.6. On 2 February 1996, subsequent to a visit by the Court in January 1996, the second importer also made a

⁽²⁰⁾ OJ L 338, 28.12.1994, p.12.

voluntary declaration to indicate that the quota had been exceeded in the period ending 30 June 1995. The importer offered to pay at the reduced rate of levy in force after 1 July 1995. This offer was accepted at the time by UK Customs without question. Recovery orders have however since been issued for ECU 1,3 million calculated at the full rate of levy.

Accuracy of weight declarations

3.7. The individual weights of cartons of butter are declared for quota purposes as 24, 25 or 26 kg according to the type of standard packaging. In reality, however, cartons are subject to systematic overfill for reasons of commercial regulatory requirements. The data made available by NZDB shows that, for liquid fill, the overweight averages 66 grams per 24 kg whereas, for solid fill, the carton overweight averages 17 grams per 25 kg. In the case of cheese the overweight per 20 kg block averages 148 grams.

3.8. While such overweights are understandable from a commercial perspective, Commission Regulation (EEC) No 2454/93⁽²¹⁾ laying down provisions for the implementation of the Community Customs Code specifies that the net mass must be declared for imported products. Furthermore, although the overweights are insignificant in percentage terms, in view of the high tonnages involved they can represent material sums of lost import levies. UK Customs have to date quantified the levies underpaid on the overweight for the whole cheese quota during the period 1.3.1994 to 30.6.1995 as some ECU 209 000. The quantification of the butter overweight is continuing.

Clearance into free circulation from bonded warehouses⁽²²⁾

3.9. Goods can be cleared into free circulation directly from a ship or after being placed under customs control in a bonded warehouse. Levy is paid when the products are declared for release into free circulation. Most of the NZ butter and cheese is initially stored in a bonded warehouse. NZ butter is declared for clearance into free circulation on withdrawal from bonded stock for de-cartoning at the standard carton weights for butter of 24, 25, or 26 kg.

⁽²¹⁾ OJ L 253, 11.10.1993, p.1.

⁽²²⁾ A bonded warehouse is one in which, subject to the lodging of a guarantee, goods may be stored prior to payment of levy and release into free circulation.

3.10. Examination of stock records and customs declarations for transactions passing through bonded warehouses showed that butter, recorded as having been in bonded stock from December 1994 to February 1996, had actually been withdrawn and used in May 1995 without payment of levies. The levies estimated to have been underpaid in this instance amount to some ECU 1,2 million. UK Customs are currently investigating the matter.

Respect of maximum fat content provisions

3.11. In September 1995 Netherlands Customs took samples for laboratory analysis of fat content from a cargo of 504 tonnes of NZ butter declared for clearance into free circulation in the Netherlands against the NZ quota. The test results showed a fat content of more than 82 %. Levies were therefore assessed at the full rate in force and the importing company was levied an additional amount of approximately ECU 1 million, covering both underdeclared weights and the ineligibility of the products for reduced levies. The importing company has appealed against this decision on the grounds that the manner in which the sample was taken was inappropriate, and the results of the tests consequently unreliable.

3.12. The Netherlands Customs authorities did not notify the Commission of the alleged irregularity as required under the provisions of Council Regulation (EEC) No 1552/89⁽²³⁾ until April 1997 nor did they communicate the facts to the UK Customs authorities as provided for by Articles 11 and 12 of Council Regulation (EEC) No 1468/81⁽²⁴⁾. As a consequence, the Commission was unable either to notify other Member States of the import risks, or to initiate its own control action.

3.13. NZDB controls the quality of butter, which is manufactured by independent dairies, by means of manufacturing specifications and the use of a manual of quality control procedures. The NZDB specifications provide for limits in respect of the contents of water, salt, milk solids-non-fat and minimum fat content. The NZDB quality control manual provides for the type, methodology and frequency of laboratory tests to be carried out by the dairies to ensure compliance with the manufacturing specifications. Failure to meet the limits results in butter either being rejected by NZDB or accepted with the dairy suffering a financial penalty.

⁽²³⁾ OJ L 155, 7.6.1989, p.1.

⁽²⁴⁾ OJ L 144, 2.6.1981, p.1.

3.14. The NZDB specifications for most of NZ quota butter did not provide for a maximum fat content prior to August 1995. Consignments of butter exceeding the maximum fat content permitted by the quota could therefore be accepted by NZDB for shipment to the Community under the quota.

3.15. NZDB maintained that the fat-content condition has never been the subject of interpretation discussions with the European Commission. It therefore interprets the condition as meaning that the annual aggregate average of butter entered into the Community should be within the fat content parameters. In the Court's view this is contrary to the Customs Code implementing measures which require the description and quantity of the goods to relate to the precise goods being declared for release into free circulation against the import declaration in question.

3.16. The Court examined a sample of 361 tests carried out in the years 1991 to 1996, selected to cover the different types of butter manufactured by the largest NZ producer of butter for the Community quota. This examination revealed a high incidence (69 %) of fat contents exceeding the maximum limit on butter produced at the same dairy from 1991 to 1996. Other documents and test results indicate that the problem affects other NZ dairies.

3.17. Because of the high incidence of butter with fat contents of 82 % or more found by this examination the Court requested, and obtained from NZDB, all available laboratory test data for butter manufactured at this dairy and cleared into free circulation against the NZ quota during the period 1 January 1994 to 31 July 1996.

3.18. The Court's analysis of that data shows that 65 % of butter from that dairy shipped to the Community between 1 January 1994 and 31 December 1994 and 54 % between 1 January 1995 and 30 June 1995 failed to comply with the maximum fat content laid down for NZ butter in Council Regulation (EC) No 3610/93 as amended by Regulation (EC) No 3232/94. The range of the excess fat content is between 0,1 % and 1,5 % in absolute terms which represents between 5 % and 75 % of the 2 % margin provided for NZ quota butter. Although invited, NZDB has not presented any evidence to refute this analysis.

3.19. NZDB considered that, because the methodology and frequency of fat-content testing had not been

addressed by the European Commission or by Member State authorities, it is not appropriate to use the results in question. It further considered that, for a number of technical reasons, any conclusions drawn from the results would be invalid. The Court notes that test results were obtained following a test methodology prescribed by the NZDB quality control manual; that the methodology is the same as that drawn up by the International Dairy Federation (IDF) and adopted as the Community reference method and that the results of the tests are used by NZDB for acceptance or rejection of butter in relation to specification requirements.

3.20. On the basis of the number of instances of the fat-content maximum being exceeded in the period 1 January 1994 to 30 June 1995 the levies estimated to have been underpaid in respect of butter produced at this dairy for retail sale in the Community during that period amount to some ECU 67 million of which some ECU 65 million is recoverable. This estimate is based on the fact that any butter with a fat content of 82 % or more, however small the percentage of excess fat may be, gives rise to the payment of the much higher full rate of levy. If butter produced at other dairies during that period was subject to the same ratio of fat content of 82 % or more a further sum of approximately ECU 24 million could have been underpaid. In NZDB's view the extrapolation of the results from one dairy to quota butter from other dairies is inappropriate. Despite requests it has not, however, provided the laboratory test data from the other dairies. By applying the same ratio to all NZ quota butter from 1990 to 1993, years which are out of time for recovery action, levies underpaid are estimated at some ECU 287 million.

3.21. In the case of imports of NZ Cheddar cheese, UK Customs also did not carry out any physical checks, at the time of acceptance of the import declaration or any *ex post* checks, to ensure that the qualifying conditions were met. In particular, no samples were taken for analysis of fat content. However, random checks carried out by the Court did not reveal evidence of non compliance in respect of the fat content.

Respect of minimum age criterion

3.22. As in the case of other eligibility criteria, the UK Customs authorities failed to carry out any checks to verify that the minimum age criterion was respected for the imported butter. Examination by the Court of a selection of Protocol 18 certificates and supporting production lists in respect of butter cleared into free circulation directly *ex-ships* has raised doubts whether, in

4 of the 98 cases examined, the butter had met the minimum age criterion. In one such case the shipping file contained *prima facie* evidence that the dates of manufacture had been misdeclared with the consequence that the butter would be accepted under the quota. In three of the cases, although the correct dates of manufacture had been indicated, UK Customs failed to check whether the minimum age criterion had been adhered to.

Respect of direct manufacture criterion

3.23. One of the eligibility criteria in respect of imported butter is that it must be manufactured directly from milk or cream. However, since 1990, 'spreadable' butter, which is manufactured from butter concentrate, has been cleared into free circulation under the quota. Such butter is, in the view of the Commission, ineligible for the quota, owing both to its indirect manufacturing process and because its Combined Nomenclature (CN) code is not included in Annex I to Regulation (EC) No 1600/95 as modified by Regulation (EC) No 1170/96. Two other types of butter manufactured from butter concentrate have also been cleared into free circulation under the quota.

3.24. NZDB has submitted an argument to the Commission that fractionated butter is manufactured directly from milk or cream because the process is continuous. This argument has been rejected by the Commission which maintains that, as described by NZDB's own manufacturing specifications, the butter is made by recombining concentrated butter with water and/or other dairy products.

3.25. As a result of an appeal by the importer the UK VAT and Duties Tribunal has considered evidence on this matter in respect of importations of two test samples of the types of butter concerned, manufactured in 1996 after the problem of direct manufacture had been raised between the Community and New Zealand. This butter may not therefore have been manufactured in the same way and from the same raw materials as the totality of the butter referred to in paragraph 3.23. The Tribunal has ruled that the butters in the two test samples are eligible under Regulation (EC) No 1600/95. This ruling is under further appeal by United Kingdom Customs.

3.26. In order to come to its ruling the Tribunal has interpreted the words 'manufactured directly from milk or cream' in Regulation (EC) No 1600/95. Moreover the Tribunal points out that the decision relates only to the two test samples and would not apply to butter manufactured by a substantially different process. The importer has also lodged appeals against the additional levies demanded by UK Customs & Excise in respect of

butter imported prior to 1 July 1995. Subject to the outcome of these appeals the Court estimates that levies amounting to ECU 29 million may have been underpaid.

3.27. The matter has also been referred to the Disputes Committee of the World Trade Organisation (WTO) for a decision whether these butters are considered eligible for the quota under the GATT/WTO Agreement which was effective from 1 July 1995. A decision by that body is expected in September this year.

Disposal

3.28. Contrary to the provisions of Article 10 of Regulation (EC) No 1600/95, the UK authorities failed to inform the Commission of measures taken to control the marketing and blending of NZ butter. Furthermore, UK Customs had never carried out controls on the disposal of NZ butter in the period 1 July 1995 to 30 June 1996.

3.29. In the course of its audit, the Court established that almost the totality of NZ butter imported for sale to retail or wholesale outlets was actually sold to such outlets. As the inherent risk of such disposals being subsequently re-exported was judged by the Court to be negligible no further verification of such disposals was undertaken by the Court. The remaining small quantities, disposed of essentially to the catering trade, were test-checked by the UK Customs at the Court's request. No irregularities were detected.

3.30. The butter imported for industrial use was sold either to processed-cheese manufacturers or to butter-concentrate manufacturers. On the basis of the audit of the disposal of this butter, the Court estimates that around one third was incorporated into processed cheese. A small proportion of this processed cheese was exported with the benefit of export refunds.

3.31. Some 67 % of the industrial butter was sold to butter-concentrate manufacturers who used it, *inter alia*, in the framework of Regulation (EEC) No 570/88, thus receiving Community aid for butter used for pastry making etc. NZ quota butter is not excluded from this latter regime in so far as it is used for the production of concentrated butter which conforms to the conditions of Regulation (EEC) No 570/88.

3.32. The rate of aid under Regulation (EEC) No 570/88 is equivalent to ECU 126 per 100 kg of butter. The reduced rate of import levy on NZ quota butter is ECU 86,88 per 100 kg. By allowing NZ butter to be used under the provisions of this Regulation, the Community

is providing a net subsidy for the butter amounting to ECU 39,12 per 100 kg. The Court questions the justification for allowing NZ butter to benefit from the full rate of aid under Regulation (EEC) No 570/88 ⁽²⁵⁾. It is estimated that 10 500 tonnes of NZ butter has already been used under the provisions of Regulation (EEC) No 570/88 from 1.7.1995 to 30.6.1996 attracting aid amounting to around ECU 13,2 million at a net cost to the Community of ECU 7,7 million per annum ⁽²⁶⁾.

3.33. The Commission has twice proposed to the Management Committee that a rule be introduced that all butter used in the framework of Regulation (EEC) No 570/88 should be of Community origin. The Committee has rejected the proposal arguing that such a requirement would pose too many control problems. The Court does not share this view because Regulation (EEC) No 570/88 already provides for physical and documentary controls over raw materials and finished products.

3.34. The audit also revealed that one Italian company had either imported directly or purchased levy-paid in free circulation 888 tonnes of NZ butter in 1995 and 1 734 tonnes in 1996, all of which had been cleared into free circulation at the reduced rate of levy. Most of that butter was either repacked or blended with Community butter and sold in 25 kg cartons for industrial use. Neither the invoice nor the packaging bore any indication of the fact that the butter was of NZ origin or that it was a blend of NZ and Community butter, contrary to Article 10(2) of Regulation (EC) No 1600/95.

3.35. The Commission has confirmed that failure to indicate the New Zealand origin on the packaging is in contravention of Article 10 of Regulation (EC) No 1600/95 and that the sanction for this infringement is a matter for the Member State authorities.

3.36. Finally, 56 tonnes of butter were traced to conversion into butteroil in Denmark which was subsequently exported to Thailand with export refunds in excess of the levy having been collected on importation. The conversion of butter into butteroil is not an operation which changes the origin of the butter. Refunds on export of the butteroil should therefore be limited to

⁽²⁵⁾ In the case of export refunds on milk products the refund rate is equal to the lower of either the rate of levy assessed at the date of importation or the rate of refund applicable on the date of exportation.

⁽²⁶⁾ EU butter is displaced from the Regulation (EEC) No 570/88 scheme by NZ butter. It therefore has to find alternative markets, typically with the aid of export refunds at ECU 160 per 100 kg. The additional net cost to the Community per 100 kg of allowing NZ butter to benefit from Regulation (EEC) No 570/88 aid is therefore the difference between the reduced rate of import levy of ECU 86,88 and the equivalent rate of aid under Regulation 570/88 aid of ECU 126, which is ECU 39,12 plus the difference between the Regulation Community 570/88 aid of ECU 126 and the rate of export refunds of ECU 160, which is ECU 34.

the levies collected on importation. The refunds found to be overpaid and recoverable in this case amount to some ECU 57 000.

Cheese for processing — Eligible end-use products

3.37. Article 2 of Commission Regulation (EEC) No 2967/79 lays down that a cheese imported under cheese for processing end-use arrangements shall only be considered as processed when it has been processed into products falling within subheading 0406 30 of the Common Customs Tariff (i.e. processed cheese). If the cheese is used in the manufacture of any other product the full rate of levy must be paid.

3.38. End use of cheese for processing is subject to written authorisation to the importer and end user for the cheese to be used for the prescribed purpose. One of the authorisations issued by the UK authorities was for the cheese to be used in the manufacture of cheese sauce, a use not authorised by Regulation (EEC) No 2967/79.

3.39. The Commission has upheld the Court's view that cheese sauce is not an eligible end use. Accordingly, additional levies amounting to ECU 1,5 million are estimated to be due. A recovery order was issued by UK Customs but it has since been withdrawn because of an administrative error. In the circumstances, the amount involved should be made available to the Community by the UK authorities.

Eligibility of processed cheese containing third country cheese for export refunds

3.40. The rate of refund for processed cheese varies between ECU 14 and 120 per 100 kg depending on composition and destination. For most processed cheese, the rate is considerably in excess of the reduced import levy of ECU 17,06 per 100 kg. According to Article 17(11) of Regulation (EEC) No 804/68 the rate of refund on re-export of third country milk products shall be the lower of the rate of refund and the rate of levy collected on importation. However, because of the failure of the Commission to clarify the position, processed cheese incorporating third country cheese imported at a reduced rate of levy has been allowed to receive the full rate of export refund.

3.41. Audits covering the use of NZ cheese for processing and the final destination of the finished product were carried out at five manufacturers of processed cheese. Three had made arrangements to ensure that third country products were only used in the manufacture of processed cheese destined for

consumption within the Community. Two had claimed refunds at the full rate on products incorporating NZ cheese, although, in these instances, the quantities involved were relatively minor.

4. SWISS EMMENTAL

4.1. The Community has been traditionally the largest market for Swiss cheese. Preferential reduced rates of import levy have been in force since 1968. Regulation (EC) No 1600/95 provides the current legal basis for the importation of Emmental, Gruyère, Sbrinz and Appenzell cheeses from Switzerland at the reduced rate of levy of ECU 9,66 per 100 kg instead of the full rate of ECU 195,42 per 100 kg. The cheeses in question are destined both for direct consumption and for manufacture of processed cheese.

4.2. There is no fixed quota to control the volume of imports. Instead the Community producers are protected by the requirement that minimum free-at-frontier prices are to be respected. The rates of levy vary with the level of the minimum free-at-frontier price. By way of example the minimum price for the lowest rate of levy of ECU 9,66 per 100 kg under Regulation (EC) No 1600/95 was set at ECU 430,62 per 100 kg.

4.3. Both Regulation (EC) No 1600/95 and preceding legislation provide for the importation of Swiss cheese at reduced rates of levy to be subject to the presentation of an IMA 1 certificate. The approved issuing agency is the Swiss Cheese Union (SCU). In completing the IMA 1 certificate, the Swiss Cheese Union was required to certify that the particulars set out on the IMA 1 form were accurate, complete and complied with the Community provisions in force, and that for the products described on the form no discount, refund or any other rebate would be granted to the buyer that would lead to the product in question having a value less than the minimum import value fixed for the product. As well as issuing the IMA certificates, SCU also sold much of the Emmental to Community customers.

4.4. As reported in Special Report No 1/94 the audit was commenced by the Court in France on the basis of information obtained and analysis of import statistics.

The investigation subsequently carried out by the French authorities at the Court's request has proved that minimum free-at-frontier prices were overstated on IMA 1 certificates supported by false invoices so that they appeared to qualify for the reduced rate of levy. The invoice price was later adjusted by a variety of methods involving SCU, including the issue of credit notes, payments to private bank accounts of directors of the importing companies and contributions made via third parties.

4.5. Subsequent investigations in Italy suggested by the Court and coordinated by UCLAF have identified some ECU 42 million in levies allegedly evaded. Independent investigations in Germany have identified an amount of ECU 1,2 million in levies allegedly evaded.

4.6. In March 1997, nearly three years after the case had first been reported to the Commission, Regulation (EC) No 1600/95 was amended by Commission Regulation (EC) No 503/97⁽²⁷⁾ in respect of imports of cheese from Switzerland. Switzerland was deleted from the Annex listing countries and agencies authorised for the issue of IMA 1 certificates; the onus is placed on the importer to declare that minimum free-at-frontier prices are respected; the importer is obliged to supply the competent authorities with any information necessary to judge compliance and allow any audit of accounts, and in cases of non-compliance, levy shall be paid at the full rate plus a penalty increase of 25 %.

5. CONCLUSION

5.1. The Court's audit of the importation and disposal of NZ dairy products imported at preferential rates has identified the absence of appropriate controls leading to estimated underpayments of levies in respect of non-compliance with quota limits and conditions amounting to some ECU 410 million and to estimated undue payments of export refunds amounting to some ECU 57 000. Of these amounts some ECU 118 million is recoverable, as detailed in Table 4.

⁽²⁷⁾ OJ L 78, 20.3.1997, p.12.

TABLE 4

Irregularities identified, amounts recoverable and recovered

Nature of irregularity	Total (ECU million)	Amount recoverable (ECU million)	Amount recovered (ECU million)
Butter — excessive fat content	378,00	87,00	
Fractionated butter	29,00	28,00	
Butter — exceeding quota	1,30	1,30	
Butter — irregular warehouse removals			
Butter — underdeclaration of carton weights			
Butter — irregular claim to export refunds	0,06	0,06	
Butter — irregular packaging			
NZ cheese — irregular end use	1,50	1,50	
NZ cheese — underdeclaration of block weights	0,21	0,21	
Sub-total NZ	410,07	118,07	
Swiss cheese — misdeclaration of minimum free-at-frontier prices	46,00	46,00	
Total	456,07	164,07	0,00

5.2. The UK Customs service failed to implement any procedures to verify that the specific conditions established for the importation of New Zealand butter and cheese at reduced rates of levy had been respected and did not ensure that the rules relating to disposal had been respected. The UK authorities have begun to take the necessary steps to ensure that the observations raised in this report are swiftly followed up and any levies found to be underpaid are recovered.

5.3. The Commission is responsible for allowing this unsatisfactory situation to continue over such an extended period. It did not ensure that adequate monitoring and control procedures were in force and that the weekly returns of butter imports were submitted and checked.

5.4. The Court furthermore concludes that the New Zealand Dairy Board has not respected the conditions and obligations imposed by Regulation (EC) No 1600/95 in respect of tariff quotas pursuant to GATT/WTO Agreements. The New Zealand Dairy Board must therefore be removed from Annex VII listing the countries and agencies approved for the issue of IMA 1 certificates in line with the action taken against the Swiss Cheese Union. The obligations on the importers and the penalty for non-compliance introduced for imports from Switzerland must likewise be applied to imports of New Zealand dairy products under Regulation (EC) No 1600/95.

5.5. In the broader context, because the control of the quota quantities and conditions of eligibility relies heavily on the issue of IMA 1 certificates, the Court questions whether agencies authorised for their issue should have a commercial/financial interest in the quota transactions as this may lead to a conflict of roles.

5.6. Finally the Court calls on the Commission:

- to take appropriate action to recover the amounts involved,
- to introduce more effective obligatory requirements for the control of imports at reduced rates of levy,
- to review the validity of the IMA 1 system,
- to initiate in depth controls of other quota agreements involving reduced rates of levy,
- to resubmit the proposal for an EU origin requirement in Regulation 570/88 and similar internal schemes,
- to clarify the rules relating to the eligibility of third country products to export refunds after processing.

5.7. The Court's report is based on fact. The Commission's general comments are largely speculative, based on hypotheses of what the New Zealand Dairy Board might have done, had certain events occurred. They suggest that the Commission has taken proper assurance as to compliance with Regulation (EC) No 1600/95, based on representations from the New Zealand dairy industry and the New Zealand Government, rather than from actual controls. The Commission asserts that if customs controls had detected non-compliance earlier then the anomalies may have been rectified for future shipments. This does not constitute a reason for the butter imports in question not to comply with the legislative requirements in the first place.

5.8. In addition, the comments do not consider parallel situations in other measures, such as export refunds. Each year national authorities detect cases where products have failed to meet the compositional requirements for export refunds and as a result the undertakings not only lose their entitlement to refunds but also suffer penalties. The products in question are nevertheless marketed. Examples of such cases and similar ones detected by the Court have been documented in Special Reports 2/92 ⁽²⁸⁾ and 7/93 ⁽²⁹⁾ and in the 1995 Annual Report ⁽³⁰⁾. It is therefore inappropriate to single out New Zealand as a special case.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 1 and 2 April 1998.

For the Court of Auditors

Bernhard FRIEDMANN

President

⁽²⁸⁾ OJ C 101, 22.4.1992, p. 1.

⁽²⁹⁾ OJ C 53, 19.2.1994, p. 1.

⁽³⁰⁾ OJ C 340, 12.11.1996, p. 80.

COMMISSION REPLIES

GENERAL COMMENTS

This report deals with serious weaknesses in the control of two of the many preferential agreements between the Community and third countries. It is important to stress that these arrangements are limited in scope and deal with only a proportion of imports of specific products from individual countries.

In the case of butter imports from New Zealand, the major subject of the report, a reduced rate of levy, later duty, was granted for the import of fixed quantities of butter. This arrangement was intended to permit the continuation of the traditional trade in salted butter between New Zealand and the United Kingdom which would otherwise become uneconomic. The butter imported at this reduced rate had to meet certain criteria which themselves reflected the attributes of the products traditionally involved. These attributes were technical and did not affect the commercial description of the goods. (There were also special arrangements for some imports of cheese.) The close and cooperative relationship between the Community institutions and the New Zealand Government was underpinned by two documents, Protocol 18 and the Dublin Declaration. Also in 1994 annual NZ/EC agricultural trade policy consultations were initiated. With this background and given that, because of their political sensitivity, decisions on quota quantities were taken on a unanimous basis, it was considered unlikely that the New Zealand Dairy Board would take or permit any action which would endanger the continuation of the arrangement.

Because of the control weaknesses described in the report, problems with the operation of the arrangement only emerged belatedly. In a six-month quota period preceding the introduction of quotas under the WTO Agreement the quantitative limit was breached. This resulted in an underpayment of duty of ECU 1,3 million and is currently the subject of criminal proceedings.

It has also emerged that goods which the UK authorities now consider ineligible had been granted reduced rates of duty. Where butter with a higher fat content than that permitted by the Regulation was imported then the effect was that of a further breach of the quota limits and thus an underpayment of duty. The maximum potential benefit thus obtained by the importing companies has been estimated, by the UK, at some ECU 1,4 million each year.

Because of the terms of the regulations under which no butter that exceeded the fat content parameters was entitled to the reduced rate, large customs debts are now being established. These debts, which also cover other eligibility issues, are estimated to total ECU 200 million, reflecting the difference between the reduced rate paid and the full rate now considered to have been due.

Although from a legal standpoint it could be considered that this figure is a loss of own resources it was never anticipated that these amounts would accrue to the Community budget. Recovery of these debts would amount to an economic sanction, as unlike the breaches in the quantitative limit, the amounts involved do not accurately reflect either a loss of anticipated own resources or any potential benefit that might have accrued to the importers. The following circumstances need to be noted:

- these were not instances where inferior products were substituted for superior items. The goods imported may not have met the specific technical requirements of the relief regarding fat content and method of manufacture but were equally as merchantable as goods that did. Although they are instances of non-compliance with the specific requirements of the Regulation these imports had little effect on the Community butter market,
- if suitable customs controls had detected the non-compliance with the technical criteria earlier then it is reasonable to suppose that the anomalies would have been rectified for future shipments. Thus no duty would have been chargeable other than on the consignment selected for laboratory analysis,
- had the necessary changes not been possible then the imports would have ceased as, without the reduced rate of duty, the trade would have been uneconomic. Again in these circumstances there would have been no own resources to collect,
- the New Zealand Government might also have attempted to renegotiate the arrangement to reflect the development of new production methods. Had they been successful, no own resources would have been due.

The Community budget may however have suffered a loss, in so far as if the imports had ceased or diminished then, less money may have been required to support Community butter prices or pay export refunds. There may also have been greater opportunities for Community butter producers. These 'costs' were doubtless taken into account when the arrangement was adopted.

The situation set out above arose because of the weakness of controls in the United Kingdom. However, it should be recognised that the arrangement is merely one of many preferential regimes and that customs controls can only be selective. The United Kingdom uses various risk-analysis techniques to target controls. These were regular imports of what had been duty-free goods. The amounts involved were restricted (when compared to the value of duty relief granted under other preferential agreements). There were only ever two companies involved in the imports which were considered to be compliant by the UK authorities. Therefore these imports were considered low-risk.

The Commission also has some monitoring and inspection responsibilities for the relief. The resources available being limited, the Commission also uses risk-analysis techniques to decide priorities. The importance of the arrangement to the New Zealand dairy industry together with the close cooperation of the New Zealand Government and the Commission all indicated compliance. However, as a result of monitoring action, queries regarding the possible breaches of the quantitative limits were passed to the United Kingdom authorities in 1983. Assurances that the quota limits had not been exceeded were received from the UK authorities and, after further checks, were confirmed. As the permitted quota diminished so did its market sensitivity and the trade was considered low-risk. The Commission aims to obtain maximum assurance from inspections and thus selects for examination topics which have a wide application for example the general system of tariff preferences which was examined in the UK in 1993.

Since the first notification of the Court's findings, the Commission has been monitoring the establishment of debts as a result of investigations made by the United Kingdom authorities. They estimate that debts totalling some ECU 202 million may eventually be established. However, it should be noted that all the debts established so far are the subject of legal appeal proceedings.

1. INTRODUCTION

Annual quotas and financial impact

1.2. The Commission agrees with the Court's conclusions that own resources may be at risk should the quota be exceeded. However, it has already in its general comments drawn a distinction between the consequences, for own resources and the Community budget generally, of breaches of the quota quantitative limits and non-compliance with the other technical requirements.

Origin of the NZ quota and reduced levy rates for butter

1.4. It should be noted that while the legal base for the arrangements remained Protocol 18 up to the adoption of Regulation (EC) No 1600/95, the nature of the arrangements changed substantially from 1 April 1981. The original arrangements in Protocol 18 were extended by a series of Council Regulations up to 31 March 1981. Council Regulation (EEC) No 858/81 introduced the new arrangements from 1 April 1981, which were then renewed with minor adaptations until 30 June 1995.

The expression 'tariff quota for New Zealand' is not completely accurate. This Agreement included a tariff quota for NZ butter replacing the autonomous concession under the special arrangements. The quota was fixed under the Agreement and in accordance with WTO obligations as 76 667 tonnes per year, an increase over the maximum quantity allowed to be imported under the special arrangements for the preceding period of 51 830 tonnes per year. The new tariff quota for NZ butter was opened by Commission Regulation (EC) No 1600/95.

2. ADMINISTRATIVE AND CONTROL PROCEDURES

Conditions of eligibility for the NZ quota for butter

2.1. There is no express reference in Regulation. No 858/81 to the reasons for the technical specifications in particular the fat content. The recitals provide only two relevant explanations about the type of butter covered by the quota:

- arrangements should be made to permit NZ to continue to export butter to the UK on special terms and
- provisions should be made that the New Zealand butter in question may be used only for direct consumption.

Besides, at that time a major simplification in the management of the system was introduced. The system based on a minimum import price, which was administratively burdensome to control was replaced, by a reduced levy system while continuing to guarantee sufficient protection of the market. The reduced levy was expressed as a percentage of the intervention price for salted butter.

In order to calculate this reduced levy it was decided, in Council, to specify the milk-fat content of NZ butter in conformity with the milk-fat content of salted butter eligible for intervention in the UK.

Finally, satisfying this provision implied that New Zealand could not artificially increase its quota by exporting butter with a fat content exceeding 82 %.

Certification of butter for quota purposes

2.2. Protocol 18 certificates were issued by the New Zealand High Commission in London, the competent authority selected by the New Zealand Government and accepted by the UK authorities. This agency was responsible for limiting the issue of certificates to the quantity agreed by Council Regulation and to products respecting the eligibility criteria. Therefore, this body had the initial responsibility for control. The UK Customs authorities were presented with four copies of the Protocol 18 certificate together with an import declaration. Since the two documents had to be presented together, there was no requirement that the details given in the Protocol 18 certificate should be repeated on the import declaration.

Control provisions

2.15. The fact that the Regulation does not contain specific control provisions is not peculiar to the New Zealand Agreement. It does not absolve the Member State from applying appropriate procedures. These procedures, in common with those for all imports, should ensure that selective controls based on a proper assessment of the risk involved are exercised.

3. RESULTS OF THE AUDIT

General

3.1(a) The Commission does not consider that import licensing procedures should have been applied given the legal basis described below. In 1980, when the Commission proposed to extend the New Zealand butter quota to all Member States, it considered introducing an import licence system. In the event the Council decided to limit the imports to the UK and the Commission opted to retain the Protocol 18 certificate as the means of controlling quantities and certifying that the eligibility criteria were met. The maintenance of this method took account of the traditional nature and national character of the special arrangements.

Title III of Regulation (EEC) No 804/68 sets out the general system applicable to trade in dairy products between the Community and third countries. Protocol 18 and the Council Regulations which subsequently continued the special arrangements for NZ butter did not provide for trade between a third country and the Community, but authorised one Member State to import certain quantities of butter from a particular third country on the condition (until 1993) that the butter was not traded within the Community or exported out of the Community. It was a special arrangement for which specific procedures were laid down in the Council Regulations whose legal base was Protocol 18. As far as the import procedures were concerned, there was therefore a *lex specialis*. While Article 13 of Regulation (EEC) No 804/68 provided generally that the import of dairy products was subject to the presentation of an import licence, Article 4 of Regulation (EEC) No 858/81 (and subsequent Regulations) provided that the import of New Zealand butter under the special arrangements was conditional on the presentation of a certificate showing that the butter met the requirements for eligibility. This specific rule took priority over the general rule.

(e) There is no obligation to perform such post-clearance checks.

(f) Regarding monitoring the use of the procedure, in 1983 the Commission asked the UK authorities to verify an apparent overshoot of the quota quantitative limits. The UK trade data showed higher butter imports from New Zealand into the UK than provided for by the quota. However, according to the UK authorities, the NZDB had given categorical assurances that they had taken the greatest possible care not to place into free circulation in any year any butter or cheese above the quantity allowed under the quota arrangements. The Commission was unconvinced by this argument and requested further checks. The UK customs authorities carried out further checks that showed that the quota limits had not been exceeded.

The Commission has limited resources for making inspections in Member States. The subjects for examination are therefore selected using risk-analysis techniques. The aim is to gain the maximum assurance from the visits made and therefore, in the absence of specific information (for example that referred to in paragraph 3.14 of the Court's report), those topics that have wide application are usually selected. Thus the procedures used to apply the standard system of tariff preferences was inspected in 1993 in the UK, as well as other Member States. (This did not include the special arrangements with New Zealand.) The 1998 inspection programme will include an examination of the workings of other specific preferential agreements.

Weekly returns of butter imports

3.3. The Commission sought detailed information for market management reasons and used the information for that purpose particularly during sensitive periods.

Control of quantity limits

3.6. The Commission has been monitoring the UK authorities' actions to establish and recover the amounts due. According to the latest information, criminal proceedings have been started for related offences. Security for the debts is held but these are currently the subject of appeals by the companies concerned. The monitoring of progress will continue.

Accuracy of weight declarations

3.8. The Commission continues to monitor the UK authorities' actions to establish and recover any amounts due. It is aware that customs debts have now been established for both butter and cheese imports. These debts are the subject of appeals.

Clearance into free circulation from bonded warehouses

3.10. The Commission will continue to monitor the outcome of the UK's further investigation of this issue.

Respect of maximum fat content provisions

3.15. The Commission agrees with the Court that the butterfat parameter should be satisfied on a consignment by-consignment basis and that the Customs Code in this respect is clear.

While reserving its position regarding the past, NZ has accepted that it apply in the future, but has asked for technical talks to establish the testing and sampling methods, on a mutually agreed basis, in order to demonstrate compliance in this regard. These technical talks are under way.

3.18 and 3.20. The applicability of the fat-content rules remains the subject of court proceedings. The NZDB has indicated to the ECA that it was unable to make further details of the analysis available because it bears directly on matters currently before the UK courts. It was also indicated that it is prepared to release that material at the appropriate time once the legal proceedings are concluded.

The Commission is aware as a result of monitoring the UK authorities' actions that customs debts have been established based on the figures given by the Court for imports of butter considered ineligible for inclusion because of its fat content. The companies concerned have appealed against the assessments. The Commission will continue to monitor future action.

3.19. See reply to paragraph 3.15.

Respect of direct manufacture criterion

3.25 to 3.26. The Commission notes that the UK authorities have a period of 56 days from the release of the Tribunal decision concerning the two specimen samples to lodge an appeal.

Disposal

3.32. Commission Regulation (EEC) No 570/88 aims to increase demand for butter with a view to improving the balance between supply and demand on the Community's butter market. New Zealand butter forms part of the supply and from a market management point of view, it is not relevant which butter is used for industrial purposes. The Commission has always estimated the cost of the butter concession to New Zealand as the sum required to export an equivalent quantity of butter to third countries less the reduced levy/duty paid on import

3.34. The Commission is monitoring an ongoing investigation concerning suspected repackaging of NZ butter.

3.35. The Commission has now been informed by the competent national authority that no sanction is applicable for such an infringement.

3.36. The Commission agrees with the Court's conclusions and is still examining these cases.

Cheese for processing — Eligible end-use products

3.39. On the basis of the information available the Commission agrees with the Court that the Member State concerned has a financial responsibility. The Commission will contact the competent authorities to obtain further information and will take recovery action if appropriate.

Eligibility of processed cheese containing third country cheese for export refunds

3.40. The Commission services are examining a possible proposal to the Council that export refunds shall be paid only on milk and milk products wholly obtained in the Community.

4. SWISS EMMENTAL

General comment

The cases referred to by the Court are all under examination by the Member States involved. Indeed France, Germany and Italy have all reported the establishment of customs debts under the irregularity reporting arrangements provided for under Regulation (EEC) No 1552/89. The Commission will follow-up appropriately the subsequent recovery action.

5. CONCLUSION

5.2. The Commission will continue to monitor the recovery action.

5.3. The Commission does not consider that the monitoring and control procedures were in force at the Commission level. The weekly returns were used by the Commission for the purposes for which it sought the information, namely for market management, in particular orderly marketing of New Zealand butter in the UK.

5.4. Should this prove necessary an appropriate proposal regarding the issuing agency will be considered when all elements are available.

5.5. The Commission wishes to point out that agencies issuing certificates while they may have a commercial and financial interest in the transaction is a possible feature of all preferential systems.

5.6. *First indent* The Commission concludes from its ongoing monitoring of actions taken by the UK authorities so far that customs debts totalling ECU 128 million have been established. The UK authorities' investigations are continuing. They have made initial estimates that a further ECU 74 million of underpaid levy may be demanded. All the debts established so far are the subject of appeals by the companies concerned.

Second and third indents A round of technical talks, as referred to in the reply to 3.15, has been initiated to ensure that the system functions properly in future.

Fourth indent Given the number of such arrangements the Commission cannot possibly conduct in-depth examinations of all these arrangements itself. (The

Commission has the resources to make around 25 visits during a year.) It is however planned that the own resources inspection programme for 1998 will cover preferential systems including some specific arrangements. The Commission will however ask Member States, who have the primary responsibility to control these arrangements, to give priority to such systems when undertaking their own examinations.

Sixth indent The Commission considers that the principles governing the eligibility of third country products to export refunds are clear. If substantial

transformation of the product in the Community gives rise to a change of origin, and hence to a new product which is exported, that product is entitled to a grant of export refunds in the normal way. If the imported product is exported without prior transformation, the refund granted cannot exceed the duty paid on import in accordance with Article 17(2) of Council Regulation (EEC) No 804/68.

The Commission is currently undertaking further work on the question of what constitutes 'substantial transformation'.
