

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT
BUDGETARY AFFAIRS **D**

Budgets

Budgetary Control



How does organised crime misuse EU funds?

STUDY



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT D: BUDGETARY AFFAIRS

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This document was requested by the European Parliament's Committee on Budgetary Control. It designated Mr Søren Bo Søndergaard (MEP) to follow the study.

AUTHORS

PriceWaterhouseCoopers Belgium
PriceWaterhouseCoopers Netherlands

RESPONSIBLE ADMINISTRATOR

Helmut WERNER
Policy Department D Budgetary Affairs
European Parliament
B-1047 Brussels
E-mail: helmut.werner@europarl.europa.eu

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ABOUT THE EDITOR

To contact the Policy Department or to subscribe to its newsletter please write to: poldep-budg@europarl.europa.eu

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DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT D: BUDGETARY AFFAIRS

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Abstract

This study focuses on the relevance whether and to what extent organised crime is involved in defrauding the EU. By research and interviews it is clear that there is no universal definition of organised crime. Different working definitions are being used by EU agencies. In this study research is conducted on the means and methods of misuse of EU funds by organised crime, a risk analysis on the different EU funds and the quantification of EU funds misused by organised crime in 2009. In addition, several recommendations are made focussing on a future implementation of a more uniform definition of 'misuse/fraud' and 'organised crime', a permanent uniform fraud prevention program in the EU institutions, a more uniform registration of cases for further analysis, a different focus from the EU agencies and the possibility of more peer review. In addition, we believe it is recommended to further develop proactive review of beneficiaries of EU funds and strive for increased transparency and accountability.

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LIST OF ABBREVIATIONS

AGRI	Agriculture and Rural Development Committee
CAP	Common Agricultural Policy
CFP	Common Fisheries Policy
CDM	Clean Development Mechanism
DG	Directorate General
CITL	Commission Community Independent Transaction Log
EAFRD	European Agricultural Fund for Rural Development
EAGF	European Agricultural Guarantee Fund
ECA	European Court of Auditors
EFF	European Fisheries Fund
EIB	European Investment Bank
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EUA	EU Allowances
Eurojust	European Union's Judicial Cooperation Unit
Europol	European Police Office
ETS	Emission Trading Scheme
GHG	Greenhouse Gas
IET	International Emissions Trading
IFI	International Financial Institutions
INTOSAI	International Organizations of Supreme Audit Institutions

IPA	Instrument for Pre-Accession Assistance
ISA	International Standards on Accounting
IT	Information Technology
JI	Joint Implementation
MLA	Mutual Legal Assistance
NAP	National Allocation Plan
NSRF	National Strategic Reference Framework
OLAF	Office européen de la Lutte Anti-Fraude – European Anti-Fraud Office
OP	Operational Programs
PV	Photovoltaic
SAPARD	Special Accession Program for Agricultural and Rural Development
TAIEX	Technical Assistance and Information Exchange Instrument
TFEU	Treaty on the Functioning of the European Union
UCLAF	Unité de Coordination de la Lutte AntiFraude - Task Force for Coordination of Fraud Prevention
UN	United Nations
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value Added Tax

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EXECUTIVE SUMMARY

Purpose of the study

This study on *'how does organised crime misuse European Union (EU) funds?'*, describes what means and methods are being used by organised crime to defraud the EU, and what recommendations can be made to strengthen the resilience of the EU funds against these frauds. This study is conducted on behalf of the European Parliament and is, according to the Terms of Reference (Appendix A.1), based on information available in the public domain and information made available to us by Europol, Eurojust, OLAF and the European Court of Auditors.

The legal base for action on the EU level to protect the EU's financial interests and the fight against fraud is laid down in article 325 TFEU. However, this article focuses not explicitly on organised crime, but on the protection of the financial interests against any type or form of crime.

Approach

The study has been conducted in two phases. In the first phase PwC explored what organised crime is, how EU funds can be characterised and exemplified cases of misuse of EU funds by organised crime and which means and methods were used. During the first phase interviews were taken at the EU institutions OLAF, Europol, Eurojust and the European Court of Auditors. After writing the first phase of the report PwC organised on 27 January 2011 an expert meeting at the European Parliament to discuss various issues encountered during the writing of the interim report. The second phase of the study examined what can be done in order to strengthen the various EU funds against attempts of misuse.

Definitions of 'organized crime', 'EU funds' and 'misuse' (fraud)

There is not one universal definition of organised crime. Organised crime is an ever changing phenomenon in an ever changing world. Definitions of this phenomenon differ in time and the various definitions reflect the different angles to look at the problem, and the different positions in the discourse. This is not problematic, as long as one working definition is being used by all actors involved in the fight against organised crime.

Although the European Union has adopted a definition of organised crime in Council Framework Decision 2008/841/JHA of 24 October 2008 (on the fight against organised crime), it turns out that in the respective institutions of the EU, differences in how organised crime is being defined can be discovered. While Eurojust uses the definition from the Council Framework Decision mentioned, Europol is using a slightly altered definition. OLAF and the ECA have no specific working definition of organised crime. However insignificant which definition is being used, when it comes to exchange of information on organised crime it could be helpful to agree, in detail, to what all parties regard as organised crime.

Taking the basic points and assumptions in consideration from the different definitions as used by used by scholars, academic and several (EU) authorities and organisations, for this study *organised crime* is defined as: a structured association, established over a period of time, acting in concert with a view to committing offences, in order to obtain,

directly or indirectly, financial or other material benefit, which causes serious damage to the financial integrity and/or foundations of the EU.

In this study, *misuse* of EU funds is defined as *fraud* with EU funds. Whereas 'misuse' is *wrong or improper use* or misapplication, fraud is generally defined as *deceit, trickery, sharp practice, or breach of confidence, perpetrated for profit or to gain some unfair or dishonest advantage*. Especially the element *perpetrated for profit* marks the distinction between unintentional acts and – specialism of organised crime – intentional acts in order to obtain financial or other material benefit.

All EU funds could be affected by fraud committed by organised crime. In this study special attention is paid to the so called spending funds. These 'funds' are part of the EU budget which according to Article 311 TFEU is financed from the EU's Own Resources among which are percentages of VAT as well as excise collected in the Member States. Since VAT as well as excises have a track record of attracting criminals, also the 'misuse' of these 'EU funds' (VAT-fraud and fraud with excises (cigarette smuggling)) are taken into account, although on a more generic level.

The management and control of EU funds

With regard to the EU 'spending' funds, where millions of Euros are paid on the basis of cost declarations by beneficiaries in many different countries, the risk of errors and even fraud is considerable. In order to make sure funds are spent for the right purposes, projects have to comply with certain objectives and priorities, defined within the limits of the legal base of the underlying EU programme by the Commission and Member States together. To control that the objectives are pursued, and obtained at the end, the Commission designed one control structure for all funds that consists of various layers.

The control structure for EU funds is primarily the responsibility of the Member State. The Member States design their national control system that has to comply to European Commission standards. After the approval by the European Commission of the design, the Member States organise the certifying and management authority and the audits over these authorities at their own best knowledge. The European Commission supervises the control systems of the Member States with very few over- and insight in the direct spending procedures on the projects. The strength of the national control system is determined by the Member States.

A lot of attention in the control structure for EU funds is paid at the quality of proposals for projects, the qualifications of the tenderer and on cost declarations and sound financial management. Less effort is put to screening of the tenderers, the people behind the tendering organisations, the ultimate beneficiaries of profit made by the tenderers.

The protection of the EU's financial interest and the fight against fraud

The legal base for action on the EU level to protect the EU's financial interests and fight fraud is laid down in article 325 TFEU. This article states that: "*The Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union [...] The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, after consulting the Court of Auditors, shall adopt the necessary measures in the fields of the prevention of and fight against fraud affecting the financial interests of the Union with a view to affording effective and equivalent protection in the Member States and in all the Union's institutions, bodies, offices and*

agencies. [...]” The fight against organised – or any other - crime that defrauds the EU by committing fraud with spending funds, VAT-fraud or fraud with excises is a relevant topic for the European Parliament, as are any possible measures to prevent such fraud.

Lack of reliable information on the extent of misuse of EU funds by organized crime

Based on the publicly available information on misuse of and fraud with EU funds as typified here above, only very general statements can be made. According to OLAF, it *“has found growing evidence that in many cases the frauds in the Structural Funds are organised and planned and have not resulted from simple opportunity.”* OLAF was however not able to present detailed and exact figures of these ‘many’ cases, nor of their magnitude, nor whether the way they were ‘organised and planned’ falls within the definition of organised crime as used for this study.

The ECA reports around 3 cases per year to OLAF, based on its audit work. Whether or not this is a case of fraud, let alone fraud committed by organised crime, is for the ECA ultimately a juridical question, something which has to be established by a court of law. The ECA does not keep account of the follow up and judicial outcome of their reported cases.

In the EU Organised Crime Threat Assessment (OCTA), no explicit facts and figures are presented with regard to misuse of or fraud with EU funds by organised crime. But when describing the EU criminal markets, reference is made in the OCTA to VAT fraud and to public procurement fraud. However, without mentioning any facts or numbers quantifying the (estimated) extent of this type of crime.

Only Eurojust was able to produce some figures: 42 cases of offences against the financial interests of the European Union have been recorded by Eurojust from January 2004 until October 2010. Of these, in 2009 three cases were registered at Eurojust as offences affecting the EU’s financial interest which were also committed by organised crime groups. Additionally, a total of 197 VAT Fraud cases have been registered at Eurojust in the period January 2004 and October 2010. However, no figures are available on the magnitude of these cases.

Based on the available information, the question concerning the extent of misuse of EU funds by organised crime, including VAT-fraud, is impossible to answer. Insufficient information is available in the public domain (nor handed over for the purpose of this study by OLAF, Europol, Eurojust and the ECA due to confidentiality) to make only a very rough estimation.

Lack of reliable information on how organized crime misuses EU funds

Based on the case studies and the information from open sources of cases of fraud with EU funds, only a few general conclusions can be drawn with regard to *how* organized crime defrauds the EU. Concerning the number of people involved, almost all cases show a network with more than two individuals and/or companies involved. Furthermore the cases show that these (criminal) networks operate transnational.

Furthermore it comes forward that the following offences often go together with the misuse of EU funds:

-
- Bribery and corruption;
 - Overstatement of the subject that relates to the fund (e.g. cost estimates, land, counselling hours, participants, ...);
 - Forged or falsified documents/certifications;
 - Illegal financial benefits;
 - Fake transactions;
 - Embezzlement;
 - Falsification of the procedures (e.g. allocation of funds, procurement or auctioning);
 - Money laundering;
 - Creation of shell companies.

With regard to the nature of the EU funds misused, the information collected provides an indication that, in general, misuse of EU funds points towards the EU funds managed by the Member States, such as the structural funds and pre-accession funds. Only in a few cases the misuse points towards funds which are directly managed by the Directorate Generals of the European Commission.

Recommendations

At this moment, an aligned focus on the phenomena (serious) fraud and organised crime seems not yet to be in place in the cooperation between OLAF, Europol, Eurojust and ECA. Within OLAF, there is no focus on organised crime, while Europol focuses on fighting organised crime, VAT-fraud and cigarette smuggling when fighting fraud. There is not a direct data connection between Europol and OLAF, and there is not a regular matching of subjects or identifiers (telephone numbers, bank account numbers) from actual investigations of the two organisations. This implies that links are not automatically discovered, if at all. The same goes for the matching of subjects and identifiers between Europol and Eurojust, or between one of the EU institutions and the Member States. A comprehensive picture of the extent of fraud committed by organised crime is difficult to draw when available information and data are not shared and matched optimally.

There is however enough relevance in determining whether and to what extent organised crime is involved in defrauding the EU. The following recommendations can be made.

Recommendation 1

Implement and use uniform definitions of the different terms used in this context: uniform definitions of 'organised crime' (or even: 'serious crime'), 'criminal organisation', 'misuse' (or better: 'fraud') and 'EU funds' should be applied by all relevant national and EU institutions. The definition of a 'criminal organisation' from the Council Framework Decision 2008/841/JHA should be implemented and used in a uniform way, with emphasis on the fact that their (serious) crime causes serious damage to the financial integrity and/or foundations of the EU.

Recommendation 2

Register, on the national and the EU level, cases of misuse of EU funds in a uniform way so that comparisons and additions can be made and a match of these registrations should, in spite of legal obstacles, ideally be matched to discover links between subjects on the national level and the EU level, but also on links between fraud and organised crime. Increase exchange of data and information between OLAF, Europol, Eurojust and the ECA on misuse of EU funds by organised crime.

Recommendation 3

Attribute EU institutions and agencies, especially OLAF, Europol, Eurojust as well as the European Court of Auditors, with the task to actively focus on 'misuse of and fraud with EU funds by organised crime'.

Recommendation 4

Investigate the possibility of more peer reviewing and auditing of spending of EU funds by officials from other than the receiving Member State.

Recommendation 5

Investigate the possibility of more standards and qualification levels for civil servants and auditors involved in the national management, control and audit of EU funds.

Recommendation 6

Update the anti-fraud policy with regard to EU funds. Include or reinforce the statement of zero tolerance.

Recommendation 7

Encourage a permanent fraud prevention programme for all EU institutions and for all Member States institutions dealing with EU funds. Such a programme should consist of i.a. implementation of clear policies, proactive screening of new staff, fraud awareness training for new and existing staff, attention for fraud awareness in evaluation of staff and attention for a safe environment to report suspicions.

Recommendation 8

Encourage the development of tools to support the proactive review of beneficiaries of EU funds and the detection of suspicious signs marking potential fraud. Efficient rules for protecting witnesses and for encouraging disclosure in the public interest (whistleblowing) should be implemented at EU (*inter alia* by a revision of articles 22a and 22b of the Staff Regulations) and Member States level.

Recommendation 9

Strive for an increased transparency and accountability by using all means available to proactively publish and disseminate data and information on spending of EU funds to civil society and the broader public.

Recommendation 10

Encourage all Member States to introduce a reverse charge mechanism with regard to VAT for trade that is vulnerable for VAT fraud.

1. PURPOSE OF THE STUDY

The purpose of the study on how organised crime misuses European Union (EU) funds, is to describe what means and methods are being used by groups of people (that can be defined as organised crime) to defraud the EU, and what recommendations can be made to strengthen the resilience of the EU funds against these frauds. This study is conducted on behalf of the European Parliament and is, according to the Terms of Reference (Appendix A.1), based on information available in the public domain and information made available to us by Europol, Eurojust, OLAF and the European Court of Auditors.

The study has been conducted in two phases. The first phase explored what organised crime is, how EU funds can be characterised, and example cases of misuse of EU funds by organised crime and how it was appropriated. The second phase of the study examined what can be done in order to strengthen the various EU funds against attempts of misuse.

The following five key questions - as formulated in the Specific Terms of Reference for this study - are answered:

- **How can 'organised crime' and types of 'misused EU funds' be defined and how can the relation between these terms and the obligation of protecting the EU's financial interests be described?** An account of the discourse on the definition of organised crime and how this has materialised through EU legislation is introduced in chapter 2. This chapter also presents the different (working) definitions that are being used by EU agencies. In chapter 3 an overview is given of the different types of EU Funds, how these funds are managed and controlled against fraud and the size of fraud within these respective funds during 2009.
- **How can the extent to which organised crime misused EU funds in 2009 be quantified?** A brief overview of facts and figures from official EU authorities is presented in paragraph 4.1, together with commentary on the limited volume of factual information and formal data which was available for this study and also what could be done to increase the ability to quantify the misuse of EU funds in 2009 by organised crime.
- **How is 'organised crime' – as defined in the context of this study - organised and which means and methods are used to defraud the Union and its Member States?** In paragraph 4.2, five case studies are presented: two cases studies from open sources and three case studies based on information provided by Eurojust. Based on these five case studies and on the general information from official EU authorities (also in paragraph 4.1) commentary is provided on how organised crime in the context of this study is organised and what means and methods were used.
- **To what degree are the various types of EU funds sensitive to being misused by organised crime?** In the chapters 3 and 4, some commentary will be provided on the fraud vulnerability for the various types of EU funds.
- **By which regulatory, organisational, technical and other measures EU and other bodies (e.g. implementing authorities in Member States) could avoid EU funds being misused by organised crime?** In chapter 5 conclusions

and recommendations are presented on a theoretical framework to assess the vulnerabilities in EU funds in more detail and also the measures to reduce these vulnerabilities. Discussions of the different approaches also consider the impact on principles like data protection, simplicity of regulations and cost-effectiveness of the measures.

The aim of this research is not to present a thorough academic dissertation on organised crime, but instead, to present a general analysis of the definitions of organised crime through giving a brief and practical overview of what are relevant elements defining organised crime in the context of this study.¹

Although VAT-fraud and cigarette smuggling cannot be considered as spending funds of the EU, and in fact does fall exclusively within the competence of the EU, information on how organised crime is involved in VAT-fraud and cigarette smuggling is also presented in the scope of 'misuse of EU funds'. In agreement with the European Parliament, this report will focus on spending funds, however VAT-fraud and cigarette smuggling will be considered at a generic level.

¹ Scope, proposed methodology and work plan were detailed and finalised during a kick off-meeting with the European Parliament on 28 September 2010. A further detail of the scope with regard to 'EU fund' and the question whether VAT-fraud should be taken into consideration was done in November 2010.

2. DEFINITION OF ORGANISED CRIME

There is not *one* agreed definition of organised crime. As a result of differences throughout Europe and the rest of the world in judicial systems, police registration methods of organised crime and differences in registration of criminal offences and police activities, defining organised crime and measuring organised crime is difficult.²

Organised crime is an ambiguous concept with a history which keeps changing over time.³ It is a social construction reflecting forms of crime perceived to be particularly dangerous by society at a given point in time and influenced by different political and institutional interests. Organised crime does not take place in a vacuum but in an ever changing environment. It is a dynamic process adapting to emerging criminal opportunities to resources and skills available to potential criminals as well as to law enforcement and other control efforts. It may also take on different forms within different societies. In the words of the director of Operations and Investigations at OLAF, *"organised crime is an ever changing phenomena that needs constant analysis."*⁴

With the paradigm shifting from a focus on hierarchical, 'bureaucratic' organised crime groups with well developed structures, to criminal networks – which may take many different shapes, some of which are more permanent or even hierarchical, and others which are loose and fluid. Therefore it becomes extremely difficult to identify "structures" and thus organised crime in the conventional sense. The idea of organised crime as a clearly distinct form of crime may be misleading. It may be more appropriate to think of a continuum where some forms of serious crime are more organised than others. Furthermore, knowledge of organised crime depends upon controls. Only those criminal activities which are investigated or analysed from an organised crime point of view become visible as such.⁵

All definitions thus mirror a certain way of looking at organised crime. Defining organised crime can have two risks: firstly the definition of organised crime is either too narrow or, secondly too broad. When a definition is too narrow, it most probably describes one specific form of organised crime resulting in the fact that other forms of crimes are neglected. A well-known example of a too narrow definition of organised crime is the definition from the President's Commission Task Force Report on Organised Crime in America in 1967.⁶ The Task Force described organised crime as a strong hierarchical organisation of Italian origin. It is obvious that this definition of organised crime is referencing the mafia and therefore excludes other types of organised crime not adhering to this definition.

As opposed to this narrow definition often too broad definitions are used to describe organised crime. In these definitions all crimes that are committed by criminal entrepreneurs is deemed organised crime, irrespective of the nature of the crimes or

² See for instance more than 150 definitions of organised crime on: von Lampe, K., Definitions of Organized Crime, www.organized-crime.de/organizedcrimedefinitions.htm

³ These conceptual notions are quoted from: Council of Europe, *Organised crime situation report 2005: Focus on the threat of economic crime*, Octopus Programme, December 2005, <http://www.coe.int/t/dghl/cooperation/economiccrime/organisedcrime/Report2005E.pdf>

⁴ Stated in the Expert Meeting on Misuse of EU funds by organised crime (European Parliament, 27 January 2011)

⁵ Council of Europe, *Organised crime situation report 2005. Focus on the threat of economic crime*, Octopus Programme, December 2005

⁶ U.S. Government, *The Task Force on Organized Crime, Task Force Report: Organized Crime*, Washington: Printing Office, 1967

businesses.⁷ A too broad definition is in the context of this study not usable because of the specific form of offence committed by organised crime which is this study's subject.

The two above-mentioned risks also occur in legal definitions. In national and international legal definitions there is often tension between those who want legislation to cover a wide set of circumstances to avoid the risk of criminals 'get away with it', and those who want the law to be specific to avoid the situations where groups are criminalised even though they pose only a modest threat.⁸

In this chapter is summarized what legal definitions are used in the EU of irregularities, fraud and organised crime. In addition is recapitulated what definitions of organised crime are used by authorities within the EU like Europol, Eurojust, OLAF and the European Court of Auditors (ECA) and by scholars and academics.

2.1. Legal definitions in the EU

Organised crime is not bound by national borders. This means that it is important that the legislation (procedural and substantive criminal law) of different countries connect with each other, especially with criminal prosecution. A common vision, policy and priority with regard to organised crime in the Member States of the EU is therefore essential to fight organised crime jointly. One of the main difficulties within the EU strategy is the penalisation of organised crime, which differs between the Member States.

The EU defined a criminal organisation in the Council Framework Decision 2008/841/JHA of 24 October 2008 on the fight against organised crime as:

"A structured association, established over a period of time, of more than two persons acting in concert with a view to committing offences which are punishable by deprivation of liberty or a detention order of a maximum of at least four years or a more serious penalty, to obtain, directly or indirectly, a financial or other material benefit."

A 'structured association' as stated in the Framework Decision means that the association is not randomly formed for the immediate commission of an offence, but does not need to have formally defined roles for its members, continuity of its membership, or a developed structure.

The Framework Decision determines that each Member State in the EU shall take the necessary measures to ensure that types of conduct related to a criminal organisation are seen as offences. These conducts are determined in Article 2 in the Framework Decision as:

"a) conduct by any person who, with intent and with knowledge of either the aim and general activity of the criminal organization or its intention to commit the offences in question, actively takes part in the organization's criminal activities, including the provision of information or material means, the recruitment of new members and all forms of financing of its activities, knowing that such

7 Van de Bunt, H. Fijnaut, C., Bovenkerk, F. and Bruinsma, G.J. *De georganiseerde criminaliteit in Nederland. Het criminologisch onderzoek ten behoeve van de enquêtecommissie opsporingsmethoden*, Tijdschrift voor Criminologie, nr. 2, p. 102-119, 1996

8 Levi, M. *The Organisation of Serious Crimes*, in Maguire, M., Morgan, R. and Reiner, R. (eds.), *The Oxford Handbook of Criminology*, 3rd edition, Oxford, Oxford University Press, 2003, p. 878 - 913

participation will contribute to the achievement of the organization's criminal activities;

b) conduct by any person consisting in an agreement with one or more persons that an activity should be pursued, which if carried out, would amount to the commission of offences referred to in Article 1, even if that person does not take part in the actual execution of the activity."

The Framework Decision stipulates that for the offences stated in Article 2, each Member State shall take the necessary measures to fight organised crime by implementing minimum penalties in their national law. The two above mentioned offences should be penalized by a maximum term of imprisonment of at least between two and five years.

As the Council Decision is a directive and is not directly applicable, the Member States have grace period to implement measures necessary to comply with the Council Decision. Nevertheless Article 10 of the Council Decision states that Member States shall implement the necessary measures to comply with the Framework Decision before 11 May 2010.

Francesco Calderoni⁹ completed an exploratory assessment of the harmonisation and the approximation of organised crime legislation among EU Member States. In his analysis Calderoni shows that the Framework Decision (to be implemented by May 2010 in all EU Member States) should not be expected to have a major impact on the national legislations of the EU Member States because of the fact that most EU Member States already comply with the EU requirements. He states: *"These results support the numerous criticisms about the broadness and ineffectiveness of international legal instruments aiming at harmonization and approximation of criminal legislation, in particular in the EU. In the light of these remarks, it is reasonable to call the European institutions and the EU Member States to reconsider the criminal law policies on organized crime, to avoid that the goal of an effective prosecution of organized crime is pursued at the cost of human rights and civil liberties."*

Opposite to the Counsel's aim to unify the definition of organised crime, a study of the European Parliament¹⁰ in February 2009 titled *"The EU Role in Fighting Transnational Organized Crime"* concludes that the Council Decision has not been constructive in defining organised crime in the national law of the Member States. Terms of definition remain very broad, highly flexible, and do not provide any legal certainty. This was also underlined by the study of Calderoni.¹¹ He claims that in general the Framework Decision requires EU Member States to adopt a broader concept of criminal organisation. Member States with more precise definitions will have to change their legislation or introduce new, and more generic offences. He points out that a possibly dangerous consequence can be that such generic provisions will create situations where a variety of situations and behaviors are labeled as 'organised crime' when in fact, they are quite different from dangerous criminal organisation activity.

Defining and criminalising organised crime can be a legally complex task, as it is difficult to translate multifarious activities of organised criminals into a legal definition with a

9 Calderoni, F., *Organized Crime Legislation in the European Union*. Heidelberg: Springer, 2010

10 Scherrer, A., Mégie A. and Mitsilegas, V. *The EU Role in Fighting Transnational Organised Crime*, European Parliament, 2009

11 Calderoni, F., 2010 *Organized Crime Legislation in the European Union*. Heidelberg: Springer, 2010

sufficient degree of legal certainty.¹² As a result, the study of the European Parliament in February 2009 states that the inexistence of a clear legal definition creates a potentially large scope of criminalization of organised crime across the EU. In addition, the study claims that this is worrying and it may lead to considerable diversity in implementation at a time where organised crime is advancing more quickly than the legislation and judicial systems of the Member States can keep up with.

In the Council Framework Decision 2008/841/JHA of 24 October 2008 on the fight against organised crime a criminal organisation is defined as: “A structured association, established over a period of time, of more than two persons acting in concert with a view to committing offences which are punishable by deprivation of liberty or a detention order of a maximum of at least four years or a more serious penalty, to obtain, directly or indirectly, a financial or other material benefit.”

2.2. Scholar definitions

Hundreds of definitions of organised crime and comments on the problem of defining organised crime from various types of sources can easily be found. All definitions mirror a certain way of looking at organised crime.¹³

Definitions of organised crime made by politicians might be obscured by political concerns¹⁴ and therefore differ somewhat from definitions developed by scholars and academics. Some of the scholars look at the phenomenon from a juridical or a criminological point of view, with others from a cultural or social perspective.

In 1976 Michael Maltz created one of the first criminological definitions of organised crime. He described¹⁵ the problems and difficulties in defining the phenomenon. His definition of organised crime was: *“Organized crime is a crime in which there is more than one offender, and the offenders are and intend to remain associated with one another for the purpose of committing crimes. The means of executing the crime include violence, theft, corruption, economic power, deception, and victim participation. These are not mutually exclusive categories; any organized crime may employ a number of the means.”*

In this definition Maltz proposed that organised crime was identifiable through a list of characteristics, of which four were considered essential: violence, corruption, continuity, and variety in the types of crime engaged in. Michael Levi commented on the definition of Maltz in 1998 with the following¹⁶: *“However, smart people who avoid using violence and trade very competently and profitably in only one product - for example, ecstasy or cannabis production - thus cannot be described as organized criminals, which would doubtless please them if they thereby received less police attention and/or lighter sentences. Neither could professional full-time fraudsters (...) be 'organized criminals'. In other words, one could sustain some distinction between people who make affluent*

¹² Scherrer, A., Mégie A. and Mitsilegas, V., *The EU Role in Fighting Transnational Organised Crime*, European Parliament, 2009

¹³ See for example: <http://www.organized-crime.de/OCDEF1.htm>

¹⁴ Shanty, F. and Mishra, P.P., *Organized crime: from trafficking to terrorism* California: ABC CLIO, 2008

¹⁵ Maltz, M. D. *On Defining Organized Crime*, *Crime and Delinquency* nr. 22, 1976, p. 338-346

¹⁶ Levi, M., *Reflections on Organized Crime: Patterns and Control* Oxford: Blackwell, 1998

livelihoods from crime - professional criminals - and those who do so according to Maltzist criteria - organized criminals."

Though it might seem logical to distinguish organised crime from professional crime - more in the line of white collar crime - there may be nothing disorganised about professional transnational financial criminals whose careers involve major frauds¹⁷. Organised crime is not only a set of criminal *actors* but – maybe even more important – also a set of *activities*¹⁸, as in this study of fraud against the EU and more specifically fraud with European funds.

In order to define a workable definition for this study it is important to focus more on *the activities* of organised crime, instead of focusing on *the offenders* of organised crime. This remark was also underlined by Edward Kleemans, Professor in Serious and Organised Crime and Criminal Justice in the Netherlands¹⁹, who was interviewed while constructing a work definition of organised crime for this study.

Mentioned earlier, is the aspect that there is also certain interweavement between white collar crime and organised crime as was already stated in 1949 by Edwin Hardin Sutherland.²⁰ Sutherland controversially stated that there is a certain overlap between white collar crime and organised crime. He defines white collar crime as *"a crime committed by a person of respectability and high social status in the course of his occupation."* Sutherland describes in his study that the illegalities committed by corporations share most of the characteristics of organised crime, namely that offenses of white collar criminals are deliberate and organised, and that they often are recidivists and commit crimes for a longer period whilst showing disdain for the law.

Sutherland concluded in 1949 that there is an amount of crossover between white collar crime and organised crime, as was again underlined in an interview with a delegate of Europol who stated that modern organised crime, involved in misuse of public (EU) funds is more sophisticated than more traditional organised crime.

Organised crime is a very complex phenomenon: it affects criminological, juridical, social, economic, political and cultural areas and the attempts to provide an adequate definition of the phenomenon gives also by scholars a controversial debate, which causes that there is also not one scholarly univocal definition of organised crime.

2.3. Definitions of irregularities, (serious) fraud and corruption in the EU

Seen from the perspective that organised crime is not only a set of actors but more importantly a set of activities and that this study focuses on fraud against the EU and more specifically fraud with European funds, we elaborate on the connection between organised crime and fraud in the following paragraphs.

¹⁷ Levi, M., The Organisation of Serious Crimes, in Maguire, M., Morgan, R. and Reiner, R. (eds.), *The Oxford Handbook of Criminology*, 3rd edition, Oxford, Oxford University Press, 2003, p. 878 – 913

¹⁸ Cohen, A.K., *The concept of a criminal organisation*, British Journal of Criminology, nr 17, 1977, p. 97-111

¹⁹ Edward Kleemans is Professor in Serious and Organized Crime and Criminal Justice in the Netherlands. He is also author of 'Organized Crime Monitor reports' for the Research and Documentation Centre for the Ministry of Security and Justice in the Netherlands.

²⁰ Sutherland, E.H., *White collar crime*, New York, Holt, Rinehart and Winston, 1949

When the authorities in the Member States discover or have suspicions of fraud and other irregularities affecting the EU's financial interests (including the EU funds), EU legislation²¹ requires the Member States to report these discoveries or suspicions. For this study it is important to make a distinction between *(serious) fraud* and *irregularities* with EU Funds.

The definitions of the terms 'irregularity', '(serious) fraud', 'corruption' and 'other illegal activities harmful to the Union's financial interests' are established in various legislative EU acts.

Irregularity is defined in Article 1(2) of Council Regulation 2988/95 on the protection of the European Communities financial interests.²² For the purpose of the structural funds and the Cohesion Fund, a specific definition is used.²³

- The European legal definition of 'irregularity' is:

"Any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure."

- Article 2 (7) of Regulation (EC) No 1083/2006 lays down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund. It defines 'irregularity' as *"any infringement of a provision of Community law resulting from an act or omission by an economic operator which has, or would have, the effect of prejudicing the general budget of the European Union by charging an unjustified item of expenditure to the general budget."*

'Fraud affecting the European Communities' financial interests' is defined in Article 1²⁴ of the Convention on the protection of the European Communities' financial interests, and 'serious fraud' is defined in Article 2²⁵ of the Convention.

- The European legal definition of behaviors characterising fraud is:

"[...] fraud affecting the European Communities' financial interests shall consist of:

a) in respect of expenditure, any intentional act or omission relating to:

- *the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities;*
- *non-disclosure of information in violation of a specific obligation, with the same effect;*

²¹ Belloch Julbe, J.A., Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interests, OJ C 316, 27.11.1995

²² Borell Fontelles, J., Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests, OJ L 312, 23.12.1995, p. 1.

²³ Heinäluoma, E., Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, Article 2(7) of Regulation (EC) No 1083/2006, OJ L 210, 31.7.2006, p. 36.

²⁴ Belloch Julbe, J.A., Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interests, OJ C 316, 27.11.1995

²⁵ *ibid.*

- *the misapplication of such funds for purposes other than those for which they were originally granted;*
- b) in respect of revenue, any intentional act or omission relating to:*
 - *the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities;*
 - *non-disclosure of information in violation of a specific obligation, with the same effect;*
 - *misapplication of a legally obtained benefit, with the same effect."*
- Article 2 (1) of the Convention states that " [...] 'serious fraud' shall be considered to be fraud involving a minimum amount to be set in each Member State. This minimum amount may not be set at a sum exceeding ECU 50 000."

'Corruption of Community officials' is defined in the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union²⁶, together with the Protocol to the Convention on the protection of the European Communities' financial interests.²⁷ Separate definitions are provided for 'passive corruption' and 'active corruption'.²⁸

- For the Convention and the Protocol to the Convention mentioned above, Article 2 (1) in both documents defines passive corruption as "[...] the deliberate action of an official, who, directly or through an intermediary, requests or receives advantages of any kind whatsoever, for himself or for a third party, or accepts a promise of such an advantage, to act or refrain from acting in accordance with his duty or in the exercise of his functions in breach of his official duties in a way which damages or is likely to damage the European Communities' financial interests shall constitute passive corruption."
- Active corruption is defined in Article 3 (1) of both the Convention and the Protocol to the Convention. Active corruption is "[...] the deliberate action of whosoever promises or gives, directly or through an intermediary, an advantage of any kind whatsoever to an official for himself or for a third party for him to act or refrain from acting in accordance with his duty or in the exercise of his functions in breach of his official duties shall constitute active corruption."

Fraud with EU funds is an irregularity committed intentionally which constitutes a criminal offence. The responsibility of the Member States is to identify which irregularities within the use of EU funds are suspicious. Fraud with EU funds is partly committed by organised crime. The following figure shows the three different levels within all irregularities.

26 Sorgdrager, W., Council Act of 26 May 1997 drawing up, on the basis of Article K.3 (2) (c) of the Treaty on European Union, the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union, OJ C 195, 25.6.1997, p. 2.

27 Protocol drawn up on the basis of Article K.3 of the Treaty on European Union to the Convention on the protection of the European Communities' financial interests - Statements made by Member States on the adoption of the Act drawing up the Protocol, OJ C 313, 23.10.1996, p. 2.

28 OLAF, OLAF Manual, Operational Procedures, 1 December 2009, p 16-17

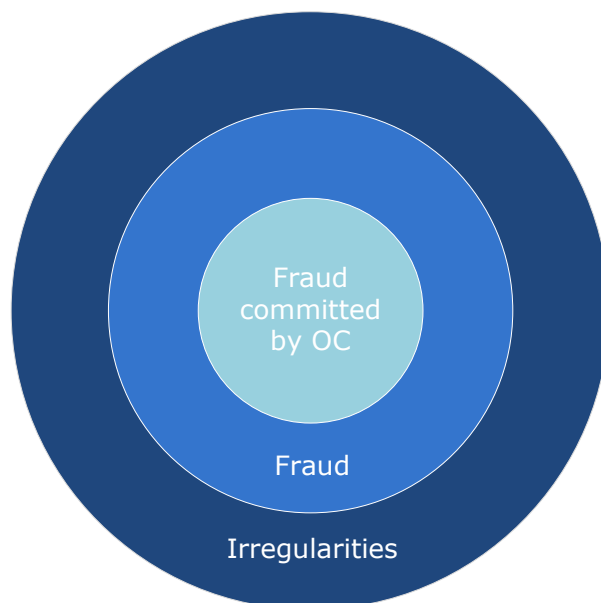


Figure 1: Three levels within irregularities

2.4. Fraud is a serious crime, as is participation in a criminal organisation

According to the European Parliament and the European Council²⁹ serious crime means the following offences under national law referred to in Article 2(2) of Council Framework Decision 2002/584/JHA if they are punishable by a custodial sentence or a detention order for a maximum period of at least three years under the national law of a Member State (only the relevant offences in the context of this study are listed):

- participation in a criminal organization;
- [...]
- corruption;
- fraud, including that affecting the financial interests of the European Communities within the meaning of the Convention of 26 July 1995 on the protection of the European Communities' financial interests;
- laundering of the proceeds of crime;
- [...]
- swindling;
- racketeering and extortion;
- counterfeiting and piracy of products;
- forgery of administrative documents and trafficking therein;
- [...]³⁰

²⁹ In their proposal for a Directive of the European Parliament and of the Council on the use of Passenger Name Record data for the prevention, detection, investigation and prosecution of terrorist offences and serious crime (COM(2011) 32 final).

³⁰ Council of Europe, Council Framework Decision 2008/841/JHA, 24 October 2008, preamble 7, OJ L 11.11.2008, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:300:0042:0045:EN:PDF>

'Serious transnational crime' regards to the same offences, if:

- They are committed in more than one state;
- They are committed in one state but a substantial part of their preparation, planning, direction or control takes place in another state;
- They are committed in one state but involve an organised criminal group that engages in criminal activities in more than one state; or
- They are committed in one state but have substantial effects in another state.

Misuse of EU funds committed by fraud affecting the financial interests of the European Communities and by using corruption and other serious crimes mentioned here above, is a serious crime. And – as will be made clear in the following paragraphs – it is serious transnational crime in several cases.

If such a serious (transnational) crime is committed by a criminal organisation, this means that only an extra serious crime is committed. But for the prevention and prosecution of fraud that affects the financial interests of the European Communities *as such*, it is not relevant whether this serious crime is committed by an individual or by a criminal organisation.³¹

Fraud with EU funds is an irregularity committed intentionally which constitutes a criminal offence. Moreover, fraud affecting the European Communities' financial interests is regarded as a serious crime, as is participation in a criminal organisation.

2.4.1. Why does the fight against organised crime require an EU approach?

Because of the fact that fraud affecting the financial interests is a serious crime, especially when it is committed by (transnational) organised crime, the fight against this type of crime requires an EU approach. Why the fight against organised crime requires an EU approach is elaborated in the following paragraphs.

The protection of human rights is ensured through Article 61 of the TFEU: *"the Union shall constitute an area of freedom, security and justice with respect for fundamental rights and the different legal systems and traditions of the Member States."*

Though *"the provision of internal security is one of the State's core functions and is consequently highly protected by the principles of national sovereignty and territoriality"*³², transnational organised crime is, by definition, a problem that requires a European approach. The Treaty of Amsterdam provided the union with an explicit mandate to provide its citizens with a *'high level of security'*³³. Through the Lisbon Treaty, Member States have conferred upon the Union, the following powers:

"The European Parliament and the Council may, by means of directives adopted in accordance with the ordinary legislative procedure, establish minimum rules concerning the definition of criminal offences and sanctions in the areas of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis"

³¹ This opinion was unanimously shared amongst the experts present at the Expert Meeting on Misuse of EU funds by organised crime (European Parliament, 27 January 2011)

³² Monar, J., *The EU and Internal Security: Origins, Progress, Limits and Prospects of a Growing Role*, Real Instituto Elcano, July 15th 2009

³³ TEU, Article 29, TEC Article 61(e), http://epress.anu.edu.au/war_terror/html/ch11.html

These areas of crime are the following: terrorism, trafficking in human beings and sexual exploitation of women and children, illicit drug trafficking, illicit arms trafficking, money laundering, corruption, counterfeiting of means of payment, computer crime and organised crime.

[...][PwC: the Council] shall act unanimously after obtaining the consent of the European Parliament.”³⁴

In the Lisbon Treaty it has been laid down that in areas which do not fall within its exclusive competence, the European Union shall act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.³⁵

The same principle has been met through the Council Framework Decision 2008/841/JHA of 24 October 2008 on fighting organised crime, which states that: *“since the objectives of this Framework Decision cannot be sufficiently achieved by the Member States, and can therefore, by reason of the scale of the action, be better achieved at Union level, the Union may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty establishing European Community, as applied by the second paragraph of Article 2 of the Treaty on European Union.”³⁶*

Due to the transnational nature of organised crime, it is a problem that cannot be solved on Member State level. What is more, EU-action is not merely necessary but adds true value by its coordinating and facilitating role.

2.4.2. United Nations

Organised crime is not only a significant part of the popular discourse of European politicians is acknowledged in the United Nations (UN) Convention on Transnational Organized Crime³⁷. This Convention defines an organised criminal group as:

“[...] a structured group of three or more persons, existing for a period of time and acting in concert with the aim of committing one or more serious crimes or offences [...] in order to obtain, directly or indirectly, a financial or other material benefit.”

The UN defines in turn, ‘serious crime’ as *“conduct constituting an offence punishable by a maximum deprivation of liberty of at least four years or a more serious penalty”* and *“structured group” as a group that is not randomly formed for the immediate commission of an offence and that does not need to have formally defined roles for its members, continuity of its membership or a developed structure.”*

In the UN Convention on Transnational Organized Crime an organised criminal group is defined as a structured group of three or more persons, existing for a period of time and acting in concert with the aim of committing one or more

³⁴ TFEU, Article 83(1), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF>

³⁵ Lisbon Treaty, Article 5.3 <http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:2007:306:SOM:EN:HTML>

³⁶ Council of Europe, Council Framework Decision 2008/841/JHA, 24 October 2008, preamble 7, OJ L 11.11.2008, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:300:0042:0045:EN:PDF>

³⁷ The United Nations Convention against Transnational Organized Crime, adopted by General Assembly resolution 55/25 of 15 November 2000.

serious crimes or offences [...] in order to obtain, directly or indirectly, a financial or other material benefit.

2.5. Definitions of organised crime used by EU Agencies and authorities

To compare the definitions of organised crime and fraud from the Council with definitions of various European authorities and agencies, like Europol, OLAF, Eurojust, EIB and ECA. The following paragraphs describe the definitions of organised crime and fraud that are being used by these authorities within the EU.

2.5.1. Europol

Europol is the European Law Enforcement Agency which aims at improving the effectiveness and co-operation of the competent authorities in the Member States, with the aim of preventing and combating terrorism, unlawful drug trafficking and other serious forms of organised crime (www.europol.europa.eu).

In the definition of organised crime used by Europol there are eleven characteristics that are associated with this definition of organised crime. Some of these characteristics are core characteristics, whilst others are secondary. This definition, used by Europol and which is also used in the annual reports on organised crime presented to the European Parliament, requires the identification of a minimum of six characteristics. The first four are mandatory criteria:

- Collaboration among more than two people;
- Extending over a prolonged or indefinite period (referring to stability and (potential) durability);
- Suspected of committing serious criminal offences, punishable by imprisonment for at least four years or a more serious penalty; and
- Has a central goal of profit and/or power.

The remaining two (or more) must be drawn from the following optional criteria:

- Specialized division of labor among participants;
- Exercising measures of discipline and control;
- Employing violence or other means of intimidation;
- Employing commercial or business-like structures;
- Participating in money-laundering;
- Operational across national borders;
- Exerting influence over legitimate social institutions (polity, government, justice, economy).

In the definition of organised crime used by Europol there are eleven characteristics that are associated with the label organised crime. Four of these characteristics are mandatory while the other seven are optional. The definition requires the presence of a minimum of six characteristics.

2.5.2. Olaf

The European Anti-Fraud Office (OLAF) is an administrative investigative service established by the Commission Decision of 28 April 1999, hereby replacing the Task Force for Coordination of Fraud Prevention (UCLAF) and taking over all its tasks.

The Commission Decision of 28 April 1999 - Article 2, states that OLAF achieves this mission by conducting internal and external investigations on an independent basis. It also provides Member States with the necessary support and technical know-how to help them in their anti-fraud activities via maintaining good relationships with local authorities of Member States (e.g. police and judicial authorities), in order to coordinate their activities. In addition, OLAF contributes to the design of the anti-fraud strategy of the EU and takes the necessary initiatives to strengthen the relevant legislation.

The mission of OLAF focuses on the fight against fraud, corruption and any other illegal activity adversely affecting the Community's financial interests. With regard to the definition of the terms 'fraud', 'corruption' and 'other illegal activities harmful to the Union's financial interests', OLAF refers to various legislative acts in its Manual for Operational Procedures.³⁸ These exact definitions of irregularities, (serious) fraud and corruption – which are also used by OLAF – are described in Section 2.3 in this report.

OLAF confirmed that no formal or working definition is used with regard to organised crime. With regard to the definitions for fraud, corruption and irregularities OLAF applies them as stipulated by the EU.

2.5.3. Eurojust

Eurojust, set up by a Council Decision 2002/187/JHA of 28 February 2002³⁹, is the body entrusted with reinforcing the fight against serious crime through closer judicial cooperation within the EU. The purpose of Eurojust is to enable the national investigating and prosecuting authorities to work together on criminal investigations involving several EU countries.

The competence of Eurojust covers the same types of crime and offences for which Europol has competence, such as terrorism, drug trafficking, trafficking in human beings, counterfeiting, money laundering, computer crime, crime against property or public goods including fraud and corruption, criminal offences affecting the European Community's financial interests, environmental crime and participation in criminal organisations.⁴⁰

In the Council Decision of 28 February 2002 *"Setting up Eurojust with a view to reinforcing the fight against serious crime"* is described in Article 4 in section (b) that the general competence of Eurojust shall cover *"the following types of crime: [...] participation in a criminal organisation within the meaning of Council Joint Action 98/733/JHA of 21 December 1998 on making it a criminal offence to participate in a criminal organisation in the Member States of the European Union."*

³⁸ OLAF, OLAF Manual, *Operational Procedures*, 1 December 2009, p 16-17

³⁹ Council of Europe, *Council Decision 2009/426/JHA of 16 December 2008 on the strengthening of Eurojust and amending Decision 2002/187/JHA setting up Eurojust with a view to reinforcing the fight against serious crime*, http://www.eurojust.europa.eu/official_documents/Eurojust_Decision/2009/NewEJDecision2009-EN.pdf.

⁴⁰ Eurojust's contribution to the study on "How does organized crime misuse EU funds?" 20 december 2010.

The definition of a criminal organisation which is used by Eurojust and fits with Article 1 of the Council Joint Action 98/733/JHA of 21 December 1998 is: *“a criminal organisation means a structured association, established over a period of time, of more than two persons, acting in concert with a view to committing offences which are punishable by deprivation of liberty or a detention order of a maximum of at least four years or a more serious penalty, whether such offences are an end in themselves or a means of obtaining material benefits and, where appropriate, of improperly influencing the operation of public authorities.”*

2.5.4. European Court of Auditors

The ECA was established by the Treaty of Brussels of 1975 and performs its role within the interinstitutional framework of:

- the Treaty on the Functioning of the European Union, Articles 310 to 325 which contain financial provisions governing the Union's revenue and expenditure;
- Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities.

The ECA was given *“the role of an EU Institution that carries out the audit of EU finances. As external auditor, it contributes to improving EU financial management and acts as the independent guardian of the financial interests of the citizens of the Union.”*⁴¹

The ECA *“carries out audits, through which it assesses the collection and spending of EU funds. It examines whether financial operations have been properly recorded and disclosed, legally and regularly executed and managed so as to ensure economy, efficiency and effectiveness.”*⁴²

In the ‘Performance audit manual’⁴³ and the ‘Court Audit Policy & Standards’⁴⁴ used by ECA, no definitions are provided for the terms ‘fraud’, ‘impropriety’, ‘corruption’ and ‘irregularities’ used in the audit instructions. Neither is there a working definition for the concept organised crime. Only a suspicion of fraud is required to contact OLAF and transfer their working files to OLAF for further examination.

The ECA's main responsibility is carrying out audits through which it assesses the collection and spending of EU funds. When a case of suspected fraud is identified specific procedures are applied, including communicating the matter to OLAF. There is no working definition for the concept organised crime used by ECA.

2.6. Definition of organised crime in the context of this study and its relevance

As shown there are many definitions of organised crime used by scholars and there is also not one univocal definition of organised crime that is used by the several (EU)

⁴¹ www.eca.europa.eu

⁴² Ibid.

ECA (European Court of Auditors), Performance Audit Manual, p.65, <http://eca.europa.eu/portal/pls/portal/docs/1/271275.PDF>

⁴⁴ ECA (European Court of Auditors), Court Policy & Standards, p. 6, <http://eca.europa.eu/portal/pls/portal/docs/1/269266.PDF>

authorities and organizations. Therefore it is necessary to make some preliminary remarks before describing a working definition of organised crime for this study.

From a scholarly perspective, organised crime is a very complex phenomenon: it affects criminological, juridical, social, economic, political and cultural areas and the attempts to provide an adequate definition of the phenomenon gives also by scholars a controversial debate, which causes that there is not one scholarly univocal definition of organised crime.

A difficulty with defining organised crime is the cultural and organisational differences between organised crime groups - the *actors* - in the Member States. Because of the variety in organised crime offences and actors within the EU countries, definitions of organised crime differ also. Additionally an important aspect to mention is that due to the quick development and changing forms in which organised crime appears – the *activities* – and also the increasing nexus between organised crime and the legitimate environment, in which it exists, causes the definition of organised crime to change over time as well.

As earlier described, organised crime is not only a set of actors, but more importantly a set of activities. This study focuses on fraud against the EU and more specifically fraud with European funds. Fraud is a serious crime, as is participation in a criminal organization. However, fighting fraud affecting the financial interests of the European Communities is not the same as fighting organised crime. On the one hand, both phenomena overlap where fraud is committed by organised crime. The nature of a lot of the misuse of EU funds suggest that some degree of organisation is required. On the other hand, the fight against fraud contains more than just the fight against organised crime (and the reverse is also valid). In order to protect the EU's Financial interests, it is therefore necessary to focus first and foremost on the prevention of fraud as such. Knowledge of organised crime groups or networks and their *modi operandi* is in this regard essential, though instrumental: it helps to design risk assessments, awareness trainings, preventive measures and early warning systems, and it may help – when fraud is detected – to find more possible cases of fraud committed by the same organisation or network.

However, there is enough relevance in determining whether and to what extend organised crime, however it is defined, is involved in defrauding the EU. This relevance lies mainly in scoring the urgency of the problem. Misuse of EU funds can be committed by individuals or groups, deliberately or by chance, only once or repeatedly and by misusing only (part of) one EU fund or misusing more EU funds. In the figure below, some elements (not exhaustive) are listed that characterise fraudsters and their frauds:

Characteristics	
O Individual	O Group

<input type="radio"/> By chance	<input type="radio"/> Deliberately
<input type="radio"/> Once	<input type="radio"/> Repeatedly
<input type="radio"/> One EU Fund	<input type="radio"/> More EU Funds
<input type="radio"/> Small amount	<input type="radio"/> Big amount(s)

Figure 2: Non-exhaustive list of characteristics of fraudsters and their frauds

If it turns out that most of the misuse of EU funds is deliberately and repeatedly committed by groups, the aim of this group is towards more (any) EU funds, and that they succeeded in defrauding the EU for large sums of money, the sense of urgency will develop differently than when it is found that the characteristics of the fraudsters is mainly a combination of the following elements: individuals, fraud by chance, only once, one EU fund and only a small amount.

It is therefore helpful to know what the characteristics are of the criminals involved in misuse of EU funds. From these characteristics it can be derived that there are similarities with (there is overlap with) those networks or organisations that are investigated as being criminal organisations (for committing the same and/or for others serious crimes). This makes a concerted approach towards these organized crime groups possible, even necessary.

Summarizing the definitions used by scholars, academic and several (EU) authorities and organisations there is not one univocal definition of organised crime. The following points should be taken into consideration in order to define a workable working definition for this study:

- Organised crime is not only a set of actors but more importantly a set of activities. These activities enclosed within this study identified fraud against the EU and more specific fraud with European funds.
- Fraud against the EU and more specifically fraud with European funds, causes serious damage, directly or indirectly, to the financial integrity and/or foundations of the EU.

Taking these points and assumptions into consideration the following working definition will be used in this study:

Organised crime shall mean a structured association, established over a period of time, acting in concert with a view to committing offences, in order to obtain, directly or indirectly, financial or other material benefit, which causes serious damage to the financial integrity and/or foundations of the EU.

The working definition for this study contains the following elements:

- 1) **structured association**; This element (also mentioned as characteristic in the above mentioned figure 2) can also be found in the definition of the Council Framework Decision and Eurojust. A structured association means that the association is not randomly formed for the immediate commission of an offence, nor does it need to have formally defined roles for its members, continuity of its

membership, or a developed structure. The association can include natural persons and/or legal entities.⁴⁵

- 2) **established over a period of time**; This element can also be found in the definitions of the Council Framework Decision, UN, Eurojust and Europol. Established over a period of time means that ad hoc 'randomly-formed associations' for the immediate commission of an offence without previous conspiracy are excluded.⁴⁶

- 3) **acting in concert with a view to committing offences**; This element can also be found in the definitions of the Council Framework Decision, UN, Eurojust and Europol.

With a view: Part of this element is 'with a view to', this means that there has to be the intention to commit the offences.

Offences: In the definitions of the Council Framework Decision, Eurojust and Europol 'the deprivation of liberty of at least four years' is a part of the definition. As a criterion to classify an offence as an 'organised crime offence', it is not very useful for the purpose of this research to use the deprivation of liberty as a distinguishing criterion, since most fraudulent actions consist of a combination of criminal offences and differs per country. It can consist for example of the offences swindling, accounting fraud and malicious deceit. And if the swindling concerns drugs, also other specific offenses are committed.

- 4) **in order to obtain, directly or indirectly, a financial or other material benefit**; This element (also mentioned as characteristic in figure 2) can also be found in the definitions of the Council Framework Decision, UN, Eurojust and Europol. Intrinsic to committing fraud with EU funds, there is the intention to obtain, directly or indirectly, a financial or other material benefit.

- 5) **causes serious damage to the financial integrity and/or foundations of the EU**; This element (also mentioned as characteristic in figure 2) is not described in the definitions, yet is mentioned and is a rather new element used in the working definition for this study. By misusing EU funds, organised crime causes serious damage, directly or indirectly, to the financial integrity and/or foundations of the EU. Directly, by using the funds for other purposes than originally sought by the EU (and in the case of VAT-fraud, when the EU misses funds due to fact that Member States miss out on VAT income), and indirectly due to the costs for preventive measures as control systems, administration and the costs for law enforcement in the fight against this type of fraud.

⁴⁵ Council of Europe, Council Framework Decision 2008/841/JHA, 24 October 2008, preamble 7, OJ L 11.11.2008, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:300:0042:0045:EN:PDF> in Article 1.

⁴⁶ United Nations Convention against Transnational Organized Crime, 2000, http://www.uncjin.org/Documents/Conventions/dcatoc/final_documents_2/convention_eng.pdf

3. TYPOLOGY OF EU FUNDS AND THEIR MISUSE

A variety of EU funds has long been available to improve the development of the EU. There are different types of funds which are spent in certain periods of time with varying purposes. Per period, the EU funds can vary in budget and goals. For example the Special Accession Program for Agricultural and Rural Development (SAPARD) funds for the period 2000-2006 to help farmers and rural communities, in 10 accession countries, to overcome restructuring problems and achieve development in rural areas in the pre-accession period. At this moment SAPARD and other Pre-Accession Instruments are replaced by The Instrument for Pre-accession Assistance (IPA).

In the period of 2007-2013, the EU will spend EUR 975 billion on funds⁴⁷ divided over four types of funds: regional assistance, natural resources, pre-accession funds and external assistance⁴⁸. In this chapter the different types of funds and their structure are summarised, followed by an explanation on the control of these funds by the EU Member States and the European Commission. Following this, a description of the misuse of EU funds is provided and finally a short oversight of VAT-fraud is described. Note that on specific request of the European Parliament, VAT fraud has been added to the scope of this study.

3.1. EU funds managed by Member States

Regional assistance. More than a third of the budget (EUR 348 billion) of the European Union is devoted to the structural funds and the cohesion funds⁴⁹. These funds are used for regional development and economic and social cohesion in the EU. The objective of EU funding under regional policy is to promote solidarity and to reduce the gaps in development among the regions and differences among the citizens in terms of well-being. Regional assistance aims to help regions that are behind in their development to catch up with the more developed regions. For example, the funds supporting the restructuring of declining industrial regions, diversify the economies of rural areas with declining agriculture and also help declining neighbourhoods within cities. Job creation is an important by-product of this fund. Poland, Spain and Italy receive the most budgetary support from these funds.

There are two structural funds: the European Regional Development Fund (ERDF) and the European Social Fund (ESF). Combined, these two funds have a budget of EUR 278 billion.⁵⁰

- The **ERDF** finances infrastructure projects, environmental investment, urban renewal, local economic development including small and medium-sized enterprises, and cross-border and inter-regional cooperation;
- The **ESF** finances training, especially for disadvantaged groups in society and the unemployed, and the development of education and training systems.

⁴⁷ Europese Commissie, *Nieuwe fondsen, betere regels: overzicht van de nieuwe financiële regels en financieringsmogelijkheden voor 2007-2013*, EC http://ec.europa.eu/budget/library/biblio/publications/funds_rules/pack_rules_funds_nl.pdf

⁴⁸ External assistance is European assistance to stabilise countries beyond EU borders. The EU has been one of the major actors in international co-operation and development assistance, as well as a major donor in the world as far as humanitarian aid is concerned. In interviews external assistance was pointed at as a field with a lot of fraud involved. After consultation with the European Parliament fraud within external assistance is out of scope therefore this study will not further investigate in fraud in external assistance.

⁴⁹ Europa - Summaries of EU legislation- Glossary http://europa.eu/scadplus/glossary/structural_cohesion_fund_nl.htm

⁵⁰ Ibid.

The *Cohesion Fund* with a budget of EUR 70 billion⁵¹ is a separate instrument with special rules for financing transport and environmental infrastructure.

Natural Resources. With an aim to contribute to the attainment of the objectives of the Common Agricultural Policy (CAP), the Common Fisheries Policy (CFP), and the Community environment policy, the EU allocates a significant share of the total Community budget. For more than 40 years, the CAP has been the EU's most important common policy although the percentage has steadily declined over recent years. The maximum total amount which may be allocated for the 2007-2013 period is EUR 371.3 billion.⁵²

Agricultural expenditure is financed by four funds, which form part of the EU's general budget:

- The **European Agricultural Guarantee Fund** (EAGF) finances direct payments to farmers and measures to regulate agricultural markets such as intervention and export refunds;
- The **European Agricultural Fund for Rural Development** (EAFRD) finances the rural development programs of the Member States;
- The **European Fisheries Fund** (EFF) finances the promotion for environmentally friendly fishery;
- **LIFE+** (Financial Instrument for the Environment) contributes to the implementation, updating, and development of Community environmental policy and legislation.

The expenditure of the funds for regional assistance and national resources is based on a system of shared responsibility between the European Commission and the Member State authorities. More than 76% of the EU budget for these funds is managed by national or regional authorities.⁵³ Firstly a Member State develops a National Strategic Reference Framework (NSRF). The European Commission approves the NSRF. A Member State also creates Operational Programs (OP), which may differ per region in a Member State but have to be consistent with the NSRF. Again the European Commission has to approve the OP's. Secondly the Member States and their regions manage these OPs. This includes implementing the OP's by selecting individual projects, controlling and assessing them. At the end of the project the European Commission is involved in overall program monitoring, paying out approved expenditure and verifying the national control systems.

To apply for the structural funds, a beneficiary has to write proposals to the program manager in a specific region. This manager will pick a proposal which fits best in the OP. The beneficiary has then to write a business plan with a financial table. After approval of the administration the beneficiary can start the project.

Pre-accession funds. The EU provides also financial aid for Acceding Countries, Candidates and Potential Candidate Countries in order to support their efforts to enhance political, economic and institutional reforms. This implies a broad range of Community

⁵¹ http://europa.eu/scadplus/glossary/structural_cohesion_fund_nl.htm

⁵² PP EC DG environment, http://ec.europa.eu/environment/index_en.htm

⁵³ Europese Commissie, *Nieuwe fondsen, betere regels: overzicht van de nieuwe financiële regels en financieringsmogelijkheden voor 2007-2013*, EC http://ec.europa.eu/budget/library/biblio/publications/funds_rules/pack_rules_funds_nl.pdf

funding for various types of projects in the fields of agriculture, environment, transport, IT, human rights, civil society, media, etc. The Pre-accession funds are divided in four type of funds:

- **IPA**: helps to facilitate countries to transfer from one status to another. For the period of 2007-2013, EUR 12.900 million is reserved for IPA;
- **Technical Assistance and Information Exchange Instrument** (TAIEX): provides short term assistance to get countries on the policy level standards which the European Commission created;
- **Prince**: is a program to provide the EU citizen with information about the enlargement of the EU. This fund contains EUR 13 million per year in the period 2007-2013;
- **Twinning**: Since 1998 the Twinning program helps Potential Candidate Countries to live up to the standards of EU Member States. This fund contains EUR 157 million a year since 1998.

The application procedure for a pre-accession fund works more or less the same as the application of structural funds. The national government is responsible for the implementation of certain projects with goals that are approved by the European Commission.

3.2. EU funds managed by the European Commission

Community Programmes. The Community Programmes are a series of integrated measures accepted by the European Commission aiming to strengthen the co-operation among the Member States regarding Community policies for a period of time. The Community Programs are financed from the general budget of the Community. All Acceding and Candidate countries have the opportunity to participate in these programs.

Contrary to the budget of previously described funds, the budget for community programs is managed by the European Commission directly. Any legal entity can apply for a submission. The submission, evaluation and settlement of the accounts along with the full administration belong to the Administration of the Directorate Generals (DG's) of the European Commission. The proposals can be submitted in a consortium with the participation of a minimum of two or more organisations from the EU Member States (specified in the Calls for Proposals). The applicants are directly in contact with European Commission officers, from the submission up to the closure of the project. However, each participating country opens a national program office or agency whose task is the collection of information and mediation in order to assist the national applicants.⁵⁴

3.3. Control over budget of EU funds

"By nature, EU expenditure - millions of Euros paid on the basis of cost declarations by beneficiaries in many different countries - bears a high inherent risk. The complex rules in many areas, such as rural development, can be difficult to apply and result in errors.

⁵⁴ Community Programmes <http://www.2007-2013.eu/community.php>

Errors are made for a variety of reasons by beneficiaries claiming funds and by the authorities responsible for making payments.”⁵⁵

In order to make sure these funds are spend for the right purposes, projects have to comply with certain objectives and priorities. These objectives are defined by the Commission and Member States together. These objectives and priorities differ regionally and locally. For each Member State there are various objectives that depend on the region and the phase of development. The Commission and Member State therefore discuss which objectives have to be complied to. To check that the objectives are pursued, and obtained at the end, there have to be effective control mechanisms. The Commission designed a control structure that has various layers. This control system is the same for each fund (external aid excluded).

In the past years there have been some substantial changes in the control systems of the EU. In 2008 the Commission adopted a 37-point action plan to strengthen the control systems. This was designed as a practical response to recommendations by the European Parliament and the ECA to strengthen management and control systems in Member States and reduce the risk of errors in payment claims. The Member States are primarily responsible for detecting and dealing with errors whilst the role of the Commission is to check if this objective is achieved. The action plan aims to ensure that national authorities thoroughly check the eligibility of structural funds' expenditure before submitting payment claims to the Commission. If they fall below standards, there are measures in place to halt payments or claw back money through financial corrections.

Another important change is the simplification of the control systems. Changes in 2009 were aimed at reducing the administrative burden on beneficiaries. Irregularities often result from complex rules that are not correctly understood or applied. The simplifications aim to reduce bureaucracy without weakening financial controls.⁵⁶

In the period 2007-2013 the Commission uses a control structure which has various layers. This control system is similar for every type of EU fund (external aid excluded). In the Member States three control levels have to be applied: the Managing Authority, the Certifying Authority and the Audit Authority. *“The multi-level control system is integrated on the basis of clearly defined responsibilities for the various actors, established standards for the work required, and reporting systems and feedback mechanisms so that each level of control builds on the preceding one to reduce irregularities.”*⁵⁷ This integration is called the ‘Single Audit’ approach which is shown in figure 3.

⁵⁵ ECA (European Court of Auditors), Frequently asked questions, http://eca.europa.eu/portal/page/portal/eca_main_pages/FAQ/15thyearwithoutacleanopinion

⁵⁶ Europa - Summaries of EU legislation- Commission efforts to strengthen controls over structural funds is paying off, 2009, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1594&format=HTML&aged=1&language=EN&guiLanguage=en>

⁵⁷ Europese Unie, Het controlesysteem voor het cohesiebeleid. Werking in de begrotingsperiode, 2007, http://ec.europa.eu/regional_policy/sources/docgener/presenta/audit2009/audit2009_nl.pdf

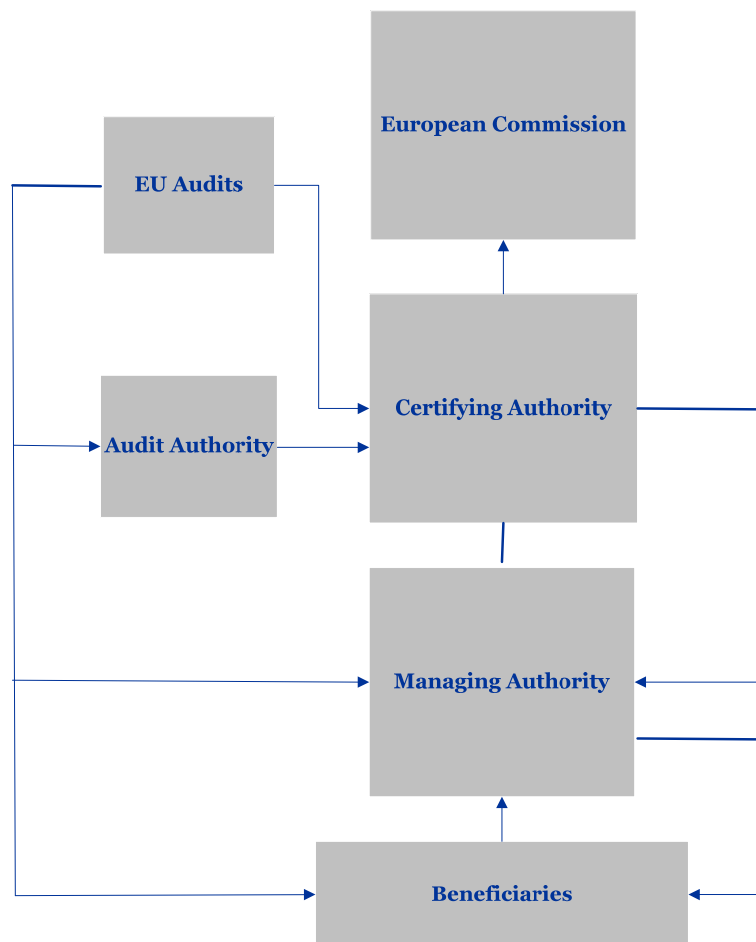


Figure 3: Single audit approach

Managing authority. The managing authority is the first level of control for the projects. The managing authority is responsible for the beneficiaries meeting the criteria of the European Commission and whether the beneficiaries follow the rules stipulated by the European Commission. They also monitor the implementation of the program and send an annual report to the European Commission.

Certifying authority. The second level of control is the certifying authority. This authority certifies the correctness of beneficiary's bills. If the fund is correctly spent, the certifying authority will send the payment order to the European Commission.

Audits. At the third level the audits control the functioning of the managing authority and the certifying authority. They check control deficiencies by which declarations are still wrongly treated. In this case, they give advice to the certifying and managing authorities for changing the procedures.

EU Commission. At EU level, the role of the Commission is to supervise the effectiveness of the control systems in the Member States. The Commission supervises the audit procedures of Member States and carries out audits on Member States. They also provide guidance in case control systems are inefficient or do not work. The Commission supervises the management of programs through its review of annual implementation reports and participation in monitoring committee meetings. At the end

of the program the commission will randomly check if the funding for the projects is justified.

A well organised control system implies the independency of the three layers. In some Member States this is not the case. For example in Bulgaria the managing authority, the certifying authority and the audits are all managed by the Bulgarian Ministry of Finance.⁵⁸ The fact that the three different authorities are situated in the same Ministry may cause conflicts of interest which can cause deficiencies in the control system.⁵⁹

The supervising role of the European Commission in other countries consists of a check of the control strategy of a Member State at the beginning of a funding period. For example the Dutch government created the strategy of control systems 2007-2013, which is checked by the European Commission on various standards. The strategy of control over the funds in the period 2007-2013 was then approved by the European Commission. A strategy presented on paper was considered as enough proof for a solid control system in the Netherlands.

Control systems are primarily the responsibility of the Member States. The Member States design the system that has to comply to European Commission standards. After the approval by the European Commission of the design, the Member States organise the certifying and management authority and the audits over these authorities at their own best knowledge. The European Commission supervises the control systems of the Member States and have very few over- and insight in the direct spending procedures on the projects.

3.4. Misuse of EU (spending) funds

Our open source research has identified a number of fraud cases with EU funds. For example, the Financial Times reports that: *"Italy's finance police have tackled thousands of cases of suspected fraud involving EU structural funds totaling hundreds of millions of Euros."*⁶⁰ In chapter 4 we present some cases in detail. Below there are figures around the irregularities and fraud in the EU funds as reported by the European Commission in their annual report 2009 *Protection of the European Union's financial interests-Fight against fraud*.

Structural funds. Reported irregularities and related financial amounts have been increasing in relation to 2008.⁶¹ *"The highest irregularity rates concern the European Regional Development Fund (ERDF) programs. For the ERDF the most plausible explanation is that this fund finances projects of a higher value and therefore irregularities tend also to involve a greater amount. According to the European Commission the ERDF remains also the most affected fund (0.29 %)."*⁶²

Pre accession funds. In 2009, within pre accession funds, there were newly detected irregular cases with an affected estimated amount of EUR117 million (reported by the national authorities in 14 reporting countries). Bulgaria and Romania reported the most

⁵⁸ Structural funds management scheme, <http://www.minfin.bg/en/search/?q=EU+funds>

⁵⁹ Ibid.

⁶⁰ Gatti, F. and Segreti, G., *Italian police combat waves of EU fraud cases*, Financial Times, 30.11.2010

⁶¹ OLAF, *Protection of the European Union's financial interests-Fight against fraud*-Annual Report, 2009, p.55 http://ec.europa.eu/anti_fraud/reports/olaf/2008/EN.pdf

⁶² Ibid. p.77

irregularities by a significant amount. In particular SAPARD funds were vulnerable. SAPARD funds aimed to help farmers and rural communities in 10 accession countries to overcome restructuring problems and achieve development in rural areas in the pre-accession period. Bulgarian SAPARD cases account for 92% of all SAPARD suspected fraud in 2009 which was reported to OLAF.⁶³ The commission asked Bulgaria to change their control systems and eventually funds were withdrawn from Bulgaria.⁶⁴

On request, OLAF provided the researchers with an analysis drafted in 2007 on how organized crime poses a threat for the EU expenditure. This analysis is somewhat dated and gives no references to its sources. Some of the assessments of OLAF as presented in 2007 still could be of relevance today.⁶⁵

According to OLAF, it is likely that the pressure of organised crime on EU expenditure will increase. In many regions of Europe currently the conditions for a real threat posed by organized crime to the EU budget and in particular relating to indirect expenditure exist.

Because of the amount and nature of the financed interventions, the concurrent national and European financing and the mechanisms of public procurement, the sector is exposed to the threat of organised crime. Public procurement could be a privileged source of financing and of illegal proceeding for criminal groups. The motivation for a possible interest of organised crime does not only lie on the huge financial flow deriving from resources devoted to public works and procurement of goods and services, but also on the possibility of

- Searching for legal economic sectors were to employ the proceeds of crimes (money laundering)
- Further strengthening the control over a given territory also through the control of local administrations
- Acquiring a legal appearance with a concurrent minor visibility of illegal activities.

The typical criminal group involved is according to OLAF likely to be indigenous and act through well established channels (infiltration in selection committees or in the public services, or control of all the offers submitted) to influence the outcome of the procurement procedure. Penetration in the public procurement sector is achieved by organized crime groups presenting very different structures and approaches.

- Highly hierarchical, centralised and structured organisation, able to alter the selection/tendering procedures, causing a relevant and substantial degeneration of the competition system.
- Decentralised, based on “families” action at local level, coordinated or uncoordinated, using as cover controlled small or medium sized enterprises

The importance of public procurement as an easy and effective way through which organised crime group’s launder the proceedings of crime, strengthening the control over a given territory and acquire a legal appearance is evident and this is especially true in regions where the social and economic influence criminal organisations have is

63 SAPARD and the other 2000-2006 pre-accession instruments have been replaced for the period 2007-2013 by the Instrument for Pre-Accession Assistance (IPA).

64 In general, for what concerns the reporting of irregularities for the expenditure part of the EU budget, 2009 should be regarded as a transition year due to the introduction of the internet based reporting system (IMS- Irregularity Management System) which may have caused problems in relation to the reporting, registration and migration of irregularities into the new system. However, the new reporting system has improved the overall conditions for irregularity reporting. It is therefore welcomed by the majority of the Member States which have already used it for the 2009 reporting year. All Member States should fully implement the IMS and be ready to use the system for the 2010 reporting exercise.

65 The text of the following paragraphs is based on OLAF's official contribution to the study on *How does organized crime misuse EU funds?* 13 May 2011.

consolidated. According to OLAF, the impact is extremely difficult to assess, especially in those cases in which (and they are the majority) in the end the financed infrastructure is completed (at a much higher cost).

The use of legitimate business structure is a pre-requisite. They are directly or indirectly controlled by the organised crime group or they suffer from an extortive pressure in order to be allowed to continue their activities. The ability of organised crime groups to create new companies at will and reorientation existing companies in order to benefit from EU contracts over a long period of time.

The complexity of procurement procedures also make the EU budget vulnerable for corruption by a specialised official, whose superiors can no longer assess the legality and opportunity of actions undertaken.

Influence and corruption can be used by organised crime groups to obtain the public/community financing at all levels of the budget management structure, from local, regional, national and Community level, so the assessment of OLAF. On the other side, it can be expected that the cost of the work or service procured will be systematically increased in order to create "black" financial reserves that could be used to bribe officials or politicians in order to strengthen the network.

Because of the amount and nature of the financed interventions, the concurrent national and European financing and the mechanisms of public procurement, (EU) public expenditure is exposed to the threat of organised crime.

3.5. VAT Fraud

Every Member State in the EU has its own defined tax regulations and VAT regulations. However, the basic principles are the same. On supplies within one Member State, a supplier charges VAT to his customer and pays the received VAT to the national Treasury (See Appendix A.2). If the customer is a business, they can reclaim the paid VAT from the Treasury. In the end it is the final consumer who bears the VAT charge as he cannot reclaim the VAT (See Appendix A.2).

A different mechanism is in place when it concerns cross-border trading supplies between Member State borders. As Member States charge different tax rates on goods, a system of VAT exemption is introduced when trading across borders. Within the EU, the goods circulate VAT free.

However, VAT is also part of the own resources of the EU budget. Member States pay a small percentage of their total VAT receipts to the EU. Currently, this contribution from Member States is based on rate 0,3% of the national harmonised VAT base, with temporary reduced rates of 0,225% for Austria, 0,15% for Germany and 0,10% for the Netherlands and Sweden over the period 2007 to 2013. In 2010 this represents EUR 14 billion.

The above described mechanisms unfortunately do not exist without any misuse. Missing-trader fraud and carousel fraud are very present within the EU Member States. As VAT is part of the own resources of the EU, VAT fraud will lead to losses of income for both the Member States and the financial interests of the EU. In addition, these fraud

types were and still are major phenomena menacing the harmony and integrity of the internal market .⁶⁶

Missing trader fraud can exist in a very simple form. A fraudster – that can be businesses or individuals - imports goods from a different Member State VAT free and sells the goods in its own country by charging VAT. Then the fraudster disappears and the VAT he received from his costumer will not be returned to the Treasury.

Carousel fraud is a more complex system, involving multiple businesses and/or taxable individuals. Within this system the goods are sold across businesses in the Member States, before being exported again. The basics of the carousel fraud mechanism work as follows: A business (B) acquires a good (or service) from a supplier (A) located in another Member State VAT free. Then business (B) makes a domestic supply for which he charges VAT to his customer (C). The VAT received from his customer, will not be paid to the Treasury and business (B) disappears. As customer (C) is a business itself, it claims the VAT paid to business (B). Subsequently, customer (C) sells the goods back to business (A) without any VAT paid as it concerns an intra-community supply and the fraud pattern resumes (see Appendix A.2) .⁶⁷

We must note that the model described above is only a very simplistic description of the fraud. In reality many different intermediary companies are involved in a series of transactions in order to hide its fraudulent nature.

The key element in this process can be defined as the VAT reclaimed by the customer is not directly linked to the actual payment of VAT to the Treasury by its supplier⁶⁸. This creates a carousel where every second buyer may recover unpaid tax. The key elements committing this fraud involve intra-Community transactions and the trader not paying the VAT received from his customer to the Treasury 'goes missing'.

It is not difficult to agree on the fact that VAT fraud, and more specific carousel fraud, is a transnational phenomenon and thus makes it very difficult for a Member State to act individually against these fraud mechanisms. The example of carbon credit fraud in section 4.2.3.3 demonstrates the international character of this new 'line of business'.

Carousel fraud can only be discovered if the tax authorities verify whether the VAT repaid to the customer claiming VAT from his purchase was indeed paid to the Treasury by its supplier. Furthermore, information between Member States regarding the intra-Community supplies are often communicated with a delay which makes it difficult to detect these fictitious trade flows. Because of these difficulties, the European Commission indicates the pressing need to define a coordinated action at EU level in order to address VAT fraud⁶⁹.

⁶⁶ Wolf, R.A., *Carrouselfraude, Een Europees probleem vanuit Nederlands perspectief: een analyse van fiscale regelgeving en jurisprudentie*, SDU Uitgevers, Den Haag, 2010, p 209

⁶⁷ *EU coherent strategy against fiscal fraud. Frequently Asked Questions. How does VAT carousel fraud work?* www.europa.eu

⁶⁸ Wolf, R.A., *Carrouselfraude, Een Europees probleem vanuit Nederlands perspectief: een analyse van fiscale regelgeving en jurisprudentie*, SDU Uitgevers, Den Haag, 2010, p 209

⁶⁹ Europa - Summaries of EU legislation- *EU coherent strategy against fiscal fraud – Frequently Asked Questions*, Memo/06/221, Brussels, 31 May 2006, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/221>

With the introduction of a general reverse charge system, carousel fraud could be limited. The system of reverse charge has already been introduced by some EU Member States. On this matter, a recently introduced Council Directive⁷⁰ states that: *"In the case of cross-border transactions, and for certain domestic high-risk sectors such as construction and waste, it is foreseen, however, to shift the obligation to pay VAT onto the person to whom the supply is made."*

However, experts indicate that introducing this new system will only provide a temporary solution as fraudsters will ultimately look for new opportunities in sectors without the reverse charge mechanism.

Quantifying tax fraud in Europe is very difficult as no detailed figures are available. During the interviews held, VAT fraud is mentioned as the largest form of misuse of EU funds.

Upon request we received information from Eurojust, in which they indicate that in the period January 2004 to October 2010, a total of 197 VAT fraud cases have been registered at Eurojust (figure 4).

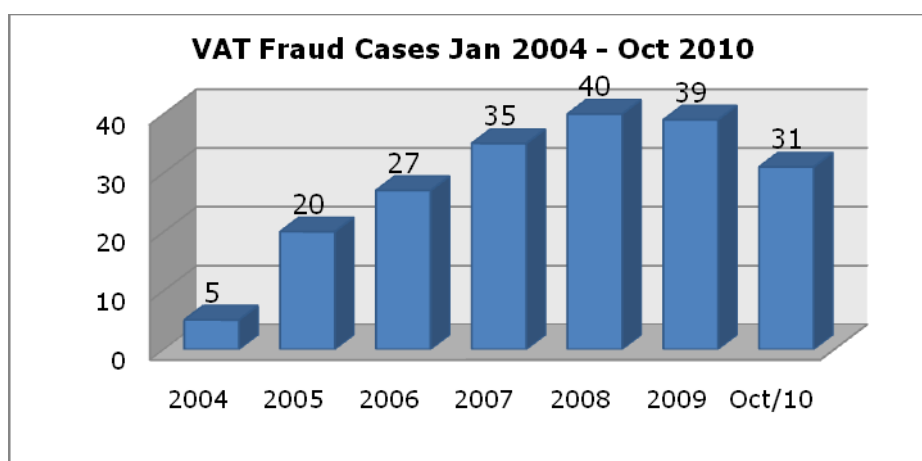


Figure 4: Overview of VAT fraud cases registered in the period January 2004 to October 2010 (Eurojust)

Out of these 197 cases, 21 cases have been recorded as committed by organised crime groups, indicating 5 cases in 2009 (figure 5).

⁷⁰ Kroes, N., Council Directive 2010/23/EU of 16 March 2010 amending Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain services susceptible to fraud, OJ L 072, 20/03/2010 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:072:FULL:EN:PDF>

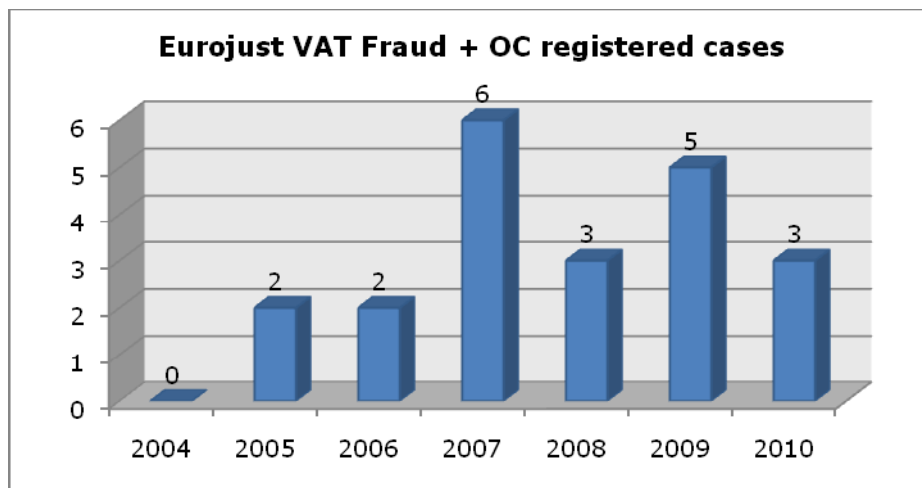


Figure 5: Overview of VAT fraud cases registered in the period January 2004 to October 2010 committed by organised crime (Eurojust)

In the majority of the cases VAT fraud is not a standalone problem. This type of fraud is often applied to *“generate money in order to finance other types of crime such as drug trafficking, trafficking in human beings, identity fraud, alcohol smuggling, counterfeiting and terrorist activities.”*⁷¹

3.6. Cigarette smuggling

Another phenomenon which influences the EU budget negatively is cigarette smuggling. There are two types of cigarette smuggling in the EU: smuggling with contraband cigarettes and smuggling with counterfeit cigarettes.

Contraband Cigarettes: cigarettes that have been imported into, distributed in, or sold in, the Territory of a Member State (or where en route to the Territory of a Member State for sale in that Member State) in violation of the applicable tax, duty or other fiscal laws of that Member State or the EU.

Counterfeit Cigarettes: cigarettes bearing a Trademark of a cigarette manufacturer that are manufactured by a third party without the consent of that cigarette manufacturer (the so called fake cigarettes). Counterfeit cigarettes shall in no event include:

- Cigarettes manufactured by the trademark holder or any affiliate thereof, regardless of the actual or intended market of distribution;
- Cigarettes bearing a trademark of a cigarette manufacturer using tobacco either produced by or sold by that cigarette manufacturer;
- Cigarettes bearing a trademark of a cigarette manufacturer that are packaged in genuine packaging of that cigarette manufacturer, including genuine cartons and packs of that cigarette manufacturer.⁷²

⁷¹Europol, EU Organised Crime Threat Assessment 2009 (OCTA), The Hague, 2009, p.21, [http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA2009.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA2009.pdf)

⁷² Cooperation agreement ITL and the European Union, 27 September 2010, p.8-9, http://ec.europa.eu/anti_fraud/budget/2010/Main-Agreement-sept2010.pdf

Since the European Communities have a Common Customs Tariff, contraband affects the collection of customs duties to the detriment of the Communities' financial interests through its impact on own resources. Cigarette smuggling causes a loss in excises and duties for Member States, which are part of the EU resources. This budget directly finances the legislative and democratic activities of the European Institutions.

Cigarette smuggling requires the construction of supply and distribution chains which can, by definition, be classified as organised crime. The international nature of cigarette smuggling results in formal and informal links between criminal groups in different geographical locations. Given the high taxes and excise duties of the goods involved, and the profits generated, perpetrators must also become involved in other types of serious crime, for example protecting themselves through extreme violence and money laundering.⁷³

It is difficult to evaluate the magnitude of cigarette smuggling⁷⁴, but it is well-known that cigarette smuggling is widespread and well organised. Cigarette smuggling is a growing problem worldwide, which is costing thousands of millions of dollars globally in lost tax revenue.⁷⁵ Because a certain amount of excises and duties of Member States are a means of resource for the EU general budget, the EU is indirectly affected too. Annual losses of revenue in the European Union can be estimated, on the basis of seizures of cigarettes notified by the Member States, at about € 10 billion per year, of which about 10% would be revenue for the European Union budget. Also, it is estimated that about 65% of the seized cigarettes are counterfeit.⁷⁶

According to Europol: *"The smuggling of contraband cigarettes and counterfeit cigarettes is a process throughout Europe. The routing of cigarettes is often a complex process which abuses the free movement of goods in the EU and changes constantly. Italy plays an important role in cigarette smuggling."*⁷⁷ Italian organised crime cooperates with foreign criminal groups to smuggle both genuine and counterfeit cigarettes to Italy and the EU. Currently around half of all cigarettes seized in Italy are counterfeits and there are indications that counterfeit cigarettes are currently introduced relatively aggressive into the EU markets.

In any case, Greece, Dubai, China and Poland/East Europe play important roles in supplying cigarettes either for the Italian market or through Italy to the other EU countries. These countries do not necessarily produce the cigarettes but are rather used as transit points towards the north of Europe. Community customs procedures can be extensively abused for criminal ends: cigarettes may be imported into the EU and placed in Community transit; after this, the transit procedure may be changed into export procedure so that the cover load (often consisting of low-value goods such as counterfeit products) is exported but the counterfeit cigarettes stay in the EU; alternatively the

⁷³ OLAF's official contribution to the study on *How does organized crime misuse EU funds?* 13 May 2011.

⁷⁴ Van Heuckelom, C., Europol: Smoke, Europol's fight against the illicit tobacco trade, AWF smoke presentation to illegal trade excise conference, p. 26, <http://www.slideshare.net/illegaltrade/awf-smoke-presentation-to-illegal-trade-excise-conference-2>

⁷⁵ Joossens, L. and Raw, M. Cigarette smuggling in Europe: who really benefits?, International Union Against Cancer, EU Liaison Office, Brussels, Belgium, p.66, <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC1759658/?tool=pubmed>

⁷⁶ Europa - Summaries of EU legislation- Contraband and counterfeit cigarettes: frequently asked questions, MEMO/10/448, 27.09.2010 <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/448&type=HTML>

⁷⁷ Europol, EU Organised Crime Threat Assessment 2009 (OCTA), The Hague, 2009, p.30, [http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA2009.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA2009.pdf)

cigarettes may be legally exported and then smuggled back into the EU and redirected to the relevant black markets.⁷⁸

Other organised crime groups which are involved in cigarette smuggling are Lithuanian groups. They redirect and traffic cigarettes from the east towards the west. Besides cigarette smuggling, these groups are involved in trafficking women for sexual exploitation, illegal immigrants, counterfeit goods, synthetic drugs precursors and heroin.⁷⁹ Also Kaliningrad appears to have a similar but more limited role in relation to cigarette smuggling into the EU.

Organised crime groups make use of illegal ways to smuggle cigarettes into/throughout Europe but (as described above) there are a lot of cases where legal structures are used. For example, in one case an organised crime group used a legitimate transport company and a legitimate tobacco company to smuggle hand rolling tobacco into the UK.⁸⁰ In another case, an organised crime group of Arabic origin which was involved in the European wide wholesale business with Arabic food products used their legal structures and logistics to smuggle and distribute predominantly cigarettes and water pipe tobacco within closed ethnic communities.⁸¹

As mentioned above one of the countries that plays an important role in supplying cigarettes in the EU is China. In the following case, the huge amount of money which can be lost due to cigarette smuggling becomes clear: *"An organised crime group involved in tobacco smuggling organised containers of cigarettes to be manufactured in China and transported to the EU via a deep sea vessel. A 40-foot container with cigarettes inside was identified, bound for the European Union after departing from China. Intelligence indicated that, if successful, the organised crime group would attempt numerous further imports on a weekly basis. If left unchallenged, this would have caused the destination member state an annual revenue loss that ran into millions of euros."*⁸²

3.7. Why does the protection of the EU’s financial interest and the fight against fraud require action on the EU level?

The legal base for action on the EU level to protect the EU’s financial interests and fight fraud is laid down in article 325 TFEU. The European Union and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Union through measures to be taken in accordance with article 325 TFEU, which shall act as a deterrent and be such as to afford effective protection in the Member States, and in all the Union's institutions, bodies, offices and agencies. Furthermore, based on the same article 325 TFEU, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, after consulting the Court of Auditors, shall adopt the necessary measures in the fields of the prevention of and fight against fraud affecting the financial interests of the Union with a view to affording effective and equivalent

78 Europol, EU Organised Crime Threat Assessment 2009 (OCTA), The Hague, 2009, p.33, [http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA2009.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA2009.pdf)

79 Europol, EU Organised Crime Threat Assessment 2009 (OCTA), The Hague, 2009, p.30, [http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA2009.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA2009.pdf)

80 Deloitte Enterprise Risk Services, Improving coordination between the EU bodies competent in the area of police and judicial cooperation: towards an European prosecutor, policy department budgetary affairs, 2011, p.51

81 Deloitte Enterprise Risk Services, Improving coordination between the EU bodies competent in the area of police and judicial cooperation: towards an European prosecutor, policy department budgetary affairs, 2011, p.50

82 Europol review 2009, Den Haag, 2010, p.32, http://www.europol.europa.eu/publications/Annual_Reports/Europol_Review_2009.pdf

protection in the Member States and in all the Union's institutions, bodies, offices and agencies.

Combating fraud is for a large part a Member State's competence. In order to assist Member States in this task, tools for administrative cooperation between Member States are available at EU level. The effectiveness of the combating of fraud against the Communities' financial interests calls for a common set of legal rules to be enacted for all areas covered by Community policies.

This also applies to VAT fraud: the tools for combating tax fraud are organised around each sector of taxation. Indeed VAT, excise duties and direct taxes all have their legal tools, committees, procedures for exchanging information and to some extent their own informatics system. These must be developed in a way that would allow a coherent approach to tackling tax fraud. Only a rapid and well targeted exchange of information and action at European level can assist Member States in their efforts to fight the rapidly adapting tax fraudsters.

4. MISUSE OF EU FUNDS BY ORGANISED CRIME

4.1. Facts and figures on misuse of EU Funds by organised crime

In this paragraph an overview is presented of everything that is stated in the Annual Reports and other formal, publicly available documents from OLAF, Europol, Eurojust and the European Court of Auditors on misuse of EU funds by organised crime, completed with information that is submitted to PwC on request for the purpose of this study.

This overview will make clear that although there are references made in most of the reports in the public domain to organised crime, misuse of EU funds or VAT fraud, and in some cases even their interconnection, there is very little factual information publicly available from these agencies to base these conclusions on. There is also very little information on the extent (quantified) to which organised crime misused EU funds in 2009, nor on how organised crime - as defined in the context of this study - is organised and which means and methods are used to defraud the Union and its Member States.

For the purpose of this study, all four EU agencies mentioned above have been interviewed and have been asked for facts and figures on the misuse of EU funds by organised crime and for case studies of such frauds. Only Eurojust has provided us with such facts and figures (used in this paragraph) and with two case studies (presented in paragraph 4.2.1). The other three agencies were not able to provide additional information, for various reasons (no such information available, no (legal) possibility to submit such information for the purpose of this study).

4.1.1. Olaf

According to OLAF suspected frauds affected 0.19% of payments made by the Commission under the cohesion policy in 2000-2008 (equivalent to EUR 383 million).⁸³

In its Annual Report over 2009⁸⁴, OLAF mentioned that it *"has found growing evidence that in many cases the frauds in the Structural Funds are organised and planned and have not resulted from simple opportunity."* The main attacks on the Structural Funds, according to OLAF, are:

- *"Attempted subversion of tendering processes through false or exaggerated bids, cartel bids, illegal or irregular sub-contracting, etc;*
- *False or exaggerated, even double/triple cost claims for inputs or services;*
- *Fraud and irregularities resulting from situations of conflict of interest which there are either no or insufficient administrative structures to combat."*

OLAF's experience is that the majority of cases arising are in Italy, Greece, Spain, Bulgaria and Slovakia. This experience is however not reflected in the same Annual Report's figure on active investigation cases opened in 2009, where it is stated that 21 cases have been opened: eight concerning Bulgaria; concerning Germany, Greece and Italy each two and concerning Belgium, Czech Republic, Lithuania, Poland, Portugal, Slovakia and United Kingdom each one.

⁸³ Europa - Summaries of EU legislation- Progress report on Action Plan to strengthen the European Commission's supervisory role for shared management of structural actions 28 October 2009, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/481&format=HTML&ag>

⁸⁴ OLAF, Annual Report 2010. Tenth activity report 1 January - 31 December 2009, Brussels 2010 http://ec.europa.eu/anti_fraud/reports/olaf/2009/en.pdf

In its Annual Report 2010, OLAF presents one case of misuse of structural funds. In one case which OLAF finalised in 2009, into a large building materials company in Spain, which had received millions of Euros in EU aid from both ERDF and ESF, the company was found to have claimed aid for non-existent services, over-claimed aid for other services and also claimed aid for old equipment which was bought second-hand and declared new. Since no detailed information on this case was made available by OLAF, nor in open sources, it was not possible to determine whether this was a case of misuse by organised crime, nor what means or methods were being used.

4.1.2. European Court of Auditors

*"Despite its name, the ECA does not have any investigative powers as far as fraud is concerned, nor any legislative powers to prosecute. [...] If, in the course of its work, the ECA across suspected cases of fraud, corruption or some other illegal activity having an impact on the EU's financial interests, it refers the matter to OLAF. It will not jeopardise subsequent OLAF investigations by carrying out its own inquiry. On average, the ECA refers three such cases to OLAF each year."*⁸⁵

The same remark by the ECA with regard to fraud was made in the context of the Annual Report on the 2009 EU budget *"The Court reports around 3 cases per year to OLAF, based on its audit work"*.

4.1.3. Europol

On request, Europol stated that *"Although Europol does not have currently ongoing initiatives focusing specifically on the misuse of EU funds by organised crime, some of the current projects do focus on criminal groups whose activities involve a tax loss aspect directly or indirectly impacting on the EU budget. This is the case for the Analysis Work File SMOKE (focusing on illicit tobacco trade and production) as well as the Analysis Work File MTIC (Missing Trader Intra-Community-fraud, focusing on VAT fraud)."*⁸⁶ Europol did however not provided the researchers with any figures or case examples drawn from these Analysis Work Files.

In the EU Organised Crime Threat Assessment (OCTA)⁸⁷, no explicit facts and figures are presented with regard to misuse of EU funds by organised crime. But when describing the EU criminal markets, reference is made in this OCTA to VAT fraud and to public procurement fraud. However, without any facts or numbers quantifying the (estimated) extent of this type of crime.

Europol considers VAT fraud among the most frequent types of trade fraud. Double invoicing, illegal trade of goods without enlistment of consumer tax and VAT, fictitious trade of goods with subsequent request of VAT return, false invoicing and carousel fraud are mentioned as frequent scenarios. Disguising the merging of legal and illegal business activities plays a key role. Catering services, transport, real estate agencies, trade in mobile phones, computer parts, fuel or cars are the most targeted businesses.

⁸⁵ ECA's contribution to the study on *How does organized crime misuse EU funds?* 15 April 2011.

⁸⁶ Europol's official contribution to the study on *How does organized crime misuse EU funds?* 23 May 2011.

⁸⁷ Europol, EU Organised Crime Threat Assessment 2009 (The Hague 2009)

[http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_\(OCTA\)/OCTA2009.pdf](http://www.europol.europa.eu/publications/European_Organised_Crime_Threat_Assessment_(OCTA)/OCTA2009.pdf)

Geographic proximity to trading countries, close relations with former colonies, trade conditions, national and international legislative anomalies and the involvement of foreigners with legal status in the EU facilitate this crime. Besides domestic criminals, also African, Arab, Asian and Russian organised crime groups are active in VAT fraud, according to Europol. Long term residence in host countries, good knowledge of the legal and tax systems, a background in financial crime and active orientation towards running business enterprises are typical features of suspects. For example, the activities of Russian organised crime groups have been observed in the Baltic region, whilst Chinese organised crime groups play an important role in the South-East region, in cooperation with domestic criminals. Importing goods into the EU through the traditional gateway, criminals invoice imported commodities to missing traders and then divert them elsewhere. The use of false commercial documentation suggesting legitimate trade and masking details of the trading process is a known facilitating factor.

Public procurement fraud is usually linked with elements of corruptive action against public administration and the private business sector, so the EU OCTA. Organised crime groups can exploit this process from its initial stages, tampering with the activities that precede the publications of tenders, and thus designing them to their advantage. Public and community funds received illegally can be laundered and re-integrated into the cycle of lawful activities or be re-invested to support other criminal activities.

Again: the word 'can' in the second and third sentence of the former paragraph leaves the impression that, although it is conceivable that organised crime groups exploit tender processes, no evidence is presented that this type of crime also actually occurs – let alone what the extent is.

4.1.4. Eurojust

Criminal offences affecting the financial interests of the EU are dealt with by Eurojust (at the request of a Member State) whenever such cases have a transnational dimension and require specific and well coordinated investigations between two or more EU Member States. If there is a practical need, Eurojust may also assist the investigations or prosecutions which concern only one Member State.

42 cases of offences against the financial interests of the European Union have been recorded by Eurojust from January 2004 until October 2010 (see figure 6 below):

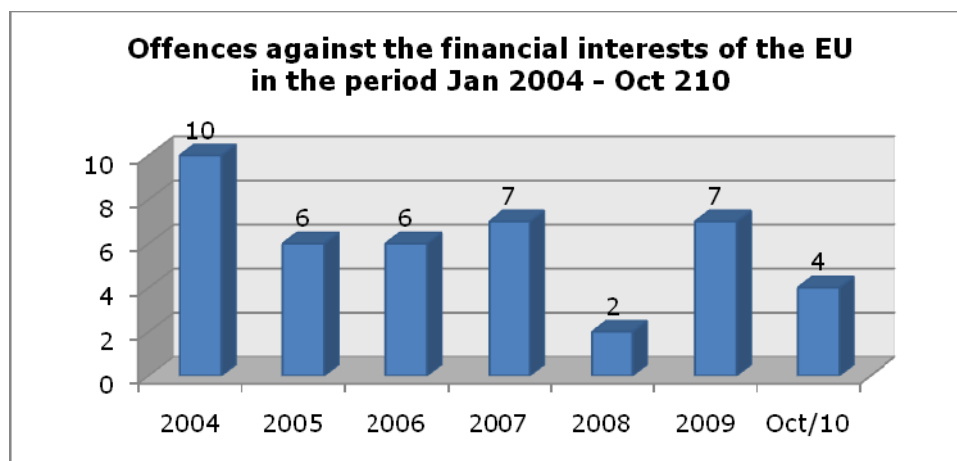


Figure 6: Offences against the financial interests of the EU in the period January 2004 to October 2010 (Eurojust)

Of these, in 2009 three cases were registered at Eurojust as offences affecting the EU's financial interest which were also committed by organised crime groups.

Additionally, a total of 197 VAT Fraud cases have been registered at Eurojust in the period January 2004 and October 2010.

4.1.5. The European Commission

Although, due to the very nature of fraud, it is difficult to put a precise figure on VAT losses on intra-EU transactions due to fraud, it is thought to be several billion euro's each year. In 2009, the Commission published a study on the EU VAT gap⁸⁸, which compared what Member States actually got in VAT receipts with what should have been expected. While this VAT gap covers more than just fraud (also legal avoidance and insolvencies), the study set the gap at EUR 106.7 billion in 2006 within the EU-25. This represents an average of 12% of the net theoretical liability although several Member States were above 20%.

In this report the researchers stated that they were unable to produce estimates on the basis of a bottom-up approach that compiles information from surveys or other studies on estimates of particular types of VAT fraud, as:

- a) Published data on the size of different types of VAT fraud are insufficient - indeed they are scant - to allow us to piece together an estimate of VAT fraud in the economy as a whole.
- b) There may be a selection bias. Presenting the value of the different types of VAT fraud detected by tax agencies, as reported by some in annual reports, would risk giving a distorted account of the relative importance of different types of VAT fraud as well as of overall level of VAT fraud.

⁸⁸ Reckon, DG Taxation and Customs Union, *Study to quantify and analyse the VAT gap in the EU-25 Member States*, Reckon LLP, 21 September 2009 http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/combating_tax_fraud/reckon_report_sep2009.pdf

- c) The raw data underlying the estimates of particular types of VAT fraud that we are aware of are based, almost invariably, on operational data held by the tax agencies. Generally, these are confidential, as are the methods used to derive them.

4.1.6. How can the extent to which organised crime misused EU funds in 2009 be quantified?

Based on the publicly available information on misuse of EU funds, including VAT-fraud, only very general statements can be made. The question what the extent of misuse of EU funds, including VAT-fraud, by organised crime is, is even harder to be answered, since no reliable information is available in the public domain (nor handed to us by one of the EU agencies) to make only a very rough estimation.

To be able to quantify the extent to which organised crime misuses EU funds, it is at least necessary to:

- a) Have and use uniform definitions of the different terms used in this context: uniform definitions of 'organised crime', 'misuse' and 'EU funds' are required and they should be applied by all relevant national and EU institutions. In chapter 2 we described the difficulties in defining organised crime, the fact that several organisations use different definitions and that (aspects) of definitions (should) develop over time;
- b) Register, on the national and the EU level, cases of misuse of EU fraud in a uniform way so that comparisons and additions can be made. These registrations should, in spite of legal obstacles, ideally be matched to discover links between subjects on the national level and the EU level, but also on links between fraud and organised crime (e.g. between subjects of investigations of OLAF and subjects of investigations of Europol). Such registrations do not exist (or are not open for this research) and matching of data between for instance OLAF and Europol is not a standard automated procedure;
- c) Attribute EU agencies with the task to actively direct their activities on misuse of EU funds by organised crime. At this moment, only Europol is actively involved in the fight against VAT fraud by organised crime. Misuse of EU (spending) funds by organised crime as such is no separate topic for Europol, Eurojust, OLAF or the European Court of Auditors. All information is thus collected through cases either directed on organised crime or fraud, and most probably does not cover the entire practise where these terms are interlinked.

4.2. Case studies

In this section, five exemplary cases of misuse of EU funds by organised crime are presented based on open sources research and interviews with representatives of Eurojust, Europol, OLAF and ECA.

We received two exemplary cases from Eurojust in order to provide an idea of to what extent organised crime misuses EU funds. However, due to confidentiality, the sensitive nature of the investigations carried out by the authorities and the fact that both the cases are still ongoing, we were only given limited insight in the specific cases and the cases were provided with limited detailed information and specifics.

We were given insight in the following two cases:

- Case one - VAT Fraud committed by organised crime – the case was registered in 2010 (Section 4.2.1.1);
- Case two - EU Funds Fraud committed by organised crime - the case was registered in 2009 (Section 4.2.1.2).

Furthermore, OLAF provided us with an analysis of organised crime groups involved in cigarette smuggling, drafted in 2007. Some of the characteristics of these organised crime groups are presented here as well, although the sources of the analysis nor underlying cases were available for the researchers.

In addition to these cases from Eurojust and the analysis from OLAF, open sources research was conducted in order to analyse the known cases and written about in the public media. Local PwC offices were contacted, conducting an initial search in the local languages.

During this open sources research a large number of examples have been identified which relate to misuse of EU funds (See Appendix A.3). However it is important to note that not all these exemplary cases involve fraud committed by a criminal organisation.

Based on the analysis of the cases identified in open sources, three illustrative cases of misuse of EU funds by organised crime are selected. The selection criteria are based on the damage caused, the methodology, the country or region where the misuse has occurred or the organised criminal network is situated in and the policy areas.

Based on these criteria the following three exemplary cases were selected:

- Misuse of structural funds by the Italian mafia in the sector of renewable energy (Section 4.2.3.1);
- Misuse of agricultural funds (SAPARD program) in Bulgaria (Section 4.2.3.2);
- Misuse of Emission Trading System involving multiple Member States (Section 4.2.3.3).

We have sourced publicly available information on relevant cases regarding the misuse of EU funds and individuals involved and have detailed our findings in section 4.2.3 below. In preparing this section PwC has collated information from the public domain and subscription databases. The research was initiated at the beginning of October and was completed on 12 January 2011. Accordingly, no representation or warranty of any kind (whether express or implied) is given by PwC as to the accuracy or completeness of the information contained within this section.

4.2.1. Case studies from Eurojust

4.2.1.1. Case 1

In 2010, Eurojust registered a large international VAT Fraud case. The fraud had been operating for two years by an organised criminal group which consisted of three nationals of an EU Member State and possibly two other individuals still to be identified. One member of the criminal group was involved with two companies registered in the EU. The

criminal group made fraudulent refund claims for VAT in several Member States, based on the arrangements provided for in the Eighth Council Directive 79/1072/EEC.⁸⁹

The investigation showed that the suspects had attempted to obtain VAT refunds through forged invoices for non-existent purchases. The suspects had used forged invoices of companies established in 14 Member States for fraudulent purposes.

From the investigations thus far, it has been established that:

- The criminal acts had been conducted in an organised form, the group being structured hierarchically;
- Forged documents had been used by the criminal group in their attempts to obtain VAT refunds;
- The fraud by way of application for undeserved VAT refunds, totaled several million euro's;
- There is material to suggest that substantial amounts from the proceeds of the VAT Fraud have been laundered;
- At least 4 Member States have already executed refunds of VAT claimed by the two companies registered in the EU.

For the purpose of this investigation, letters of request have been addressed by the investigative judge to the authorities of six Member States. These letters of request have been sent in order to obtain information and documents with regard to possible requests for refund introduced by the criminal group in these countries. At the same time, the letters have requested that the Member States involved provide all material that could make possible the identification and location of two suspects that might have been involved within the same organised criminal group. The two non-identified suspects have been mentioned as contact persons of the two companies on several forged invoices used in some Member States.

A letter of request has been also sent to a third state (jurisdiction outside the European Union), as the investigations thus far show that one of the bank accounts provided by the organised group for the refund of VAT was a bank account opened by the companies there. The investigating judge has also issued a European Arrest Warrant against one of the suspects who is allegedly the head of the criminal group.

Due to the complexity of the case and the difficulties and delays in the execution of mutual legal assistance requests, the assistance of Eurojust has been requested by the investigative judge in order to facilitate the cooperation and coordination of investigations. A coordination meeting was organised by Eurojust in October 2010 to make possible the exchange of information and the facilitation of MLA requests between the countries involved. The aim of this meeting included establishing possible links of this case with other countries and whether criminal proceedings against the same suspects/criminal group for the same crimes had been initiated in other countries

⁸⁹ Europa - Summaries of EU legislation- Eight Council Directive of 6 December 1979 on the harmonization of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in the territory of the country (79/1072/EEC) http://europa.eu/legislation_summaries/taxation/l31014_en.htm

involved. The investigating magistrate has sought the assistance of Eurojust in pursuing the organised crime group.⁹⁰

4.2.1.2. Case 2

Member State A is currently conducting an investigation into offences affecting the European Communities' financial interests. The case was registered in 2009 by Eurojust and concerns an organised group that claimed to run a business for the development of a specific product. The product did not exist, and the group created a virtual network of companies in order to simulate real trade in goods and services, making use of false invoices to justify purchases and then claiming back public monies from both the Italian authorities and the European Commission. The financial loss due to this fraud is estimated to involve millions of Euros. In addition to the company supplying the purported product, the investigation has established that companies allegedly supplying materials in two other Member States were being used in the fraud. The existence of links to bank accounts in a third state has also been established. The companies in the Member State where the investigation began, do not have physical locations.

The *modus operandi* consists of simulating legal trade and financial activity by transferring money from the accounts in the third state to the suspect company in Member State A and also directly to suppliers in other Member States. The money transferred to the suspects' company in Member State A is used to pay the alleged suppliers there.

In all cases the alleged suppliers issue false invoices to justify this fictitious trade. In a subsequent phase the money allegedly used to pay the suppliers was sent back by them to the accounts in the third state and afterwards used again to simulate new transactions. This way the suspects invested a limited amount of money which was used repeatedly in order to create large fictitious money flows. The final step involved seeking public funding and supporting the request with false invoices that justify the virtual and non-existent financial activity. Member State A has addressed this cross-border fraud by seeking the assistance of Eurojust.⁹¹

4.2.2. Analysis of organised crime groups involved in cigarette smuggling from OLAF

On request, OLAF has provided the researchers with an analysis of organised crime groups involved in cigarette smuggling. Although this analysis is from 2007 and the references to the sources used, the number of cases that founded the analysis nor the cases themselves were handed to the researchers, the analysis gives quite an overview of the origins of organised crime groups, their respective roles and some means and methods used by these groups in this area of criminal activities.

⁹⁰ Eurojust's contribution to the study on *How does organized crime misuse EU funds?* 20 december 2010.

⁹¹ Ibid.

Origin/location of organised crime group's	Activities with regard to cigarette smuggling	The criminal groups' structure	Use of legitimate business structures
China/ Vietnam	<i>Activities are supplying cigarettes and manufacturing counterfeit cigarettes</i>	<i>Well structured OCG, low level visibility in any one Member State</i>	<i>Extensive use of legitimate business structures i.e. legitimate tobacco factories used to manufacture counterfeit cigarettes and legitimate companies used as consignors for cigarette smuggling</i>
The UAE, in particular Dubai and Middle East	<i>Activities are utilising the existence of free port zones to allow containers of cigarettes to tranship from outside the EU, into the EU</i>	<i>Family connections, hierarchical structures, not necessarily nationals of these countries but have migrated there</i>	<i>legitimate freeports used to tranship containers and often the highjacking of company details located in this area are used as consignees and the containers are then diverted on to Western Europe misdescribed as other goods.</i>
Ethnic Albanian groups located in the Balkans, F.Y.R. Macedonia, Greece	<i>Activities are as middle layer of moving cigarettes across Europe, supplying transport and personnel to work in illegal cigarette factories producing counterfeit cigarettes also have presence in final destination countries to source the customers</i>	<i>Extreme violence, hierarchical willing to work with other OCG's</i>	<i>Use of legitimate transport companies</i>
Russia	<i>Activities include the laundering of the financial proceeds of cigarette smuggling</i>	<i>Hierarchical structure, high levels of violence within their group and towards other OCG's</i>	<i>legitimate financial institutions used, plus investment in property and legitimate businesses in Europe</i>
Indigenous European "mafia style" organised crime groups		<i>Family connections, hierarchical structures, well integrated into local environment, high levels of violence within their group and towards other OCG's</i>	<i>legitimate financial institutions used, the ability to set up and maintain legitimate companies demonstrates an ability to blend in with the legitimate business environment allowing them to exercise political influence and provide cover for corruption/coercion of officials</i>

Some means and methods used by organised crime groups involved in cigarette smuggling that are of interest are:

Document forgery – Especially in relation to the Chinese organised crime groups when producing false Bills of Ladings to accompany containers of cigarettes and Balkan organised crime groups when producing CMR's⁹² to accompany lorries containing cigarettes.

Technology – Increasing use of internet cafes by organised crime groups in order to communicate with each other whilst making it difficult for Law Enforcement agencies to police. Also use by organised crime groups of writing information to each other and saving it in draft folders. Therefore making it impossible for the Law Enforcement agencies to monitor and intercept their activities. This is in particular used by UK nationals who have temporarily based themselves in the UAE and Middle East. Also use by organised crime groups of third party calling companies. Telephone calls are dialled via a third party offering reduced rates abroad. But by doing this the person who is being contacted cannot be identified via caller ID so evidentially it makes it more difficult to prove that the person was ever called.

Misuse of the transport system – Predominately the Balkan, Polish and Western European organised crime groups. Use of transport companies to move cigarettes by lorry overland. Indigenous organised crime groups use of fleets of empty lorries to collect toll/petrol receipts to provide as evidence of cross border shipments.

The exploitation of the financial sector, mainly utilised by the Middle Eastern organised crime groups and by the Russian speaking groups, utilising Bureaux de Changes and underground banking systems i.e. hawala banking. The use of complex international money flows in cooperation with other organised crime groups to prevent law enforcement identifying the final beneficiaries.

Borders – strong family ties exist on the borders of the European Union and Russia and the Ukraine and as such family members have found their families split between two countries. The advantage of this for organised crime groups is access to the infrastructure of two rather than one country to exploit in the facilitation of smuggling illicit cigarettes.

4.2.3. Case studies from open source research

4.2.3.1. Case 1: Misuse of structural funds by the Italian mafia in the sector of renewable energy⁹³

In November 2009 the Italian finance police arrested 15 people, including two of the country's most prominent businessmen in the wind energy sector, Oreste Vigorito and Vito Nicastri. The charges the two men face relate to fraud involving public subsidies to construct wind farms. An additional investigation is looking into the sale of these wind farms to foreign companies as it seems these wind farm projects were used to launder money for the mafia which they illegally obtained through criminal-related activities.

⁹² CMR: Convention Relative au Contrat de Transport International de Marchandises par Route.

⁹³ This section is written based on the documents and articles in Appendix A.5

In the fraud scheme, a number of companies were set up and money was transferred from one company to the other, making the outside world believe that all companies were in good financial health. All these companies later on applied for public funding to setup and construct wind farm projects. However, only a portion of these grants would go toward the development of these wind farms. They rotate the millions in EU funds through a web of companies that are used to obtain additional EU fund by fictitious financial statements of these shell companies.

This complex operation would not have been realised without the help of politicians and people working for the public bodies. Contacts and insiders at every level of government were used to obtain the permissions necessary to proceed with the construction. With regard to obtaining plots of land to build the wind farm projects, it was often impossible for the owners to operate independently from the Italian mafia who were not afraid of using extortion, intimidation and violence to achieve their goals.

It looks like the businessmen were taking advantage of Italy's high feed-in tariffs and poor government management to create new companies and recycle cash. It is known that the regulation is poor and lacks proper and effective controls within this sector. According to public sources, Oreste Vigorito was allegedly trying to embezzle up to EUR 30 million in EU funds through the fraud scheme and despite his conviction in 1996 for fraud involving wind farms, Mr Nicastri was still able to engineer the aforementioned construction.

We refer to Appendix A.4 for a more in-depth description of the case.

4.2.3.2. Case 2: Misuse of agricultural funds (SAPARD program) by Mario Nikolov and Lyudmil Stoykov in Bulgaria⁹⁴

When Bulgaria joined the EU on 1 January 2007, it did not meet several expectations with regard to the judicial reform and the fight against corruption and organised crime. As a result, the European Commission has the right to monitor these areas of concern on a regular basis.

Over a six month period in 2008, OLAF investigators worked closely together with the Prosecutor's Offices of Bulgaria, Germany and Switzerland and their respective national authorities on a large-scale investigation directed at Mario Nikolov and Lyudmil Stoykov, with an estimated financial impact of EUR 7.5 million.

According to OLAF, the Nikolov-Stoykov group – as they call it – is a cover for a *"criminal company network composed of more than 50 Bulgarian enterprises and various other European and offshore companies."*⁹⁵

With regards to the SAPARD fund, the OLAF report states that *"In the framework of the SAPARD projects of the companies [...] which are all linked and controlled by the NIKOLOV-STOYKOV GROUP, the responsible individuals used falsified and inflated offers to support their SAPARD application. The Criminal Group sold old second-hand meat processing equipment [...] from their own Bulgarian companies – via two own companies, based in the USA [...] and Ireland [...], respectively – to accomplices in Germany. These German companies then resold the equipment in question back to SAPARD applicants in*

⁹⁴ This section is written based on the documents and articles in Appendix A.7

⁹⁵ OLAF, *Report – internal report leaked to public media*, 2008, http://www.mediapool.bg/site/images/doklad_OLAF_en.pdf

Bulgaria using highly inflated invoices [...]." In addition, the report identifies other SAPARD projects that might also be linked to the Nikolov-Stoykov group using falsified offers.

On 20 October 2008, the case against Mario Nikolov and eight other defendants regarding the embezzlement of EUR 7.5 million from the SAPARD fund went to trial. In the meantime, Luydmil Stoykov was cleared from all charges related to the embezzlement due to insufficient evidence, but was charged separately for money laundering. Later on, Mario Nikolov and his wife were charged for money laundering.

On 29 March 2010, the Court sentenced Mario Nikolov to 10 years imprisonment and his wife, Mariana, to 8 years with regard to the money laundering charges. In addition, all those found guilty have to pay a fine of BGN 30.000 and will have to repay BGN 12 million to the SAPARD program. Lyudmil Stoykov was acquitted by the Court.

Three months later, the Sofia Court sentenced Mario Nikolov to 12 years imprisonment on charges of embezzlement and fraudulent draining of approximately EUR 7.5 million.⁹⁶ In addition, he is banned from applying for EU subsidies for three years.

We refer to Appendix A.6 for a more in-depth description of the case.

4.2.3.3. Case 3: Specific case of VAT fraud: credit carbon fraud⁹⁷

From our open sources review, we learnt that the EU Emission Trading Scheme (ETS) was affected by 3 types of fraud during the last few years: 1) VAT fraud; 2) phishing attacks against EU ETS accounts – cybercrime; 3) reselling emission reductions that had already been used for compliance CER's. This case differs from the previous cases because it does not present one specific case study. It provides a general description of one form of VAT fraud within the carbon credit market, a VAT-evasion scheme known as 'carousel' fraud.

On its website, Europol published the following statement *"the European Union (EU) Emission Trading System (ETS) has been victim of fraudulent traders in the past 18 months. This resulted in losses of approximately 5 billion euro for several national tax revenues. It is estimated that in some countries 90% of the whole market was caused by fraudulent activities."*

According to Europol, carbon credit fraud can be considered as a variation on the VAT carousel fraud and operates as follows (for a visual overview chart, see Appendix A.8):

- Criminals open a trading account in a national carbon credit registry which is linked with the European Commission Community Independent Transaction Log (CITL);
- The fraudster buys EUA's VAT free from companies located in other countries;
- The EUA's are then transferred to the country where they are registered;
- The fraudster trades the EUA's to an unregulated broker, selling the allowance on a carbon spot trading exchange often through various buffer companies;

⁹⁶ It is said that he only has to serve the longer sentence of 12 years and not both sentences (totalling 22 years).

⁹⁷ This section is written based on the documents and articles in Appendix A.10

- The fraudster charges VAT on the transaction, but does not pay the collected VAT to the tax authorities;
- The fraudulent trader goes missing.

According to Europol suspects of illicit trading activities were notified in late 2008 and were made very public due to EU wide police and tax authority raids on 28 April 2010. In this case a total of 230 offices and homes were raided in Germany, with a total of 150 suspects from 50 different companies. Among these companies were the offices of RWE, one of the leading energy companies in Germany and the premises of Deutsche Bank. Deutsche Bank said seven of its employees were suspected in the investigation, but states that all allegations can be rebutted.

However, this is not the only case. In July 2009 the Paris prosecutor's office announced a probe is under way into a suspected multi-million euro VAT fraud in the French carbon emissions market and that also the Dutch ministry of finance has stated they have clear indicators of fraudulent activity in the Dutch carbon emissions market. As a counter action, the Dutch ministry places the obligation to pay VAT on the carbon permit buyer, instead of the seller. In August 2009 the British tax office arrests seven people in London for a suspected fraud in the EUA market and one month later several Member States take action by revising their tax system to avoid the occurrence of such fraud mechanisms.

We refer to Appendix A.9 for a more in-depth description of the case.

4.2.4. Conclusions on misuse of EU funds by organised crime based on the case studies

4.2.4.1. Information on cases of misuse of EU funds by organised crime

In the sections above, five cases of misuse of EU funds by organised crime are presented. Two cases were provided by Eurojust and three cases were selected based on open sources research. The three illustrative cases of misuse of EU funds by organised crime were selected from our results based on indicators as the damage caused, the methodology, the country or region involved and the EU funds that were affected. Based on this selection, additional information was gathered in order to further substantiate the methodology and case details. These three illustrative case studies are described in the section above.

With regards to the open sources research our work was performed in two phases. In the first phase, we concentrated our research on a general collection of information available in publicly available sources. During this information gathering a significant amount of misuse was collected, including public funds (non-EU) and EU funds, organised networks and simplified alliances. As the research progressed, we often redefined the information selected according to specific parameters. In the second phase three illustrative cases of misuse of EU funds by organised crime were selected. These three illustrative case studies are described in section 4.2.3.

In Appendix A.3 we provide an overview of cases of misuse of EU funds as collected in the open sources research. The characteristics of the presented cases are: country, fraudulent period, article, funds, victim, main suspects, allegations, methods, total amount defrauded, investigated by, sentence, short description and bibliography.

We note that the overview of the fraud cases with EU funds provided in Appendix A.3 only represents a mere part of the information available due to

timing, language barrier and subject focus during the research. Nevertheless, this overview provides an interesting and realistic indication of the information presented by the media concerning misuse of EU funds by organised crime.

As it is the case with quantifying the extent of misuse of EU funds by organised crime, previously described in this report, same goes for the analysis of the methodology and specifics. Based on the information available in the publicly available sources only very general statements can be made concerning the misuse of EU funds by organised crime. This can be explained by understanding the confidentiality and the sensitive nature of the investigations carried out by the specific authorities and institutions.

4.2.4.2. Conclusions based on the five extensive case studies

In the five case studies presented in section 4.2.1 and 4.2.3, the misuse of EU interests committed by organised crime is a key factor. Further analysis of the cases indicate that there are elements which are similar, but there are also characteristics that vary from case to case. The table in appendix A.11 shows a short oversight on the different elements and extent in the cases. Due to a lack of specific (and verified) information in the cases, it is difficult to compare the cases on all elements. Nevertheless, some general conclusions can be made.

Concerning the number of people involved, all cases show a network with more than two individuals and/or companies involved. Furthermore, the cases show that these (criminal) networks operate transnational. In all cases at least two EU Member States are involved, either as the home base of the network involved or as a country where the criminal network is connected with.

4.2.4.3. Conclusions based on general characteristics of a number of open sources case studies

In the overview of cases of fraud with EU funds (Appendix A.3), general information from open sources about *'misuse of EU funds by organised crime'* is described. Furthermore, 85 specific cases from Poland, Italy, Lithuania, Hungaria, Romania, Latvia, Estonia, The Netherlands, Belgium, Greece, Scotland, Denmark, Spain and Bulgaria are listed. In 45 of the 85 cases, where the amount of what is defrauded is mentioned in the open sources, the total amount that is defrauded varies between € 5.500 and 1 billion Euro's.

We have to consider the different forms of irregularities (see section 2.3) that are taken into consideration for this study: irregularities, (serious) fraud and fraud committed by organised crime. Often it is a thin line between an irregularity and fraud. For many of the cases presented in Appendix A.3 this distinction cannot be made from the information available. When a certain number is provided which defines the extent of the defrauded amount, we can only infer that fraud is seen as serious fraud when the total amount that is defrauded is a minimum amount of € 50.000⁹⁸. The total amount that is defrauded in 28 of the 57 cases, is above € 50.000 and thus considered to be serious fraud.

Expanding the analysis to the overview of cases of fraud with EU funds, we note that in practically all these cases the misuse of EU funds do not stand alone. Other types of criminal offences are committed which differ case by case. It is difficult to explain this diversity due to a lack of detailed information. However, if we look at the table presented

98 Article 2 (1) of the Convention, [http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=41995A1127\(03\)&model=guichett](http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=41995A1127(03)&model=guichett)

in Appendix A.3 it becomes apparent that the following offences often go together with the misuse of EU funds:

- Bribery and corruption;
- Overstatement of the subject that relates to the fund (e.g. cost estimates, land, counseling hours, participants, ...);
- Forged or falsified documents/certifications;
- Illegal financial benefits;
- Fake transactions;
- Embezzlement;
- Falsification of the procedures (e.g. allocation of funds, procurement of auctioning)
- Money laundering;
- Creation of shell companies.

With regard to the nature of the EU funds misused, the information collected provides an indication that, in general, misuse of EU funds points towards the EU funds managed by the Member States, such as the structural funds - and pre-accession funds. We identified also that in some cases the misuse points towards funds which are directly managed by the Directorate Generals of the European Commission.

The open sources research also clearly indicates that not only the EU's expenditure is impacted by misuse. Upon request from the European Parliament, VAT fraud has been added to the scope of this study. Several cases from the open sources research also show that the EU's revenue is affected by organised crime.

In addition to this overview, questions need to be raised about the involvement of organised crime when we speak about the misuse of EU funds. As previously described in this report (see section 2), defining organised crime is difficult. Because of a lack of detail in the information from the open sources, it is not clear whether the fraud is committed by organised crime or not.

The findings in the overview could be biased because in some east-European countries (like Bulgaria), practically any economic and corporate crime committed is identified as organised crime.⁹⁹ Similarly, the concepts of organised crime and corruption are intertwined to a very high extent. To really understand these concepts, it is necessary to begin with an overview of the country's recent history and a review of the current state of the institutions affected by organized crime and its corruption instruments. The same remarks may also be applicable for Italy.

⁹⁹ Gounev, P. and Bezlov, T., *Examining the links between organised crime and corruption*, Center for the Study of Democracy, 2010

5. INITIATIVES FROM THE EUROPEAN COMMISSION TO PROTECT THE EU FINANCIAL INTERESTS

The protection of the EU financial interests is an important element of the European Commission's political agenda, in order to consolidate and to increase public trust and give assurance that taxpayers' money is being used correctly¹⁰⁰. The Lisbon Treaty has considerably reinforced available tools to act in this regard (Articles 85, 86 and 325 of the Treaty on the Functioning of the European Union - TFEU). Articles 310(6) and 325 TFEU oblige both the EU and its Member States to counter all forms of illegal activity affecting the EU financial interests. The EU has thus in place a comprehensive set of tools to prevent and detect misuse of the EU budget. According to the Commission, further challenges include how to overcome difficulties in obtaining accurate data on the extent of fraud and prosecution in the Member States, how to improve cooperation in cross-border cases and how to enhance effective court action in criminal law. The Commission will therefore formulate new anti-fraud and anti-corruption strategies as part of an integrated approach. Protecting EU funds by effective and equivalent legal action throughout the Union has to become a priority for the national authorities. This chapter provides a brief overview of relevant recent initiatives from the Commission with regard to the protection of the EU financial interests.

5.1. Fighting fraud against the European Union's financial interests

Despite the progress made in the last 15 years, the level of protection for EU financial interests by criminal law still varies considerably across the Union. Criminal investigations into fraud and other crimes against the financial interests of the Union are characterised by a patchy legal and procedural framework: police, prosecutors and judges in the Member States decide on the basis of their own national rules whether and, if so, how they intervene to protect the EU budget. Despite the attempts to provide for minimum standards in this field, the situation has not changed noticeably: The Convention of 1995 on the protection of financial interests of the EU and related acts¹⁰¹, which contains provisions on criminal sanctions, - albeit incomplete - was implemented fully by only five Member States. Given the extent of the financial issue at stake, the protection of the EU budget needs more frequent and more thorough investigation and prosecution by criminal justice authorities. An integrated policy to protect EU financial interests by criminal law and by administrative investigations must be consistent, credible and effective. Only then will it allow those responsible for crimes committed to be prosecuted and brought to court and have a deterrent effect on potential perpetrators¹⁰².

In May 2011 the Commission presented its Communication on the protection of the financial interests of the European Union by criminal law and by administrative investigations. According to the Commission, insufficient protection against criminal

100 Communication on the protection of the financial interests of the European Union by criminal law and by administrative investigations: An integrated policy to safeguard the taxpayers' money, COM(2011) 293 final, p.2.

101 Convention of 26 July 1995 (OJ C 316, 27.11.1995, p. 49) (fraud); First Protocol (OJ C 313, 23.10.1996, p. 2) and Convention of 26 May 1997 (OJ C 195, 25.6.1997) (corruption); Protocol of 29 November 1996 (OJ C 151, 20.5.1997, p. 2) (court interpretation); Second Protocol of 19 June 1997 (OJ C 221, 19.7.1997, p. 12) (money laundering).

102 Communication on the protection of the financial interests of the European Union by criminal law and by administrative investigations: An integrated policy to safeguard the taxpayers' money, COM(2011) 293 final.

misuse of the EU budget and insufficient legal action to fight criminal activity are the main policy challenges with regard to the protection of the financial interests of the European Union. These challenges find their causes partly in the variety of legal traditions and systems which lead to divergent judicial practices of Member States. However, very concrete gaps in the quality of justice are involved as well, such as the absence of a common level playing field in criminal law (e.g. there is wide variation across the Union in definitions of relevant criminal offences), insufficient cooperation between authorities and insufficient investigation powers.

The Lisbon Treaty equips the Union with strengthened competences in the field of the protection of EU financial interests and in the field of judicial cooperation in criminal matters. Four ways to protect EU financial interests under the Treaty on the Functioning of the EU:

- (i) Measures on procedural judicial cooperation in criminal matters (Article 82).
- (ii) Directives containing minimum criminal law rules (Article 83).
- (iii) Legislation on fraud affecting the financial interests of the Union (Articles 310(6), 325(4)).
- (iv) Article 85 granting Eurojust investigative competences and Article 86 allows for the establishment of a European Public Prosecutor Office (EPPO) from Eurojust to combat crimes affecting the financial interests of the Union.

The Commission, in its Communication on the protection of the financial interests of the European Union by criminal law and by administrative investigations, presents initiatives at three levels:

1. Strengthening criminal and administrative procedures: building upon existing instruments, such as the European Judicial Network in Criminal Matters and the European Judicial Training Network, asset recovery and confiscation, providing the bases for cross-cutting exchanges of information among police, customs, tax authorities, the judiciary and other competent authorities and ensuring evidentiary value of OLAF investigative reports, as well as upon other measures that might facilitate transnational gathering of evidence.
2. Strengthening substantive criminal law: preparing of an initiative on the protection of EU financial interests that guarantees consistency and fairness in application of criminal sanctions relating to fraud and that may include, to the extent relevant for the protection of EU financial interests, more systematic rules on aiding and abetting, instigation, attempt, as well as on intent and negligence.
3. A strengthened institutional framework: modernisation of Eurojust capacities, possibly equipping it with powers to trigger on its own initiative criminal investigations into criminal activities affecting the Union's financial interests, and a specialised European prosecution authority such as a European Public Prosecutor's Office could contribute to establishing a common level playing field by applying common rules on fraud and other offences against the financial interests of the Union in a consistent and homogeneous way, investigating, prosecuting and bringing to court the perpetrators of, and accomplices in offences against the Union's financial interests, and the reform of OLAF.

5.2. Reform of OLAF

In March 2011 the Commission proposed the reform of the Anti-Fraud Office (OLAF) as a means of strengthening the effectiveness and efficiency of administrative investigations. The proposal for amending the legal framework of OLAF¹⁰³ aims at increasing the efficiency and speed of OLAF investigations, at strengthening procedural guarantees, as well as at reinforcing OLAF's cooperation with Member States and at improving its governance.

5.3. Fighting corruption

According to the Commission, the EU should put stronger focus on corruption in all relevant EU policies – internal as well as external. The Commission will therefore, in particular, propose modernised EU rules on confiscation of criminal assets in 2011, a strategy to improve criminal financial investigations in Member States in 2012, and adopt in 2011 an Action Plan for how to improve crime statistics. The Commission will also work with EU agencies such as Europol, Eurojust and CEPOL, as well as with OLAF to step up judicial and police cooperation and improve training of law enforcement officials. It will continue to prepare modernised EU rules on procurement and on accounting standards and statutory audit for EU companies. Also, the Commission announced to adopt a strategy to combat fraud affecting the financial interests of the EU in 2011, mainly covering measures under the responsibility of the Commission for the protection of EU financial interests.

In its Communication on fighting Corruption in the EU¹⁰⁴, the European Commission states that although the nature of corruption varies from political corruption, corrupt activities committed by and with organised crime groups, private-to-private corruption and so-called petty corruption. Organised crime groups are explicitly mentioned in relation to their use of corruption to commit other serious crimes, such as trafficking in drugs and human beings - misuse of EU funds (or any other public funds) is not named.

The Commission also expresses its intention to continue support for the strengthening of institutional capacity and make it available to all Member States and regions. The EU's cohesion policy supports the strengthening of institutional capacity in Member States to make public services and administrations more efficient. A total of 3.5 billion Euros has been allocated under those guidelines to strengthen institutional capacity at national, regional and local level of which 2 billion Euros stem from the European Social Fund. According to the European Commission, such support for institutional capacity will have a positive impact on preventing corruption, by making public services and administrations more efficient and transparent.

In its Communication on fighting Corruption in the EU, the Commission calls on EU Member States to ensure that all relevant legal instruments are fully transposed into their legislation and, crucially, effectively followed up and enforced through the detection and prosecution of corruption offences, backed up by criminal law provisions and a systematic track record of deterrent penalties and asset recovery. To achieve this, firmer political commitment by all decision-makers in the EU is needed. The existing

103 Amended Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1073/1999 concerning investigations conducted by the European Anti-fraud Office (OLAF) and repealing Regulation (EURATOM) No 1074/1999 SEC(2011) 343 final.

104 Communication on fighting Corruption in the EU, COM(2011) 308 final.

international monitoring and evaluation mechanisms have, so far, not produced the necessary momentum.

To that end, the Commission will set up the EU Anti-Corruption Report to periodically assess Member States' efforts, starting in 2013. In parallel, the EU should negotiate its participation in the Council of Europe Group of State against Corruption (GRECO). Greater focus should be put on corruption in the areas of judicial and police cooperation, on modernised EU rules on confiscation of criminal assets, a revised EU public procurement legislation, better EU crime statistics, an enhanced anti-fraud policy to protect EU financial interests.

5.4. Public procurement

Public expenditure on works, goods and services accounts for roughly 19% of EU GDP in 2009 and almost a fifth of this expenditure falls within the scope of the EU Directives on public procurement (i.e. approx. €420 billion, or 3.6% of EU GDP). The financial risks at stake and the close interaction between the public and the private sectors make public procurement a risk area for unsound business practices, such as conflict of interest, favouritism and corruption.

In January 2011, the Commission launched a consultation¹⁰⁵ on the modernisation of EU public procurement policy. It raises the question whether a common definition of 'conflict of interest' and possible safeguards against such situations are needed at EU level, including the publication of concluded contracts to enhance transparency, the extension of exclusion grounds and 'self-cleaning' measures. The Commission announced in its Communication on fighting Corruption in the EU the preparation of a modernised EU public procurement legislation, for which the Commission will carefully consider these issues, as well as proposing legislation on concessions to create better conditions for the fair and competitive award of these contracts, thus reducing the risks of corruption.

5.5. The initiatives of the Commission and organised crime

What is striking in the recent Communications from the Commission on protection of EU financial interests by criminal law, by administrative investigations, by reform of OLAF, or by fighting corruption or modernisation of EU public procurement policy is that none of the initiatives seem to focus on organised crime. All Communications are directed to *any* act of fraud or corruption, regardless whether fraudsters act in concert or alone, structured or not, over a period of time or just in one instance. The approach of the Commission seems to be an all hazard approach, fighting any form of fraud (and corruption).

Furthermore it is noticeable that often in the Communications is pointed at the difficulties in obtaining accurate data on the extent of fraud, the failing monitoring and evaluation mechanisms, and the need for better EU crime statistics.

105 Green Paper on the modernisation of EU public procurement policy. Towards a more efficient European Public Procurement Market, COM(2011) 15 final.

6. CONCLUSIONS AND RECOMMENDATIONS

6.1. Conclusions

6.1.1. Definitions of organised crime and fraud, typology of EU funds

There is not one universal definition of organised crime. Organised crime is an ever changing phenomenon in an ever changing world. Definitions of this phenomenon differ in time and the various definitions reflect the different angles from which to look at the problem, and the different positions within the discourse. This is not problematic, as long as one working definition is being used by all actors involved in the fight against organised crime. Although the European Union has adopted a definition of organised crime in Council Framework Decision 2008/841/JHA of 24 October 2008 (on the fight against organised crime), it turns out that in the respective institutions of the EU, differences on how organised crime is being defined can be discovered. Whilst Eurojust uses the definition from the Council Framework Decision mentioned, Europol is using a slightly altered definition. OLAF and the ECA have no working definition of organised crime. However insignificant which definition is being used, when it comes to exchange of information on organised crime it could be helpful to agree, in detail, to what all parties regard as organised crime. For this study, in order to be able to identify cases of misuse of EU funds *by organised crime*, organised crime is defined as:

Organised crime shall mean a structured association, established over a period of time, acting in concert with a view to committing offences, in order to obtain, directly or indirectly, financial or other material benefit, which causes serious damage to the financial integrity and/or foundations of the EU.

In this study, *misuse* of EU funds is defined as *fraud* with EU funds. Since 'misuse' is *wrong or improper use* or misapplication, fraud is generally defined as *deceit, trickery, sharp practice, or breach of confidence, perpetrated for profit or to gain some unfair or dishonest advantage*. In particular, the element *perpetrated for profit* marks the distinction between unintentional acts and – specialism of organised crime – intentional acts in order to obtain financial or other material benefit.

All EU funds could be affected by fraud committed by organised crime. In this study special attention is paid to the so called spending funds: Regional Assistance funds, Natural Resources funds and Pre-accession funds managed by the Member States and Community Programmes managed by the European Commission. These funds are accumulated via several sources, among which are percentages of VAT as well as excises collected in the Member States. Since VAT and excises have a track record of attracting criminals, the 'misuse' of these 'EU funds' (VAT-fraud and fraud with excises) are also taken into account, although at a more generic level.

This means that the overall goal of this study is to assess how organised crime, as defined in the working definition above, defrauds the EU by committing fraud with spending funds, VAT-fraud or fraud with excises.

6.1.2. Organised crime and fraud with EU funds in relation to the obligation of protecting the EU's financial interests

The legal base for action on the EU level to protect the EU's financial interests and fight fraud is laid down in article 325 TFEU. This article does not explicitly focus on organised crime, but on the protection of financial interests against any type or form of crime. Furthermore, based on the same article 325 TFEU, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Court of Auditors, shall adopt the necessary measures in the fields of the prevention of fraud which affect the financial interests of the Union. This is done with a view to affording effective and equivalent protection in the Member States and in all the Union's institutions, bodies, offices and agencies. The fight against organised – or any other – crime that defrauds the EU by committing fraud with spending funds, VAT-fraud or fraud with excises is therefore a relevant topic for the European Parliament, as are any possible measures to prevent such fraud.

6.1.3. The extent to which organised crime committed fraud with EU funds

Based on the publicly available information on fraud and the misuse of EU funds as typified here above, only very general statements can be made. According to OLAF, it *"has found growing evidence that in many cases the frauds in the Structural Funds are organised and planned and have not resulted from simple opportunity."* OLAF was not able however to present figures of these 'many' cases, nor of their magnitude, nor whether the way they were 'organised and planned' falls within the definition of organised crime as used for this study.

The ECA reports around 3 cases per year to OLAF, based on its audit work. Whether or not this is a case of fraud, let alone fraud committed by organised crime, is ultimately a juridical question for the ECA, something which has to be established by a court of law. The ECA does not keep account for the follow up and judicial outcome of their reported cases.

In the EU Organised Crime Threat Assessment (OCTA), no explicit facts and figures are presented with regard to fraud or misuse of EU funds by organised crime. But when describing the EU criminal markets, reference is made in the OCTA to VAT fraud and to public procurement fraud. However without any facts or numbers quantifying the (estimated) extent of this type of crime.

Only Eurojust was able to produce some figures: 42 cases of offences against the financial interests of the European Union have been recorded by Eurojust from January 2004 until October 2010. Of these, in 2009 there were three cases which were registered at Eurojust as offences affecting the EU's financial interest which were also committed by organised crime groups. Additionally, a total of 197 VAT Fraud cases have been registered at Eurojust in the period January 2004 and October 2010. However, no figures are available on the magnitude of these cases.

The question of what is the extent of the misuse of EU funds, including VAT-fraud, by organised crime is, based on the available information, impossible to answer. Insufficient information is available in the public domain (nor handed over for the purpose of this study by OLAF, Europol, Eurojust and the ECA) to make accurate calculations. This is in line with remarks of the European Commission in its Communications, pointing at the difficulties in obtaining accurate data on the extent of

fraud, the failing monitoring and evaluation mechanisms, and the need for better EU crime statistics.

6.1.4. How does organised crime misuses and defrauds EU funds?

Based on the case studies and the available information from open sources on cases of fraud with EU funds only a few general conclusions can be drawn.

Concerning the number of people involved, almost all cases show a network with more than two individuals and/or companies involved. Furthermore, the cases show that these (criminal) networks operate transnational.

Furthermore, it comes forward that the following offences often coincide with the misuse of EU funds:

- Bribery and corruption;
- Overstatement of the subject that relates to the fund (f.e. cost estimates, land, counseling hours, participants, ...);
- Forged or falsified documents/certifications;
- Illegal financial benefits;
- Fake transactions;
- Embezzlement;
- Falsification of the procedures (f.e. allocation of funds, procurement of auctioning);
- Money laundering;
- Creation of shell companies.

With regard to the nature of the EU funds misused, the information collected provides an indication that, in general, misuse of EU funds points towards the EU funds managed by the Member States, such as the structural funds and pre-accession funds. We also identified that in some cases the misuse points towards funds which are directly managed by the Directorate Generals of the European Commission.

6.1.5. Existing preventive measures and controls against fraud with EU funds

With regard to the EU 'spending' funds, where millions of Euros are paid on the basis of cost declarations by beneficiaries in many different countries, the risk of errors, and even fraud, is considerable. In order to make sure funds are spent for the right purposes, projects have to comply with certain objectives and priorities, defined by the Commission and Member States together. To ensure that the objectives are met, and obtained at the end, the Commission designed a control structure for all funds that consists of various layers.

The control structure for EU funds is primarily the responsibility of the Member State. The Member States design their national control system that has to comply to European Commission standards. After the approval by the European Commission of the design, the Member States organise the certifying and management authority and the audits over these authorities to the best of their knowledge. The European Commission supervises the control systems of the Member States with very little insight over the

direct spending procedures of the projects. The strength of the national control system is determined by the Member States.

A lot of attention is paid to the control structure for EU funds at the cost of the quality of proposals for projects, the qualifications of the tenderer and on cost declarations and sound financial management. Less attention is paid to the screening of the tenderers, the people behind the tendering organisations, the ultimate beneficiaries of profit made by the tenderers.

VAT is part of the own resources of the EU budget. Member States pay a small percentage (0,3%) of their total VAT receipts to the EU. In 2010 this represents EUR 14 billion. As VAT is part of the own resources of the EU, VAT fraud will lead to losses of income for both the Member States and the financial interests of the EU.

VAT fraud and more specifically carousel fraud, is a transnational phenomenon and thus makes it very difficult for a Member State to act individually against these fraud mechanisms. With the introduction of a general reverse charge system, carousel fraud could be limited. The system of reverse charge has already been introduced by some EU Member States. However, experts indicate that introducing this new system will only provide a temporary solution as fraudsters will ultimately look for new opportunities in sectors without the reverse charge mechanism.

Besides VAT Fraud, cigarette smuggling also causes a loss in excises and duties for Member States. Because a certain amount of excises and duties of Member States is a mean of resource for the EU general budget, the EU is indirectly affected as well. Experts state that cigarette smuggling is a growing problem in the EU.

Besides the controls and preventive measures in place, several law enforcement and intelligence agencies, on the national and on the EU level, are involved in fighting this type of serious fraud. Fraud is a serious crime, as is participating in a criminal organization. However, fighting fraud which affects the financial interests of the European Communities is not the same as fighting organised crime. On the one hand, both phenomena overlap where fraud is committed by organised crime. The nature of a lot of the misuse of EU funds suggest that some degree of organisation is required.

On the other hand, the fight against fraud contains more than just the fight against organised crime (and the reverse is also valid). In order to protect the EU's financial interests, it is necessary to focus first and foremost on the prevention of fraud as such. Knowledge of organised crime groups or networks and their *modi operandi* is in this regard essential. Although instrumental: it helps to design risk assessments, awareness training, preventive measures and early warning systems, and it may also help – when fraud is detected – to find more possible cases of fraud committed by the same organisation or network.

At this moment, an aligned focus on the phenomena of (serious) fraud and organised crime does not seem to be in place in lieu of the cooperation between OLAF, Europol, Eurojust and ECA. Within OLAF, there is no focus on organised crime, whilst Europol focuses on fighting organised crime and focusing on VAT-fraud and cigarette smuggling when fighting fraud. There is not a direct data connection between Europol and OLAF, and there is no regular matching of subjects or identifiers (telephone numbers, bank account numbers) from actual investigations of the two organisations. This implies that

links are not automatically discovered, if at all. The same applies for the matching of subjects and identifiers between Europol and Eurojust, or between one of the EU institutions and the Member States. A comprehensive picture of the extent of fraud committed by organised crime is difficult to draw when available information and data are not shared and matched optimally.

All recent Communications from the Commission on protection of EU financial interests by criminal law, by administrative investigations, by reform of OLAF, or by fighting corruption or modernisation of EU public procurement policy are directed to *any* act of fraud or corruption, regardless whether fraudsters act in concert or alone, structured or not, over a period of time or just in one instance. The approach of the Commission seems to be an all hazard approach, fighting any form of fraud (and corruption).

6.2. Recommendations

6.2.1. Focus on fraud

The EU must focus on fraud prevention and the fight against fraud by organised crime. Fraud against EU funds wastes tax payers' money, threatens the legitimacy of the EU institutions and reduces the possibilities for the EU to implement policy measures. And the protection of the EU financial interests against misuse by organized crime is an obligation in the TFEU. It is essential to constantly draw attention to the threat of fraud against EU funds, the prevention of fraud and to the results and effects of the fight against fraud and the fight against organized crime. Therefore, a good overview of the extent to which organized crime misuses EU funds, the activities on EU and Member State level in prevention of fraud, management and control of EU funds and the fight against fraud and against organized crime is necessary.

In order to be able to better quantify a more detailed overview of the extent to which organised crime misuses EU funds in the (near) future, it is recommended to:

Recommendation 1

Implement and use uniform definitions of the different terms used in this context: uniform definitions of 'organised crime' (or perhaps better: 'serious crime'), 'criminal organisation', 'misuse' (or better: 'fraud') and 'EU funds' should be applied by all relevant national and EU institutions. The definition of 'criminal organisation' from the Council Framework Decision 2008/841/JHA ("A structured association, established over a period of time, of more than two persons acting in concert with a view to committing offences which are punishable by deprivation of liberty or a detention order of a maximum of at least four years or a more serious penalty, to obtain, directly or indirectly, a financial or other material benefit.") should be implemented and used in a uniform way, perhaps with emphasis on the fact that their (serious) crime *causes serious damage to the financial integrity and/or foundations of the EU*.

Impact on data Protection	No impact
Simplicity of regulations	Simple
Cost-effectiveness	High

Recommendation 2

Register, on the national and the EU level, cases of misuse of EU fraud in a uniform way so that comparisons and additions can be made and a match of these registrations should, in spite of legal obstacles, ideally be matched to discover links between subjects on the national level and the EU level, but also on links between fraud and organised crime.

Increased exchange of data and information between OLAF, Europol, Eurojust and the ECA on misuse of EU funds by organised crime.

Impact on data Protection	Possibly high: This means new registration and exchange of data, some of which are foreseen in the current legal framework, all subject to data protection regularisations;
Simplicity of regulations	Medium degree of complexity: the registration, exchange and matching is not complex as such, but to build consensus on the need for registration and exchange and to construct the proper legal framework could impose some difficulties
Cost-effectiveness	High

Recommendation 3

Attribute EU institutions, especially OLAF, Europol, Eurojust and the European Court of Auditors, with the task to actively focus on 'misuse of and fraud with EU funds by organised crime'.

Impact on data Protection	No impact
Simplicity of regulations	Simple, reaching commitment for this task could take some effort
Cost-effectiveness	High

6.2.2. One quality standard in management, control and audit of EU funds

With regard to oversight and accountability¹⁰⁶, the EU has a uniform control system in place that is the same for all EU spending funds. The organisation of this control structure in the Member States is a national responsibility: a national check on EU funds for national projects. The quality of this national control system relies heavily on the way it is organised and staffed within the individual Member State. The education and professional standards of civil servants and auditors may very well vary between the Member States. Introduction of (more) peer reviews, or even management and control of funds for project in one Member State by other Member States could perhaps alleviate

¹⁰⁶ Oversight as the process of independently monitoring and investigating — internally or externally — the operations and activities of a government agency, company or civil society organisation to ensure accountability and efficient use of resources, and accountability being the concept that individuals, agencies and organisations (public, private and civil society) are held responsible for executing their powers properly.

these differences. Improving the quality standards and the education standard of auditors and civil servants involved in the management, control and audit of EU funds at the national level could help to reach a higher standard of quality.

Recommendation 4

Investigate the possibility of more peer reviewing and auditing of spending of EU funds by officials from other than the receiving Member State.

Impact on data protection	Some impact
Simplicity of regulations	Simple , reaching commitment for this task could take some effort
Cost-effectiveness	Considerable costs , also considerable benefits

Recommendation 5

Investigate the possibility of more standards and qualification levels for civil servants and auditors involved in the national management, control and audit of EU funds.

Impact on data Protection	Considerable impact
Simplicity of regulations	Complex , to bring Member States at the same level of quality and introduce new rules and regulations with regard to management, control and audit of EU funds
Cost-effectiveness	Considerable costs , also considerable benefits

6.2.3. Create fraud awareness

It remains important to raise fraud awareness and to maintain fraud awareness on a high level for everyone involved in dealing with EU funds. This should not be a one-off program but instead a structural part of policies and procedures, but also including recruitment, training and benefits to staff, in cooperation with other organizations the general public and also media.

Recommendation 6

Update the anti-fraud policy with regard to EU funds. Include or reinforce the statement of zero tolerance.

Impact on data Protection	No impact
Simplicity of regulations	Simple
Cost-effectiveness	Considerable costs

Recommendation 7

Encourage a permanent fraud prevention program for all EU institutions (and perhaps even for Members States institutions) dealing with EU funds. Such a program exists of i.a. implementation of clear policies, proactive screening of new staff, fraud awareness training for new and existing staff, attention for fraud awareness in evaluation of staff and the provision of a safe environment in which to report suspect activity.

Impact on data Protection	Considerable impact
Simplicity of regulations	Complex , this may require the modification of some existing policies and potentially or legal frameworks
Cost-effectiveness	Considerable costs , required to bring institutions to the same level of permanent fraud prevention, considerable benefits

Recommendation 8

Encourage the development of tools to support the proactive review of beneficiaries of EU funds and the detection of potential fraud activity. Efficient rules for protecting witnesses and for encouraging disclosure in the public interest (whistleblowing) should be implemented at EU (*inter alia* by a revision of articles 22a and 22b of the Staff Regulations) and Member States level.

Such tools could further include:

- Compendium of all appropriate legal means to review of projects, persons and entities, suspend disbursements, to recover misapplied funds and implement remedial measures in funded projects.
- Risk assessment and review procedures such as, proactive integrity review of potential beneficiary projects of EU funds through a proactive in-depth review of the proposed project, an extensive risk assessment to identify potential risks of fraud

(e.g. to identify complex projects or a difficult environments). Such a review can be supported by a review in open sources of the beneficiary companies (including subcontractors) or individuals (e.g. have these companies ever been linked to organized crime or fraudulent activities, were the companies set up just before an application for funding, etc.)

- Exclusion procedures, a fair and transparent process based on defined criteria which contain opportunities to review the evidence and allow commentary and appeals which may help to remove entities that have engaged in fraud or organised crime from projects financed by EU funds, perhaps backed by a system of cross debarment¹⁰⁷ with other EU and Member State institutions involved in the management of EU funds.
- A functioning structure of hotlines, complaints offices, protection of whistleblowers, rewarding staff for reporting signs of fraud or organized crime.
- Tools to support these procedures, such as software applications to help to find signs of fraud or connections with organized crime in open sources and EU owned data.¹⁰⁸

Impact on data Protection	High impact , since this requires proactive review of projects, individuals and entities, data has to be collected, processed, stored and analysed. Based on the collected data decisions on awards of funds will be made.
Simplicity of regulations	Complex , as this probably not only means making use of existing rules and regulations, but also the modification of to include an extended or new legal basis
Cost-effectiveness	Limited but structural cost , potentially high return on investment

6.2.4. Increase transparency and accountability

Increased transparency of how public money is spent, notices of awarded funds to the public that ultimately should ultimately benefit from the awarded project, media reporting of deadlines, progress reports to civil society and end users help to empower and encourage the civil society to monitor the integrity of public spending.

¹⁰⁷ Debarment, a procedure where companies and individuals are excluded from participating or tendering projects. Governments and multilateral agencies use this process to publicly punish businesses, NGOs, countries or individuals found guilty of unethical or unlawful behaviour.

¹⁰⁸ For example analysts of the Recovery Accountability and Transparency Board, established by the American Recovery and Reinvestment Act to prevent and detect fraud, waste and abuse in Stimulus Spending, use a system (Palantir) to carry out their mission by fusing open source and transactional data sets to find anomalous spending patterns. Once anomalous behavior has been discovered analysts link the corporate entities and individuals associated with the fraud to build a target package for investigation and prosecution by the appropriate agencies in the oversight community. The Board captures its analytical experience by building predictive models in Palantir that agencies use to better allocate resources to combat fraud.

Adequate data systems should be in place for the collection, analysis and dissemination of information on procurement processes, including the decisions taken and money spent. The decentralisation of procurement should not be an excuse for poor information keeping, particularly on statistics. Technology in use should facilitate broad public access for increased transparency and accountability. Technical information needs to be presented in a simplified way in order to be accessible to civil society and the broader public.

Recommendation 9

Strive for an increased transparency and accountability by using all means available to proactively publish and disseminate data and information on spending of EU funds to civil society and the broader public.

Impact on data Protection	Some impact , publication of this data could affect (commercial) interests of the individuals and/or companies involved in projects
Simplicity of regulations	Not complex
Cost-effectiveness	High

6.2.5. VAT-fraud

Under the new EU VAT directive, it is possible to introduce a reverse charge (end user pays) mechanism, which makes it difficult or even impossible to commit missing trader and carousel fraud. Since fraudulent trade is moving to Member States that still have not implemented such anti-abuse legislation, it could be recommended to encourage all Members States to implement a reverse charge mechanism.

Recommendation 10

Encourage all Members States to introduce a reverse charge mechanism with regard to VAT for trade that is vulnerable for VAT fraud.

Impact on data Protection	No impact
Simplicity of regulations	Simple
Cost-effectiveness	High

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APPENDICES

A.1. Specific Terms of Reference for the study on how organised crime misuse EU Funds

Brussels, 22 July 2010

- External Research Study -
Specific Terms of Reference (Specification)

How does organised crime misuse EU funds?

Definition:

The study should start with a definition of "organised crime" and types of "misused EU funds". How do these terms relate to the obligation of protecting the European Union's financial interests (Art. 325 TFEU)

The scope of the study:

- ❖ based on literature, studies and reports and on information from OLAF, European Court of Auditors, Europol and Eurojust the study should undertake to quantify the extent to which organised crime misused EU funds in 2009;
- ❖ based on the above information the study should subsequently describe how "organised crime" is organised and which means and methods are used to defraud the Union and its Member States; based on the damage caused and method (type) used the contractor should undertake to illustrate the misuse in at least three case studies involving different countries/regions and different policy areas (for example CO2 emission allowance trading, VAT, or financial assistance in the event of a major disaster in a Member State (EU Solidarity Fund));
- ❖ the study should assess to what degree the various types of EU funds are sensitive to being misused by organised crime;
- ❖ the study should analyse by which regulatory, organisational, technical and other measures EU and other bodies (e.g. implementing authorities in Member States) could avoid EU funds being misused by organised crime, and formulate appropriate recommendations; the discussion of the different approaches should also consider the impact on principles like data protection, simplicity of regulations and cost-effectiveness of the measures.

Timetable: The draft interim report should be available by mid-January 2011 and the final report by end of April 2011.

Language: The final report should be drawn up in English, checked by a native speaker, and should comprise between 50 and 80 pages (without counting appendices). An executive summary of not more than 5 pages must be provided in English and Italian.

The study shall be presented in the EP Committee on Budgetary Control in Brussels or Strasbourg on a date set by the committee.

A.2. Conceptual model of VAT

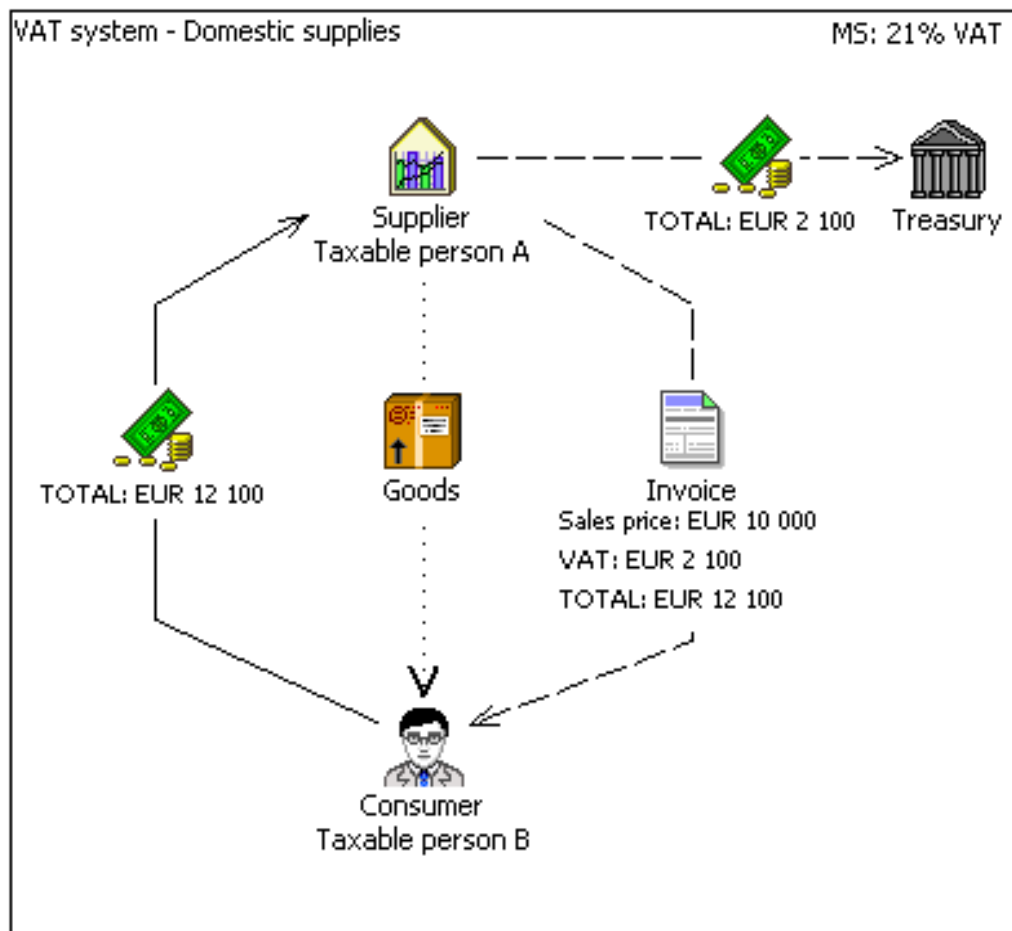


Figure 7: Conceptual model of VAT

Conceptual model of VAT – multiple businesses

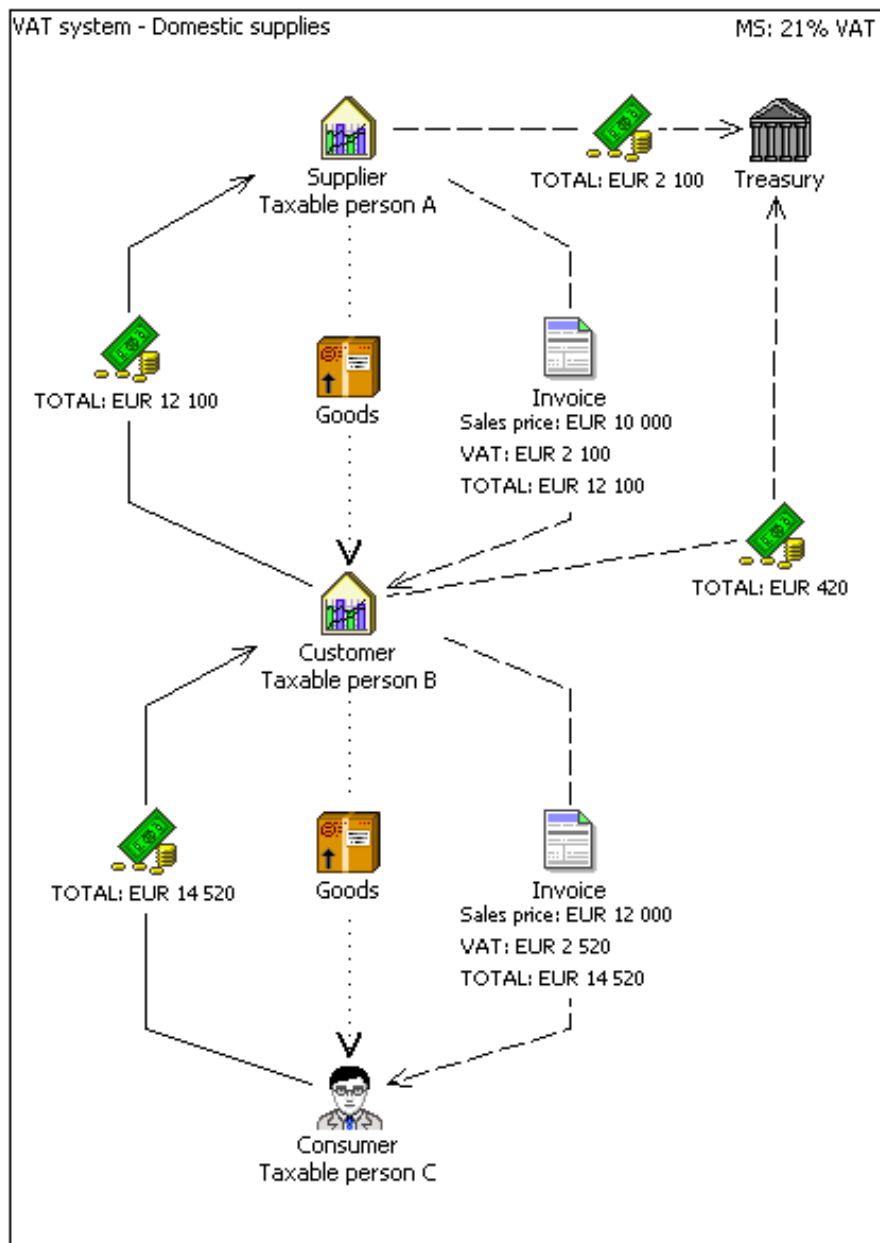


Figure 8: Conceptual model of VAT – multiple businesses

Conceptual model of carousel fraud

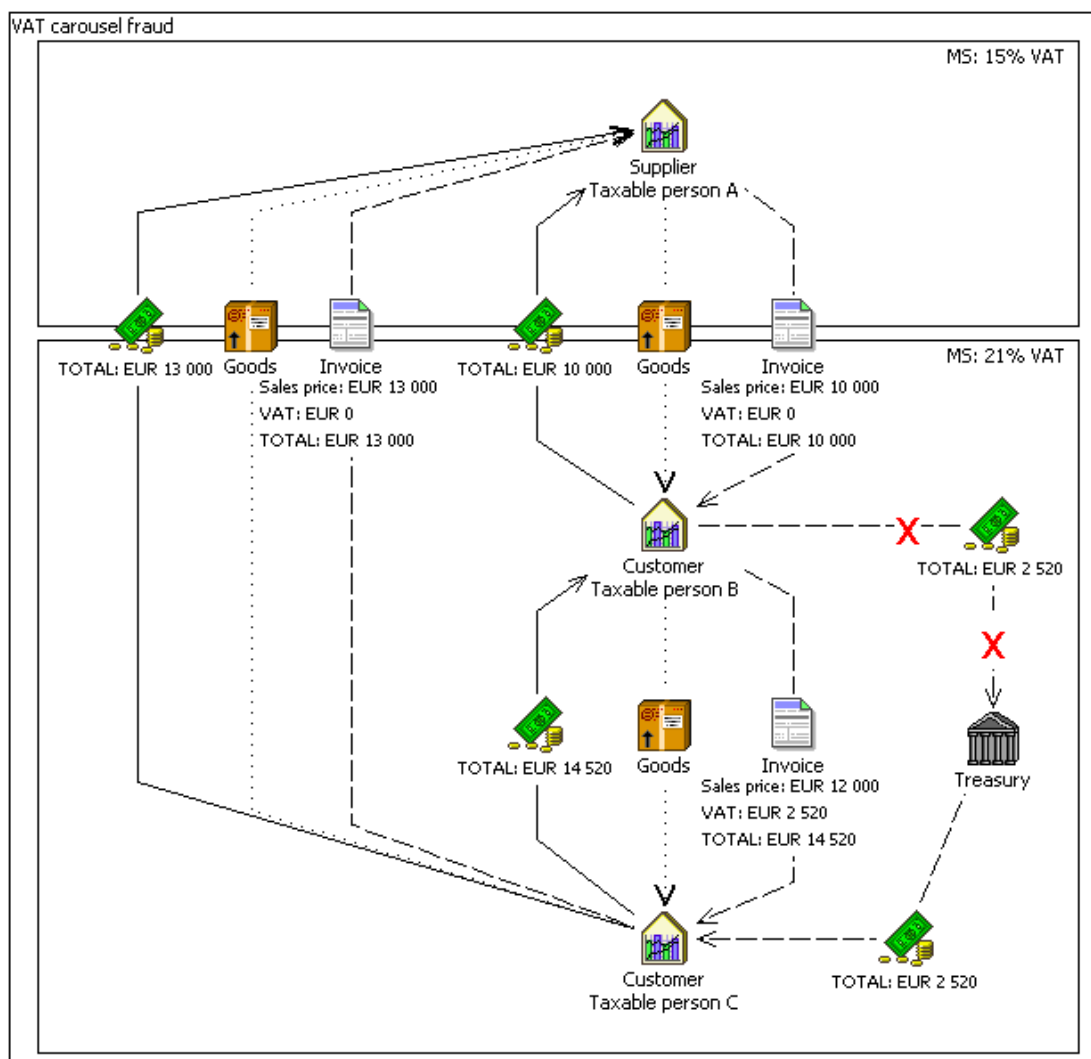


Figure 9: Conceptual model of carousel fraud

A.3. Open Sources research

In this appendix A.3 we provide an overview of the fraud cases with EU funds identified during the open source search. It is from this list of cases we have made the selection for further exploration in the frame of this study. We refer to Chapter 4 of this report for the three selected cases. In addition, one should clearly be aware that the information is retrieved from open sources implying that we cannot assure the accuracy and completeness of the information. Note also that by no means we will be able to provide an overview of all fraud cases with EU funds occurred in the past.

A.4.Case 1: Misuse of structural funds by the Italian mafia in the sector of renewable energy

Global trends in energy supply and use are unsustainable. Without a decisive action, energy-related emissions of CO₂ will more than double by 2050 and increased oil demand will heighten concerns over the security of supplies.

Many countries recognise that these concerns justify government action and figures demonstrate an incremental growth in renewable energy project compared to previous years. But the current financial and economic crisis is having a profound impact on energy investment with potentially grave impacts on supply and efforts to mitigate climate change. In order to fulfill this shortage short-term economic stimulus package announced to date (about 5% of a total of USD 2,6 trillion) has been directed at energy efficiency and renewable energy.

Selected renewable energy indicators

Selected global indicators	2006	2007	2008	2009
Investment in new renewable capacity (annual) (billion USD)	63	104	130	150
Existing renewable power capacity, excl. large hydro (GW)	207	210	250	305
Wind power capacity (existing) (GW)	74	94	121	159
Solar (PV) power capacity (grid connected) (GW)	5,1	7,5	13	21
Ethanol production (annual) (billion litres)	39	53	69	76

Figure 10: Selected renewable energy indicators¹⁰⁹

At the G8 Summit 2009 held in L'Aquila (Italy) the G8 Ministers (with the European Energy Commissioner) endorsed the proposal to launch an international low-carbon energy technology platform to strengthen and increase investment in clean technology research and development, including through public-private partnerships

And in response to this pace of change, Europe's renewable aspirations continue to grow ever more ambitious.¹¹⁰ In March 2007 a target was set by the European leaders to source 20% of their energy needs from renewable energy by 2020. To meet this objective, the new Renewable Energy Directive¹¹¹ on promoting renewable energies has been issued and constitutes the cornerstone of the EU's legislative drive by that date. This new EU directive requires each member state to increase its share of renewable energies, such as solar, wind or hydro.

¹⁰⁹ REN 21: Renewables 2010 Global Status Report, http://www.ren21.net/Portals/97/documents/GSR/REN21_GSR_2010_full_revised%20Sept2010.pdf

¹¹⁰ The Renewable Energy Directive: your Q&A Guide, Part of the 2020 climate package series, http://www.cms-cmck.com/Hubbard.FileSystem/files/Publication/3cbbd928-6838-4a9c-a2fe-1590be180ced/Presentation/PublicationAttachment/ee1a266d-e204-4acb-8593-4064d2c5ac58/2020_Renewables.pdf

¹¹¹ Directive 2009/28/EC of the European Parliament and the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:140:0016:0062:en:PDF>

The first Renewable Directive in 2001, which has remained the main legislative tool at EU level to support the share of electricity derived from renewable sources, had a not dissimilar structure. It required each Member State to reach a specific renewable energy target (Italy's for example being set at 25% share of gross electricity consumption by 2010) consistent with the EU's overall objective of producing 22% of electricity from renewable energy by 2010.

The new Renewable Energy Directive, as part of the EU climate and energy package which was agreed by the European Parliament and Council in December 2008 and became law in June 2009, replaces the old Directive and path the way of a new journey to achieving the desired mix of renewables in the energy production.

According to the New Renewable Energy Directive, each member state has a target calculated as the sum of the gross final consumption of electricity and energy for heating and cooling from renewable energy sources. Moreover, the share of energy from renewable sources in the transport sector must amount to at least 10% of final energy consumption in the sector by 2020. For each member state the targets are reflected in a National Action Plan.

The responsibility for reaching the targets set in the Action Plans lays with the individual Member State and is encouraged by paragraph 23 of the Directive¹¹² which indicates that: "*Member States may encourage local and regional authorities to set targets in excess of national targets and to involve local and regional authorities in drawing up national renewable energy action plans and in raising awareness of the benefits of energy from renewable sources.*" Member States must inform the Commission if they think they will be unable to meet their share of renewable energy targets due to so-called "force majeure" circumstances (i.e. circumstances beyond a Member State's control). The European Commission is then required to adopt a decision on whether that particular Member State has successfully demonstrated the existence of a force majeure and, if so, will decide what adjustment should be made to the renewable energy target of that particular Member State.

In addition to increasing renewable energy generation in a Member State, the Directive provides various options to Member States to help them reach their renewable energy targets. These additional options include the possibility of:

- Making statistical transfers (Article 6);
- Taking part in joint projects between Member States (Article 7 and 8);
- Taking part in joint projects between Member States and third countries (Article 9 and 10);
- Taking part in joint support schemes (Article 11).

In order to face these challenges, the Italian Government is currently working out the details of more ambitious support mechanisms for the development and use of renewable energy sources. In fact, the Italian Government recognise the need to diversify its energy supply portfolio to reduce its heavy dependence on fossil fuels and electricity imports,

112 Directive 2009/28/EC of the European Parliament and the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:140:0016:0062:en:PDF>

and to decrease its growing greenhouse gas emissions. In order to promote renewable energy sources, Italy has adopted the following schemes¹¹³:

- Priority access to the grid system is granted to electricity from renewable energy sources and Concentrated Heat Power plants;
- Quota obligation for electricity generators to feed a given proportion of renewable energy sources into the power system. The renewable energy obligation for Italian suppliers will increase annually by 75% to 2012 starting from the 2007 share of about 3,05%. After 2012, a new annual increase percentage will be established by the Italian Government;
- Tradable Green Certificates (which are tradable commodities proving that certain electricity is generating using renewable energy sources) are used to fulfill the renewable energy sources obligation;
- A feed-in tariff for Photovoltaic (PV) exists. This is a fixed tariff, guaranteed for 20 years and adjusted annually for inflation;
- Other instruments such as fiscal and investment incentives.

Despite these promising developments in many sectors and the success of the Green and White Certificates (tradable commodities for energy savings) many challenges remain. Italy, in fact, faces a major challenge in complying with Europe's new climate and energy package targets. Several factors contribute to this situation. Firstly, there is a large element of uncertainty due to recent political changes and ambiguities in current policy design. Secondly, there are administrative constraints such as complex authorisation procedures at local level.¹¹⁴

For example, the Italian Law 488¹¹⁵ passed in 1992 established the mechanisms for allocating direct grants to businesses in less developed areas of Italy and put regional authorities in charge of disbursing funds. This occurs through competitive auctions according to pre-determined criteria, such as the proportion of own funds invested in the project, the number of jobs involved and the proportion of assistance sought.

Indeed it is through these mechanisms that the Italian mafia has found its way to earn some extra money. Politicians now admit that the legislation was seriously flawed and according to the Italian finance police more than EUR 2 billion of European funding was lost between 2006 and 2010 to 488 fraud.

In Italy, power from wind farms is sold at a guaranteed rate of EUR 180 per Mwh – the highest rate in the world. On the other hand there are a lot of project developers lured by the appeal under the current regulatory framework that obliges Italy's national grid operator to pay wind farm owners even when there is no production.

Our Open Sources Research¹¹⁶ identified several articles in the public media in which the Italian mafia is involved in using EU funds for building wind farms in Southern Italy. These new entrepreneurs are known as the 'lords of the wind'.

¹¹³ Directorate General for Energy and Transport, *Italy Renewable Energy*, Fact Sheet, 2008

¹¹⁴ OECD, *Energy Policies of IEA Countries: Italy*, 2009

¹¹⁵ Gazzetta Ufficiale della Repubblica Italiana no. 299, 21 December 1992

¹¹⁶ During our research we crossed several references to similar cases to the Sicilian mafia, such as in Puglia and Campania: 12 December 2010 – *Rinnovabili e mafia: necessaria l'anagrafe degli impianti*, 11 December 2010 – *Fotovoltaico e mafia: subito consigli comunali aperti*, www.iltaccoditalia.info; 11 Giugno 2010 – *Gli intrecci tra mafia e*

The Sicilian mafia has reinvented itself as a 'white collar organisation' and invested a great deal of time and effort in what was a highly complex operation. A number of companies were set up and money was transferred from one entity to the other, making the outside world believe it were all companies in good financial health. All these companies later on applied for public funding to setup and construct wind farm projects. In addition, they rotate the millions in EU funds through the different front companies so the organisations appear to be operating legitimately and can attract further EU grants.

During the investigation the Italian prosecutors realised that there are hundreds of companies that produce alternative energy. But at the end they discovered that behind all these companies under different names, there were the same three or four people with links to the mafia who secured themselves in an effective monopoly.

This complex operation would not have been realised without the help of politicians and people working for the public bodies. Contacts and insiders at every level of government were used to obtain the permissions necessary to proceed with the construction. A lot of projects are co-funded by the EU, but managed by the regional authority. The mafia identified who was managing the project and then act to control them.

With regard to obtaining plots of land to build the wind farm projects, it was often impossible for the owners to operate independently from the Italian mafia who were not afraid of using extortion, intimidation and violence to achieve their goals.

In addition to receiving EU funding on a fraudulent basis, wind farms are also attractive as investment for illegally obtained money to fund criminal-related activities. Some criminal organisations (national and international¹¹⁷) have illicitly secured licenses to build a wind farm and then sold these onto legitimate firms who have invested in good faith.

In November of 2009 the Italian finance police arrested 15 people, including two of the country's most prominent businessmen in the wind energy sector, Oreste Vigorito and Vito Nicastrì, as a result of their operation, called 'Gone with the Wind'. Oreste Vigorito is head of the IVPC Energy Company and president of Italy's National Association of Wind Energy. Vito Nicastrì, a Sicilian business associate of the notorious Mafia mobster Matteo Messina Denaro. Both men deny any wrongdoing. Two other men were arrested in Sicily and the Naples area, while 11 others were charged, but not arrested.

The charges the two men face relate to fraud involving public subsidies obtained to construct wind farms, Oreste Vigorito allegedly was trying to embezzle up to EUR 30 million in EU funds. In the fraud scheme companies would apply and receive subsidies from the EU, but only a portion would go toward the development of the wind farms. The remainder would go to a web of companies and be used to obtain additional EU funds by fictitiously enhancing the solidity of these shell companies.

clan delle rinnovabili uniscono tragicamente Sicilia, foggiano e Salento?, Forum Ambiente e Salute, demonstrating the interconnections between different "renewable clans" in the South of Italy and with similar characteristics to the one exposed in the text. Although a vast literature is publicly available nowadays there has not been yet any follow-up on the current ongoing investigations that would require further intelligence analyses with the local authorities.

¹¹⁷ 11 January 2011, *Se anche la mafia investe sulle rinnovabili*, according to the article "anche in ragione della presenza, sulla scena, di attori ed intermediari di non chiara riconoscibilità", mirata attenzione e' stata riservata agli investimenti esteri in settori nazionali strategici, segnatamente nel comparto manifatturiero, energetico, chimico e farmaceutico, dell'industria metalmeccanica ad alto tasso di tecnologia e del terziario avanzato. Per quell che concerne in particolare il comparto energetico, si e' rilevato il crescente interesse di investitori stranieri verso il settore dell'energia rinnovabile del gas e del petrolio", www.rinnovabili.it

An additional investigation is looking into the sale of these wind farms to foreign companies as apparently these wind projects were used to launder money for the mafia.

The operation 'Gone with the Wind' started in 2007 and began by blocking public subsidies worth EUR 9,4mio granted by the ministry for economic development. In 2008 the police confiscated seven wind farms with 185 turbines in Sicily which were linked to IVPC. Two companies in the Netherlands and three in Spain who were also linked to IVPC, were asked for documentation by the police. Italian affiliates of IVPC in Ireland and the UK were asked to provide information by the Italian authorities.

Despite a long track record it is remarkable that Vito Nicastrì was able to engineer the described construction and acts. Already in 1996 Mr. Nicastrì was convicted for fraud involving wind farms. He admitted receiving 30 billion Italian Lira in public funds (equivalent to EUR 15 million) from the EU dedicated to the wind energy sector and bribed politicians for 3 billion Italian Lira. He was sentenced for these acts to 18 months in jail, but never went to prison. In addition Mr. Nicastrì is mentioned but not charged in a 530-page court document that resulted in the arrests in February 2009 of eight people accused of corruption in a wind farm project (Operation called Eolo).

We can state that the businessmen were taking advantage of Italy's high feed-in tariffs and poor government management to create new companies and recycle cash. It is clear that the regulation is poor and lacks of proper and effective control in this sector. Despite the current trends, the Regional Council ('Consiglio Regionale') of Puglia has promptly responded to the alert sent out by the President of Antimafia Commission, Mr. Giuseppe Pisanu, by submitting a regulatory proposal ('proposta di legge') to stop this process. The proposal requests the settlement of a registration authority ('anagrafe') that would track projects based on a very selective number of criteria among those it is worth to mention a land use characterisation of the area puts to use as the renewable energy plant, authorisations regarding land ownership, renewable energy plant management, insurance, balance sheet and track records of the tenderer, direct use of the renewable energy produced, a detailed description of the source of renewable energy.

At the time we are writing such proposal has been passed yet.

Italy is not the only Member State where renewable energy fraud is committed. High guaranteed rates for electricity and power produced by wind farms give people motive to declare higher production than actual production. In other cases, it concerns windmills that stand derelict or are simply never built, while others are used to launder profits from other crime enterprises.

A.5. References used for case 1: Misuse of structural funds by the Italian mafia in the sector of renewable energy

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A.6.Case 2: Misuse of agricultural funds (SAPARD program) in Bulgaria

The next case described in this section relates to the SAPARD program. The Community framework came into effect in January 2000¹¹⁸, in order to support sustainable agricultural and rural development in the central and eastern European applicant countries during the 2000-2006 pre-accession process.

The objectives of the SAPARD program are helping the implementation of the Community acquis concerning the common agricultural policy and solving priority and specific problems for the sustainable adaptation of the agricultural sector and rural areas in the applicant countries.

Again, with regard to this EU fund the management is decentralised. In order to adapt the SAPARD program to the specific conditions, problems and needs of the countries involved it was decided that the selection of the measures was left to the countries themselves.¹¹⁹

One of the 10 countries for which the SAPARD program is available, is Bulgaria who joined the EU on 1 January 2007. In the period 2002-2006 Bulgaria was allocated an annual indicative budget of EUR 52.124 million to invest in local projects. However, since Bulgaria did not meet several expectations with regard to the judicial reform and the fight against corruption by the date of their EU accession, the Commission has the right to monitor these areas of concern on a regular basis.

A second report on Bulgaria regarding these issues was published in February 2008 which focused on the fact that not enough convincing results have been demonstrated in the fight against corruption and organised crime. Based on the negative conclusions in this report, the Commission imposed the first financial sanctions. In its third report in July 2008 the Commission criticised investigations and the judicial system in Bulgaria and as a result of a separate report on the management of EU funds, the Commission suspended, among others, EUR 121 million from the SAPARD program.

These conclusions were supported by several audits carried out in Bulgaria by OLAF which identified mismanagement and corruption on a large scale. In its report, which was leaked to the public, OLAF refers to one of the most serious cases of fraud, which OLAF named the 'Nikolov-Stoykov-case'.

Over a 6 month period, OLAF investigators worked closely together with the Prosecutors' Offices of Bulgaria, Germany and Switzerland and their respective national authorities on a large-scale investigation directed at the Nikolov-Stoykov Group with an estimated financial impact of EUR 7.5 million.

This group consists of dozens of companies with interests from meat processing and cold storage to scrap metals and a Black Sea resort. According to OLAF the Nikolov-Stoykov

¹¹⁸ Europa - Summaries of EU legislation- Council Regulation (EC) No 1268/99 of 21 June 1999 on Community support for pre-accession measures for agriculture and rural development in the applicant countries of central and eastern Europe in the pre-accession period, http://europa.eu/legislation_summaries/agriculture/enlargement/160023_en.htm

¹¹⁹ Stanisewska, M. An overview of the SAPARD Programme. Does SAPARD Programme help sustainable rural development and nature conservation in CEECs? Speech, Polish Ecological Club, Poland

Group is a cover for a “criminal company network composed of more than 50 Bulgarian enterprises and various other European and offshore companies.”¹²⁰

What is remarkable in this case, is that both men are very closely connected to some of Bulgaria’s top politicians. Lyudmil Stoykov is connected to financing the election campaign of President Georgi Parvanov and has ties to a former deputy minister of foreign affairs, who, according to the OLAF report, tried to influence an ongoing investigation into Lyudmil Stoykov. His background could be traced back to some traditional forms of organised crime, as he was the local representative of one of the so-called racketeering/insurance companies in Bulgaria, VIS. By this he was able to rig in some of the privatization deals and to gradually acquire some local assets in Pernik, the town where he’s from.

Mario Nikolov forged discreet alliances to Prime Minister Sergey Stanishev by transferring money to Stanishev’s Socialist Party.

In the OLAF report it was established that the Nikolov-Stoykov Group is involved in 1) tax fraud; 2) subsidy fraud; 3) forgery of documents; 4) money laundering; 5) illegal imports into Bulgaria and exports to EU (during pre-accession) of Chinese rabbit and poultry meat with falsified health certificates and 6) in addition they are involved in alleged irregularities involving the purchase and resale of second-hand railway carriages.

Related to the SAPARD program the OLAF report states the following:

- ‘In the framework of the SAPARD projects of the companies RODOPA GOLD, RODOPA MEAT, RODOPA KONSERV, EUROFRIGO, PALMGRA and PTTZEKLANITZA CHOUBRA which are all linked and controlled by the NIKOLOV-STOYKOV GROUP, the responsible individuals used falsified and inflated offers to support their SAPARD application. The Criminal Group sold old second-hand meat processing equipment (originating Ia, from ex-GDR) from their own Bulgarian companies - via two own companies, based in the USA (KINGSTON ENTERPRISES) and Ireland (MKFORM LTD), respectively – to accomplices in Germany. These German companies then resold the equipment in question back to SAPARD applicants in Bulgaria using highly inflated invoices. [..]
- The financial impact on the Community budget for these projects is approximately EUR 6.1 million.
- ‘In the framework of five SAPARD projects under investigation (companies RICOM, SOLVEX MERA FRUCT, SHIKS KERA MANMANOVA, KARTEL VALENTIN JANEV and SOLARIS), the Bulgarian Public Prosecutor's Service has informed OLAF that there are certain indications that the beneficiaries in these projects, having submitted false offers, are also linked to the NIKOLOV-STOYKOV GROUP.
- The financial impact on the Community budget for these projects is approximately EUR 1.8 million.’
- ‘OLAF is also aware of seventeen other SAPARD projects which are linked to the NIKOLOV-STOYKOV-GROUP and being investigated by the Bulgarian Public Prosecutor's Service. These projects also involve the use of falsified offers. Payments for these projects were stopped as a result of OLAF's early intervention.

¹²⁰ OLAF, Report – internal report leaked to public media, 2008, http://www.mediapool.bg/site/images/doklad_OLAF_en.pdf

If paid, the financial impact on the Community budget for these projects would have been approximately EUR 18 million.'

An investigation by the Supreme Cassation Prosecutor's Office goes back to November 2006, after notification from the German customs that Bulgarian businesses have misused SAPARD funds through the use of false documents to purchase used meat processing and packing machines, and subsequently presenting them as new machines. This information led to preliminary legal proceedings against Mario Nikolov and six other individuals with regard to receiving almost BGN 14 million from the SAPARD fund in the period 2002-2005.

Already in 2007 both Mario Nikolov and Lyudmil Stoykov were arrested for a short time on suspicion of fraud. But both men became known to the public when the OLAF report leaked in June 2008.

On 20 October 2008 the case against Mario Nikolov and eight other defendants regarding the embezzlement of EUR 7.5 million from the SAPARD fund went to trial. In the mean time Lyudmil Stoykov was cleared from all charges related to the embezzlement due to insufficient evidence, but was charged separately for money laundering. Later on, Mario Nikolov and his wife were charged for money laundering. Both trials for embezzlement and money laundering started in February 2009.

On 29 March 2010 the Court sentenced Mario Nikolov to 10 years imprisonment and his wife, Mariana, to 8 years with regard to the money laundering charges. Lyudmil Stoykov was acquitted by the Court. Four other defendants were sentenced to 6 years. In addition, all those found guilty have to pay a fine of BGN 30.000 and will have to repay BGN 12 million to the SAPARD program.

On 30 June 2010, the Sofia Court sentenced Mario Nikolov to 12 years imprisonment on charges of embezzlement and fraudulent draining of approximately EUR 7.5 million from the SAPARD program. It is said that he only has to serve the longer sentence of 12 years and not both sentences which would have amounted to 22 years. In addition Mr Nikolov is banned from applying for EU subsidies for three years.

In the mean time the German accomplices, identified by OLAF, were put on trial in Germany and convicted.

Not only in Bulgaria, but for example, also in Romania this problem is present. In 2008 the president of Romania announced that 62 out of the 211 SAPARD projects for the meat industry are suspected of embezzlement. In 17 of these cases OLAF already asked for the money to be returned. By investigating both cases in Romania and Bulgaria OLAF came to the conclusion that some Bulgarian companies involved in embezzling EU money had the same kind of connections with SAPARD beneficiaries in Romania. In addition it is important to understand the influence of corruption on law-enforcement or judiciary (prosecution) in East European countries. In this Bulgarian case a lot of pressure was put by the European Commission, which gave almost no room for the mechanisms of corruption.

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A.8.Europol methodology of carbon credit fraud

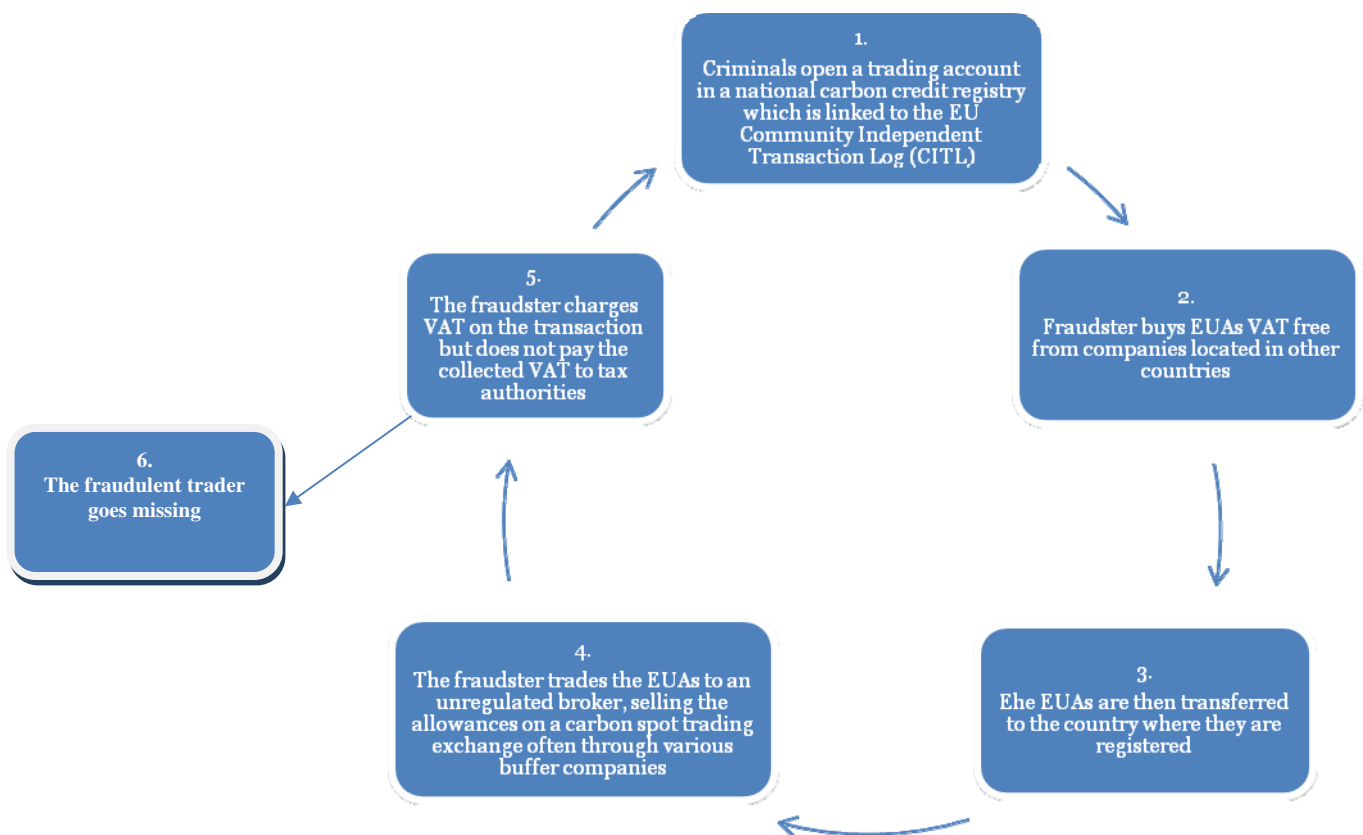


Figure 11: Europol methodology of carbon credit fraud

A.9.Case 3: Specific case of VAT fraud: carbon credit fraud

The last case described in this section relates to the misuse of the EU Allowances (EUA's) under the EU Emission Trading Scheme (EU ETS), the world largest carbon market since its launch in 2005. This case differs from the previous cases because it does not present one specific case study. This case gives a general description of one form of VAT fraud. It gives a description on how this type of VAT fraud is committed, which Member States are victim of this VAT fraud and how these Member States combat this form of VAT fraud.

Climate Change is a challenge for all Governments, businesses and individuals. New scientific evidence from the Intergovernmental Panel on Climate Change¹²¹ has reconfirmed the severity of the threat. Politically, action has been undertaken through the creation of the United Nations Framework Convention on Climate Change (UNFCCC) that entered into force on March 21, 1994 and the adoption of the Kyoto Protocol on 11 December 1997 that entered into force on 16 February 2005. The Protocol is the main instrument of the UNFCCC aimed at fighting global warming. The objectives set forth in the Protocol describe the commitments of 37 industrialised countries and the European community to reduce greenhouse gas (GHG) emissions. The overall target agreed upon was an average reduction of 5,2% from the 1990 levels by 2012. Each year the participating countries must submit annual emission inventories and a national report.

In first instance the countries must meet their targets through national measures. However, the Kyoto Protocol offers additional tools for meeting their targets. One of them is the use of the International Emissions Trading (IET) system also known as 'Cap-and-trade scheme'.

The Cap-and-Trade is an economic instrument used to reduce GHG emissions. It requires all emitters to acquire permits for their planned emissions. The government or international institution implementing the scheme establishes an overall target for emissions and then issues a certain number of emission permits according to the target. Permit holders can trade them among themselves and as a result, prices are established through a mechanism of supply and demand (rather than a fixed rate as in carbon tax) as well as through the tightness of the target established at the outset. Putting a price on environmental externalities such as in the case of Cap-and-Trade constitutes an important source of government revenues: for instance, if all industrialised countries were to cut their emissions by 20% by 2020 relative to 1990 levels, and this was done via Cap-and-trade schemes (with full permit auctioning), the amount of proceeds generated in 2020 could be as high as 2,5% of GDP on average across countries.¹²²

One of the most advanced emissions trading systems is the one developed by the EU: the EU Emission Trading Scheme (ETS). The common trading 'currency' under the Scheme is the European Union Allowance (EUA) and lays at the basis of the EU ETS. Each EUA gives to its holder the right to emit one ton of CO₂.

The EU ETS has been structured in three phases, a 1st phase from 2005 to 2007, and a 2nd phase corresponding with the Kyoto Protocol commitment period from 2008 to 2012

¹²¹ Solomon, S., D. Qin, M. Manning, Z. Chen, M. Marquis, K.B. Averyt, M. Tignor and H.L. Miller (eds.). Climate Change 2007: The Physical Science Basis. Summary for Policymakers; the Fourth Assessment Report (AR4), Cambridge University Press, February 2007

¹²² Interim Report of the Green Growth Strategy: Implementing our commitment for a sustainable future, 27-28 May 2010, <http://www.oecd.org/dataoecd/42/46/45312720.pdf>

and a 3rd phase from 2013 to 2020. In the first and second phase, each EU Member State agrees on its national emission limit or 'cap' in a National Allocation Plan (NAP), which allocates a number of allowances free of charge for the installations in the scheme, allowing them to emit the corresponding amount of CO₂ without any cost.

During phase 1 (the learning by doing phase) the allocation of the allowances was most commonly done via the principle of 'grandfathering'. This indicates that allowances are provided based on either historical or expected future requirement for such allowances by the installation. Due to the fact that allocation plans were based on estimates of emissions, more allowances were handed out to installations than were required.

Based on the experience accrued during phase 1, the Commission expanded the scope significantly in the phase 2 by introducing the use of international credits under the Kyoto Protocol (via project-based mechanisms such the Clean Development Mechanism (CDM) and Joint Implementation (JI)) through the EU Linking Directive, settling the introduction of aviation emissions expected to be included from 2012 and other three non-EU members, Norway, Liechtenstein and Iceland joined the scheme.

Companies having difficulties in remaining within their emissions 'cap', must cover the excess emissions by taking measures to reduce their emissions and/or buy additional EUA's. Companies that don't use all their allowances, which indicates that they emit less than they are entitled to, can sell their EUA's and make a profit.

In order to manage the trade in these allowances and verify holdings, the ETS requires all 27 EU Member States to create a national emissions allowance registry, holding accounts for all companies included in the scheme. Like on a stock market, companies and individuals operate through brokers and on electronic exchanges.

Since its launch in 2005, the value of the EU ETS carbon market has increased tenfold from around EUR 7 billion to around EUR 70 billion worth in 2009. Over the same period, the volumes traded have increased from a few hundred million allowances to more than 5.5 billion. The first year have seen the development of a range of sophisticated products such as spot, futures and option contracts, and over half of trading now takes place at various climate exchanges.¹²³

In 2009 over 70% of spot transactions occurred during first half of the year, when the financial cash-strapped EU businesses monetised allowances to raise funds in the midst of the financial downturn. In addition to the industry sell-off of allowances, many trading (and brokering) and financial companies took the opportunity to gain free, temporary funds via the VAT levied across the EU on spot transactions, which contributed substantially to the growth of the spot volume. A VAT-evasion scheme known as "carousel" VAT-fraud then emerged.

From our open source review we learn that the European scheme was affected by 3 types of fraud during the last few years:

- VAT Fraud;
- Phishing attacks against EU ETS accounts (cybercrime);

¹²³ Global Carbon 2010, Environmental and Carbon Finance, May 2010, <http://www.environmental-finance.com/features/view/456>

- Reselling emission reductions that had already been used for compliance CERs (better known as 'Recycled CERs').

In this case study we will focus on VAT fraud as introduced above. On its website, Europol published a statement stating that *"the European Union (EU) Emission Trading System (ETS) has been victim of fraudulent traders in the past 18 months. This resulted in losses of approximately 5 billion euro for several national tax revenues. It is estimated that in some countries, up to 90% of the whole market volume was caused by fraudulent activities."* (www.europol.europa.eu, December 2009).

EUA's are treated as goods and thus are subject to VAT, while futures and options trades are considered financial transactions and as such are exempted from VAT within the EU. According to Europol, carbon credit fraud can be considered as a variation on the VAT carousel fraud and operates as follows (for a visual overview chart, see Appendix A.4):

1. Criminals open a trading account in a national carbon credit registry which is linked with the European Commission Community Independent Transaction Log (CITL);
2. The fraudster buys EUA's VAT free from companies located in other countries;
3. The EUA's are then transferred to the country where they are registered;
4. The fraudster trades the EUA's to an unregulated broker, selling the allowance on a carbon spot trading exchange often through various buffer companies;
5. The fraudster charges VAT on the transaction, but does not pay the collected VAT to the tax authorities;
6. The fraudulent trader goes missing.

It is worth noting that, although executing high volumes of trades (such as in the case of EUA's via spot contract) with the purpose of maximising the value of the VAT-based funding raised is an aggressive trading practice, it is not illegal and does not constitute fraud. VAT fraud only occurs when a fraudster does not declare the VAT to the relevant authority and disappears. Spot carbon trades were an easy target due to their relatively high value and ease of import and export. EUA's, especially, are easily transferred across Member States' borders through registries.

Not only Europol, but also the International Emissions Trading Association (IETA) acknowledges the threats the EU ETS has to face. In its letter of 11 February 2010 "Closing the door to fraud in the EU ETS" the IETA asks to European Commissions to take seven actions in order to protect the European trading scheme.

According to Europol suspects of illicit trading activities were noted in late 2008 and made very public due to the EU wide police and tax authority raids on 28 April 2010. In this case a total of 230 offices and homes were raided in Germany, with a total of 150 suspects from 50 different companies. Among these companies were the offices of RWE, one of the leading energy companies in Germany and the premises of Deutsche Bank. Deutsche Bank said seven of its employees were suspected in the investigation, but states that all allegations can be rebutted.

But this is not the only case. In July 2009 the Paris prosecutor's office announces a probe is under way into a suspected multi-million euro VAT fraud in the French carbon emissions market and the Dutch ministry of finance has stated to have clear indicators of fraudulent activity in the Dutch carbon emissions market. As a counter action, the Dutch ministry places the obligation to pay VAT on the carbon permit buyer, instead of the seller. In August 2009 the British tax office arrests seven people in London for a suspected fraud in the EUA market and one month later several Member States take action by revising their tax system. Also in 2010 different press releases indicate the hard work of national police departments investigating carbon credit fraud.

In order to prevent further losses countries such as France, the Netherlands, the UK and most recently Spain, have all changed their taxation rules concerning the exchange of allowances, by either making carbon permits exempt from VAT or by implementing the reverse charge mechanism (i.e. the domestic purchaser, rather than the seller, is responsible for paying the relevant tax). Italy is currently looking to create a law to combat VAT fraud in carbon trading and to resume suspended operations in the local market. In addition, Europol has set up a specific project to collect and analyse information in order to identify and disrupt the organised criminal structures behind these fraud schemes. In September 2009, in a more coordinated response, the EU gave countries the option of applying a temporary reverse charging mechanism that would operate until 2014. However, such a solution would be subject to implementation challenges, making it likely that a broad reform of the EU VAT collection procedures might ultimately be needed to eliminate the risk that VAT fraud will proliferate.

A recent report commissioned by the French Government, heavily involved during the VAT fraud case at the exchange Bluenext, assessed regulatory issues in the carbon market and calls for a harmonised system including i) a unified legal, accounting and taxation framework across the EU, ii) stricter access to registry accounts to avoid fraud and market abuse, iii) greater transparency on market fundamentals, iv) sanctions to discourage and punish market abuse, v) a market surveillance authority, vi) greater coordination with the upcoming international carbon markets (New Zealand, Australia and United States).¹²⁴

This is timely, as the European Commission intends to finalise its carbon market regulation before the EU ETS enters Phase 3. When the third phase of EU ETS will commence in 2013, it is most likely that a few of the changes already suggested by the European Commission in 2008 will be put into place. The suggested changes include a centralised allocation by an EU authority – not defined yet –, a turn to auction a greater share of permits rather than allocating them freely (an option that is not used very much now) and the inclusion of other greenhouse gases.

¹²⁴ State and Trends of the Carbon Markets 2010, Carbon Finance Unit, World Bank, May 2010,

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A.11. Characteristics of the case studies

	Casus 1 Eurojust	Casus 2 Eurojust	Case 3 Wind farms*	Case 4 Nikolov- Stoykov
Type of fraud				
VAT fraud	X			
Misuse of EU funds		X	X	X
General facts				
Type of funds misused	None	?	Structural funds	SAPARD fund
Duration of misuse	2 years	?	?	At least 3 years
Number of criminals / size of the group	3 to 5	?	at least 15	at least 8
Estimated number of companies involved	2	?	7	> 50
Group structure	Structured, hierarchical	Organised	?	A network of companies
Estimated financial loss	Several million Euros	Several million Euros	Up to 30 million Euros	7,5 million Euros
EU Member State victims	At least 4 Member States	At least 3 Member States, including Italy	?	?
Modus operandi				
Forged invoices	X	X		
Nonexistent purchases	X			
Simulate real trade		X		
Simulate money flows		X	X	
Set up a fake business network	X	X		
Falsify offers				X
Links with businessmen			X	

Links with politicians					X
Transnational	X	X	X		X
Other crimes committed					
Money laundering	X				X
Forgery of documents	X				X
Extortion			X		
Intimidation			X		
Violence			X		
Tax fraud					X
Illegal import and export					X

Figure 12: Characteristics of the case studies

*) Case 3 from the open source research - the specific case of VAT fraud: credit carbon fraud - is not included in this table because this case study contains only generic modus operandi.

A.12. Report on the expert meeting “How does organised crime misuse EU funds?”

Background of the meeting

On 27 January 2011, PwC organised an expert meeting in the European Parliament in Brussels on the topic ‘*How does organised crime misuse EU funds?*’. This meeting was set up to discuss questions and dilemmas which were encountered by the research team of PwC while writing a report for the study with the same subject and title. The purpose of the report ‘*how does organised crime misuse EU funds?*’, is to describe what means and methods are being used by organised crime to defraud the EU, and what recommendations can be proposed to strengthen the resilience of EU funds against these frauds. This study is conducted on behalf of the European Parliament and is based on information available in the public domain and information made available by Europol, Eurojust, OLAF and the European Court of Auditors.

Experts that attended the meeting were Mr. Van Heuckelom, Head of the Financial and High-Tech Crime department at Europol; Mr. Savona, professor of Criminology at the Università Cattolica del Sacro Cuore in Milan; Mr. Patz, advisor for the Transparency International EU office; Mr. Cretin, Director of Directorate A (the anti-fraud office of the European Commission) at OLAF; Mr. Kleinegris, head of Sector Intelligence Direct Expenditures and Fraud rates at OLAF and Mr. Wolf, Tax lawyer at Baker & McKenzie Amsterdam. On behalf of the European Parliament Mr. Søndergaard MEP and other Members and staff participated in the meeting. The research team of PwC moderated the expertmeeting.

While drafting the interim report the researchers encountered first of all that there is not one unified definition for ‘organised crime’. To define ‘organised crime’ for this report the researchers studied over a hundred different definitions of organised crime formulated by scholars as well as definitions used by the various EU institutions mentioned above.

Secondly, during interviews the term ‘EU funds’ was described differently by various experts. Initially, the main focus of the research was on ‘EU spending funds’; signifying the various types of funds spent by the EU for further development of the EU and its Member States. In interviews experts of Europol, Eurojust, OLAF and the European Court of Auditors mentioned VAT fraud as a type of misuse of EU funds as well. Europol claimed that cigarette smuggling has to be included in the study as well, because this type of crime costs the EU a considerable amount of its levies and duties.

A third dilemma raised while writing the interim report, was the difficulty in finding and getting access to reliable data on the misuse of EU funds by organised crime. During the interviews

various reasons were mentioned by experts why it is hard to get access to trustworthy information. The research team partially solved this problem by investigating open sources but this investigation mainly gave information on the modus operandi of organised crime misusing funds and not on the amount of money misused.

Another question raised during research was the level of priority the European institutions give to the fight against misuse of EU funds by organised crime. The fight against fraud and the fight against organised crime (or serious crime) is high on most agenda's, although these topics have to compete with other issues in the domain of security and justice. Misuse of EU funds by organised crime as such is not on any priority list of any EU institution.

To get answers on these questions and dilemmas, the research team invited experts with various backgrounds for an expert meeting. The experts as well as relevant MEP's all received an interim report in advance with preliminary findings. The meeting itself was clustered around three themes: definitions of 'organised crime' and 'EU funds', the difficulty to get reliable, verifiable and factual information and data on misuse of EU funds by organised crime and the priority of the fight against misuse of EU funds.

The meeting

The chair of the expert meeting, Mr. Søndergaard MEP, opened the meeting with a word of welcome. He explained how important it is for the European Parliament to gain knowledge on the modus operandi of organised crime when misusing EU funds. With this knowledge the European Parliament can decide how, to what extent and what precisely it can do against this

"Organised crime uses EU funds, that is a fact. The big problem and question is: how, to what extent and what can be done about it?"

Mr. Søndergaard, European Parliament

problem. He then kindly requested Mr. Wensink from the PwC research team to moderate the meeting.

In the introduction round most issues already were touched upon: that organised crime is a very complex phenomenon, that it is hard for EU institutions to provide reliable information, that there are different opinions about the definition of 'EU funds' and that it is not that evident what priority the fight against misuse of EU funds by organised crime should get.

The definition of 'organised crime' in the context of this study.

After the introduction of the experts, the first issue mentioned by Mr. Wensink was the absence of one clear uniform definition of organised crime used by EU institutions and experts. Definitions of organised crime used by the EU institutions and in the academic world vary. During interviews the research team observed that EU institutions (Eurojust, Europol, European Court of Auditors and OLAF) use different criteria which have to be met before a phenomenon is called 'organised crime'. OLAF even confirmed that in OLAF no formal or working definition is used with regard to organised crime.

"I don't believe there is a need for a very uniform definition. I am always fearing a bit uniformity, because then there is no place for flexibility and adaptation."

Mr. Cretin, OLAF

The experts were unanimous in their opinion that there is not one uniform definition of 'organised crime' (possible), but that the absence of such a uniform definition is not an obstacle for a

successful fight against organised crime. They all agreed that "organised crime is a constantly moving phenomenon that needs continuous analysis instead of using one fixed definition", as eloquently formulated by Mr. Cretin. Besides that, during investigations on organised crime the EU institutions normally focus on the type of activities (crimes like fraud) instead of analysing the definition of the people who committed the crime. The overall opinion of the experts was that the focus on criminal activities is the best way to fight organised crime. So for strengthening the fight against organised crime a uniform definition is not absolutely necessary.

Against this background, Mr. Savona pleaded that for the fight against misuse of EU funds by organised crime, the EU institutions shouldn't focus on the perpetrators, but have to look at the potential victims of the criminals: the markets regulated by the EU through revenues and subsidies. EU institutions have to look at the 'vulnerabilities' in these markets. The vulnerabilities in these markets can be detected by looking at the attractiveness and the accessibility of the money the EU spends on a certain market. Attractiveness is the result of something which is profitable (a lot of money) minus the chance of being detected. Accessibility is the ease for organised crime to penetrate a market. Through discovering vulnerabilities it is possible to predict which markets attract organised crime for misuse of money.

"The clever issue will be to find remedies before they (organised crime) go there, because otherwise it becomes very complex."

Mr. Savona, Professor of Criminology

There is no uniform definition for organised crime. Experts all agree that this uniformity is not necessary to strengthen the fight against organised crime. EU institutions better centre their

attention on vulnerabilities on the markets regulated by the EU through revenues and subsidies. Furthermore they should focus on the modus operandi of the misuse instead of 'who' commits the crime.

The scope of 'misuse of EU funds'

Mr. Wolf explained how VAT-fraud works. He stated that there are a lot of varieties of VAT-fraud. The type of fraud addressed in the interim report '*How does organised crime misuse EU funds*' is the 'missing trader fraud' or 'carousel fraud'. Mr. Wolf divided the modus operandi in this type of VAT-fraud in a few stages. The fraud starts with a fraudulent company that starts up trading activities and buying goods or services in other Member States. These goods and services are VAT free. The next step is that the so called 'missing trader' sells the goods locally and charges local VAT; it collects the purchase price together with the local VAT from its customer. Finally, the missing trader leaves the country with the money – no VAT is paid to the tax authorities.

"VAT within the EU is harmonised. All national VAT laws are based on the same VAT directive, which is implemented by each state. A certain percentage of the aggregate national VAT table amount is paid to the EU as own resource, the so called VAT resource. The European court of Justice made it very clear that the right to deduct VAT is a right derived from EU law. So in that respect, VAT is also an EU fund."

Mr. Wolf, tax lawyer

Mr. Wolf said that especially the fraud in the emission trade markets, the so-called carbon carousels, is a very interesting phenomenon. The carbon carousels are also explained in the interim report "*How does organised crime misuse EU funds?*" Traders buy VAT-free emission rights in other Member States and sell the rights locally, charge and collect local VAT and disappear with the money. Mr. Wolf stated that it is very easy to set up trade operations and to generate huge turnovers in this emission rights market, if the trader is willing to sell emission rights at a loss (but 'earns' the local VAT).

Mr. Wolf explained that when this type of VAT-fraud was discovered, several countries – France, the UK and the Netherlands – unilaterally changed their VAT rules. They introduced zero rate (no VAT) or reverse charge (end user pays), so fraud became impossible. Unfortunately, these newly introduced rules were not allowed under the EU VAT directive. In March 2010 the VAT directive changed, allowing all the countries within the European Union to introduce a reverse charge mechanism on the local sales of emission rights. Mr. Wolf observed that the trade is moving to Member States that still have not implemented such anti-abuse legislation.

Mr. Wolf claims that VAT has to be seen as an EU fund. His reasoning is that VAT is a resource for the EU. So, when misusing VAT the EU will receive less VAT.

Mr. Heuckelom stated that if VAT fraud is included in the study, cigarette smuggling has to be included as well. He explained that the estimated loss of revenue worldwide because of cigarette smuggling generates between 30 and 50 billion dollars. The criminal cigarette smuggling market for the EU is estimated between 10 and 12 billion Euros. This lost money

"Levies and duties on high tax of goods, such as cigarettes, are a mean of resourcing the European Union general budget. It goes directly to legislative and democratic activities of the European Institutions, whereas VAT is an indirect source."

Mr. Heuckelom, Europol

otherwise would directly fund the legislative and democratic activities of the European institutions.

An observation made by Mr. Patz is the difference between fraud with EU spending funds and VAT-fraud. He mentioned that fraud with EU spending funds is fraud at the expenditure side of the EU. VAT-fraud and cigarette smuggling is fraud on the income side.

Mr. Cretin stated that the difference between EU spending funds, VAT and levies and duties is important when looking at 'normal' fraudsters. For organised crime it does not matter if the committed fraud is on the expenditure side or the income side of the EU. He based his explanation on the rationalisation theory. The rationalisation theory focuses on the rationalisation used by the perpetrator. A perpetrator is mostly aware of the fact that he is doing something that he is not allowed to do. It is difficult for a person to rationalise that. For the average fraudster it is easier to rationalise fraud at the income side (VAT-fraud) than to rationalise fraud on the expenditure side. But Mr. Cretin said that for organised crime, this rationalisation does not matter that much because organised crime goes where the big money is. He stated therefore that VAT-fraud, cigarette smuggling or fraud with EU spending funds should all be treated the same in the context of this study. As long as there is money, organised crime will be interested.

The conclusion of the discussion on the scope of 'misuse of EU funds', was that VAT fraud as well as cigarette smuggling can be interpreted as misuse of EU funds. The difference between fraud with EU spending funds is that VAT fraud and cigarette smuggling are crimes on the income side of the EU. Fraud with EU spending funds is fraud on the spending side of the EU. For organised crime both types of fraud are attractive as long as there is money to earn.

"What their (organised crime) rationalisation basically represents is optimisation of their benefits. They do not care about moral considerations, as people at the income side might still have or might be act as deterrent for not committing fraud. That is not the case for organised crime; they just go for the big money."

Mr. Cretin, OLAF

Availability of reliable data and information on the subject 'misuse of EU funds by organised crime'

The third topic raised by Mr. Wensink was the availability of reliable data and information on the subject 'misuse of EU funds by organised crime'. It proved hard to find and to receive reliable, verifiable data or information on misuse of EU funds by organised crime from for instance OLAF, Europol and Eurojust. This resulted in an information gap on the misuse of EU funds – spending funds, but also VAT – and a lack of information on the modus operandi of organised crime misusing EU funds. From open sources some information was found on *how* organised crime is misusing EU funds, but these sources cannot be verified, nor is it possible to estimate to what extent this search resulted in a complete overview. During the meeting the experts of OLAF and Europol shared their views on the reasons why reliable data is hard to provide for this study.

First of all, experts of Europol and OLAF mentioned that they work with classified and/or sensitive information which cannot be presented for the study. For instance

"It is necessary to look at political priority instead of figures."
Mr. Cretin, OLAF

Mr. Heuckelom said that he is not able to provide any actual cases of organised crime misusing EU funds (with modus operandi included) because Europol is an intelligence organisation in support of the Member States law enforcement agencies. Information is not owned by Europol, and can therefore not be made public by Europol. Some general information is presented in public versions of annual reports. However, in these annual reports not many numbers and figures were given. Mr. Cretin agreed with Mr. Van Heuckelom and underlined that the same obstacles prevent OLAF from disseminating information to the European Parliament or the public.

"We have the known unknowns and even the unknown unknowns."

Mr. Kleinegris, OLAF

Another reason mentioned by Mr. Kleinegris for not providing data on organised crime is the so called 'dark number'. When investigating organised crime, by definition this is an investigation in a 'not easily visible' area. Organised crime operates both in legal

and illegal ways. So no one knows the exact operation field of organised crime. Presenting numbers gives the risk of underestimation or overestimation of the problem.

Mr. Wolf pointed out that numbers and figures on VAT-fraud are always an underestimation of the problem. With VAT-fraud, the real burden is not in the VAT misuse itself. The VAT-fraud causes serious damage to the EU economy as a whole. Bona fide companies carry the real burden of VAT-fraud because goods without VAT are sold on the market for less money than the goods from bona fide companies. This will end up in unfair concurrence positions.

Another reason why organisations cannot provide many figures on organised crime is because in a lot of 'normal' fraud cases under investigation it is not clear whether organised crime is involved or not. Mr. Kleinegris mentioned that in a lot of fraud cases organised crime comes in sight at the end of the investigation, not at the beginning. Keeping in mind that some fraud cases can take decades to investigate and go through the whole channel of justice, it is hard to present accurate, actual numbers of organised crime misusing EU funds.

The organisations OLAF and Europol also mentioned that they find it risky to present numbers and figures of organised crime because they see it as a possibility that figures are wrongly interpreted by others, for example by politicians.

Mr. Patz said that you cannot collect data on the misuse of EU funds because the money spent by the EU is not transparently presented right now. He claims that the separation of EU spending funds over various DG's accommodates that there is no clear overview where and how these spending funds are used. Mr. Patz gave an example of a beneficiary who asked for funds at two different DGs and the DGs were not even aware of the double application. Another reason why Mr. Patz stated that the spending of EU funds is not transparent enough is due to the fact that 80% of the EU budget is spent by Member States themselves. So DGs will not have fully insight on the spending of the EU budget.

"Mentioning exact numbers and figures holds the risk that it becomes an issue with even political stakes at hand."

Mr. Heuckelom, Europol

Mr. Wensink asked during the meeting if open source information is useful and can be used as a basis for a study on misuse of EU funds by organised crime. All experts agreed that open source information is useful but has to be rightly and appropriate interpreted.

The conclusion in this part of the meeting on the availability and reliability of data was that it is hard to find and get access to reliable data of organised crime misusing EU funds. Reasons for

"The problem with EU spending is that it is not completely transparent right now. There is no full database of all EU spending."

Mr. Patz, Transparency International

this problem vary: information is classified, there is exists a dark number in misuse which nobody knows, facts and figures can be wrongly interpreted and the way the EU spends funds are not always transparent.

Priority of the fight against misuse of EU funds

An observation of a Member of the European Parliament was that when it is hard to present facts and figures of organised crime misusing EU funds or organised crime involved in VAT fraud, it is also hard for politicians to set priority in certain areas. What then should they use as the base of priority when information is hardly transparent?

Mr. Cretin said that the EU institutions like OLAF are able to estimate certain levels of risk in certain areas. For example, in cigarette smuggling it is clear that Italy has a big role as distributional point for the rest of Europe. Then the EU institutions can recommend to specific DG's that they should focus on these specific areas. This is the way priorities can be made.

Mr. Savona claimed that it is sometimes hard to set priority because fraud and corruption can be interpreted differently in various cultures which results in different considerations fighting fraud per country. Some countries may accept a certain level of fraud. Again the experts pleaded to focus on the vulnerabilities on the EU market and the opportunities of organised crime to penetrate the market instead of strengthen the already existing control systems to detect fraud.

Conclusions

All participants at the meeting agree that misuse of EU (spending) funds by organised crime is an issue that should be addressed. In this fight against organised crime misusing EU funds, there is no need to focus on the definition of 'organised crime'. Instead, to strengthen the fight, the European Parliament has to focus on the modus operandi of people who misuse EU funds, whether this is organised crime or not.

The European parliament should also focus more on the weaknesses in the EU markets regulated by subsidies and revenues, because the weaknesses in the system are used by people who want to earn money in an illegal way.

The misuse of EU funds by organised crime is not easy to investigate due to a lack of reliable information. The research team used a lot of open resources in the interim report because they could not get access to classified information of the EU institutions.

Even if the research team would have got access to data from OLAF, Europol and Eurojust on the misuse of EU funds by organised crime, the size of the problem would not have become clear. The data of the EU institutions will always be the visible part of a bigger problem which is invisible.

Although the size of the problem would not become clear, the modus operandi may become more clear when EU institutions want to share more information

"Fraud means intention. So, by definition, it is something we should not accept".

Member of the European Parliament

with the research team because in the interim report only open sources are used to investigate this modus operandi. But in the end, when investigating organised crime, everybody has to accept that there will always be an invisible part on the way how organised crime operates.

In the final report the research team will not further investigate the various definitions of organised crime. The focus will turn to the weaknesses in the regulation of the EU market by

subsidies and revenues. Furthermore VAT fraud and cigarette smuggling will be included in the final report.

A.13. Overview of the respondents

Organisation

Europol

Eurojust

OLAF

European Court of Auditors

European Investment Bank

Dutch Ministry of Social Affairs and Labour

Dutch Ministry of Justice

Transparency International

Professor in Serious and Organised Crime and Criminal Justice in the Netherlands

Dutch Ministry of Economic Affairs, Agriculture and Innovation

Dutch Ministry of Justice

Figure 13: Overview of respondents



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT BUDGETARY AFFAIRS **D**

Role

Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

Policy Areas

-  Budgets
-  Budgetary Control

Documents

Visit the European Parliament website: <http://www.europarl.europa.eu/studies>

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