

Conditionality and the Rule of Law

The Conditionality Regulation of December 2020 creates a general regime of conditionality that makes European Union (EU) Member States' access to money from the EU budget conditional on respect for the principles of the rule of law.¹ Both Poland and Hungary brought actions for annulment of the Regulation in March 2021, which the Court dismissed on 16 February 2022.² Following the Court's rulings on the compatibility with EU law of the Conditionality Regulation, the European Commission seemed hesitant to formally apply the conditionality mechanism to national plans of Hungary and Poland under the Recovery and Resilience Facility (RRF), a large fund involving grants and low-interest loans available to EU Member States upon presentation and approval of national plans.³ Though Poland had submitted its national plan for the recovery fund on 3 May 2021, and Hungary did so on 12 May 2021, the Commission has withheld disbursement of the RRF money to the governments of Poland and Hungary, without formally starting the procedure under the Conditionality Regulation. Only on 5 April 2022, after the Hungarian elections, did the Commission announce it would formally apply the conditionality mechanism in relation to Hungary.⁴ On 27th April, it officially triggered the mechanism by sending a letter to Hungary.⁵

The conditionality mechanism enshrined in Regulation 2020/2092 was originally designed in 2020 as part of a post-pandemic crisis recovery package, to protect European taxpayers from frauds. However, its application has been delayed for various legal, bureaucratic and political reasons.⁶ After numerous pressing calls by MEPs and political groups, its application should now be unambiguous after the CJEU's recent judgment dismissing Poland's and Hungary's appeals.

¹ Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 Dec. 2020 on a general regime of conditionality for the protection of the Union budget, OJ 2020 L 4331/1, and corrigendum OJ 2021 L 373/94.

² Judgments of the CJEU in Cases C-156/21, *Hungary v. European Parliament and Council*, ECLI:EU:C:2022:97; C-157/21, *Poland v. European Parliament and Council*, ECLI:EU:C:2022/98.

³ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 Feb. 2021 establishing the Recovery and Resilience Facility, OJ 2021 L57/17.

⁴ <https://www.euractiv.com/section/politics/news/commission-to-trigger-mechanism-that-could-see-hungary-lose-eu-funds/>; <https://euobserver.com/rule-of-law/154672>; <https://hungarytoday.hu/ec-to-activate-rule-of-law-conditionality-mechanism-against-hungary/>.

⁵ <https://www.dw.com/en/eu-triggers-rule-of-law-procedure-against-hungary/a-61607618>.

⁶ <https://www.eipa.eu/wp-content/uploads/2021/09/EIPA-Briefing-2021-4-The-EU-Conditionality-Regulation-%E2%80%93-Variations-on-Procrastination-.pdf>.

Suspending endorsement of the national RFF plans of Poland and Hungary has explicitly been linked to the rule of law situation in both countries. In the case of Poland, the link was confirmed during the European Parliament plenary debate on ‘the rule of law crisis in Poland and the primacy of EU law’ on 19 October 2021 discussing the consequences of the Polish Constitutional Court’s ruling of 7 October 2021 stating that some provisions of the EU Treaty are unconstitutional.⁷ Here, Commission President von der Leyen referred to three conditions for disbursing the RRF funds to Poland, namely (1) the liquidation of the illegal Disciplinary Chamber, (2) the reinstatement of the judges suspended by it, (3) changes in the disciplinary system for judges.⁸ As for Hungary, the Commission made it clear already in January 2021 that it required changes in Hungary’s public procurement system before RFF funds would become available.⁹ The formal language in the documents related to the RFF procedure is less explicit and merely mentions that the assessment process is ‘ongoing’ in cooperation with the respective Member States.¹⁰

Evidently, the Commission seemed to wait for the outcome of the Court’s rulings in the annulment procedures brought by Poland and Hungary in order to start any formal application of the rule of law mechanism. This was also in line with the European Council’s Conclusions¹¹ of December 2020 forming the ultimate stepping-stone to reach a political compromise and adopt the Regulation. The Conclusions instructed the Commission not to apply the mechanism before having adopted guidelines on its application. The guidelines should take account of CJEU rulings following eventual annulment proceedings. Besides raising several problematic issues that prompted intense debates about the effects, scope and legal nature of the Regulation,¹² the EU Council Conclusions were much to the discontent of the European Parliament that adopted resolutions in December 2020, June and October 2021 calling on the European Commission to take action under the Conditionality Regulation and even brought an action against the Commission for failure to act.¹³ With the Court’s rulings providing support to formalize suspension of the approval of the RRF plans of Poland and Hungary under the Conditionality Regulation and

⁷ K3/21.

⁸ See <https://www.greens-efa.eu/en/article/document/letter-to-commission-president-von-der-leye-n-on-the-approval-of-polands-rrp>.

⁹ <https://www.eureporter.co/world/hungary/2021/02/08/eu-to-hungary-change-procurement-to-ban-systemic-fraud-from-recovery-stimulus/>.

¹⁰ In its Mar. 2022 report on the implementation of the RRF, COM(2022)75 final, the Commission writes the assessment process is ‘ongoing’ with Poland, Hungary, Sweden and Bulgaria, in cooperation with the respective Member States, at 5. Meanwhile, the Swedish plan has been endorsed on 29 Mar. 2022, the Bulgarian plan has been endorsed on 7 Apr. 2022.

¹¹ Paragraph I.2 c. European Council meeting (10 and 11 Dec. 2020) – Conclusions <https://www.consilium.europa.eu/media/47296/1011-12-20-euco-conclusions-en.pdf>.

¹² <https://www.eipa.eu/wp-content/uploads/2021/09/EIPA-Briefing-2021-4-The-EU-Conditionality-Regulation-%E2%80%93-Variations-on-Procrastination-.pdf>.

¹³ Case C-657/21 *European Parliament v. Commission*, pending.

subsequent adoption of the guidelines by the European Commission on 2 March 2022,¹⁴ the road seems finally clear to start applying the conditionality mechanism vis-à-vis both countries.

Meanwhile, the EU's external circumstances changed dramatically on 24 February as Russia invaded Ukraine. With Poland and Hungary being among the frontline Member States that have received and taken care of a high number of arrivals from Ukraine, withholding their recovery money seemed to be reconsidered, at least according to several media reports.¹⁵ However, later media coverage reports that von der Leyen explicitly stated that the Commission refuses to link disbursement of recovery funds to reception of Ukrainian refugees and the Commission will not be 'more flexible' for that reason.¹⁶

All of the above shows that there is ample disagreement and lack of clarity about the nature, purpose and actual application of the Conditionality Regulation. Such uncertainties originate on the one hand, from the nature and political embeddedness of the Regulation and, on the other hand, from external circumstances such as the current refugee crisis sparked by the Ukrainian conflict and the pressure this puts on the relationship between Poland and Hungary as well as on their relationship with the EU.

Before going further into the positions of Poland and Hungary under the Regulation, we shortly introduce the mechanism set up by the Conditionality Regulation and the Court's assessment of it.

Originally, the Regulation developed from a commonly shared view that systemic deficiencies of the rule of law in certain Member States had to be addressed beyond the politically sensitive and largely ineffective Article 7 procedure.¹⁷ One way to address this rule of law crisis was arguably to link such deficiencies to the EU budget. Accordingly, the Conditionality Regulation creates a 'general regime of conditionality' that makes Member States' access to money from the EU budget conditional on respect for the principles of the rule of law. Article 2 of the Regulation defines the Rule of Law as referring to the Union values enshrined in Article 2 TEU and including:

¹⁴ C(2022) 1382 final, Communication from the Commission, *Guidelines on the application of the Regulation (EU, EURATOM) 2020/2092 on a general regime of conditionality for the protection of the Union budget*.

¹⁵ See letter of the Greens in EP to Commission President von der Leyen of 24 Mar. 2022, <https://www.theguardian.com/world/2022/mar/17/european-commission-ready-to-release-recovery-funds-poland>.

¹⁶ <https://www.politico.eu/article/poland-not-there-yet-reform-receive-eu-recovery-funds-vdl/>.

¹⁷ N. Kirst, *Rule of Law Conditionality: The Long-Awaited Step Towards a Solution of the Rule of Law Crisis in the European Union?*, 6(1) Eur. Papers 101–110 at 102 (22 Apr. 2021); *Proposal for a Regulation of the European Parliament and the Council on the Protection of the Union's Budget in Case of Generalised Deficiencies as Regards the Rule of Law in the Member States* COM(2018) 324 final – 2018/0136(COD).

the principles of legality implying a transparent, accountable, democratic and pluralistic law-making process; legal certainty; prohibition of arbitrariness of the executive powers; effective judicial protection, including access to justice, by independent and impartial courts, also as regards fundamental rights; separation of powers; and non-discrimination and equality before the law.

The Conditionality Regulation lists the breaches of the rule of law that will lead to appropriate measures when they affect or seriously risk affecting in a sufficiently direct way the sound financial management of the Union budget or the protection of the financial interests of the Union. The list includes functioning of the authorities, that relate to carrying out financial control, monitoring and audit, effective and transparent financial management and accountability systems; investigation and public prosecution services; effective judicial review by independent courts; prevention and sanction of fraud, corruption or other breaches of Union law; recovery of budget unduly paid; effective and timely cooperation with the European anti-fraud office (OLAF) and where relevant with the European Public Prosecutor's Office (EPPO); and 'other situations or conduct of authorities that are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union'.¹⁸ The measures the Union may take in case of these breaches include suspension of approval, disbursement in full or in part, reductions, prohibitions on entering into new legal commitments or agreements on loans, or interruptions of payment.¹⁹ The RRF Regulation for its part obliges the Commission to manage the RRF in accordance with the relevant rules, in particular with the Conditionality Regulation.²⁰

In its February judgment, the Court fully dismissed Hungary's and Poland's actions for annulment against the general regime of conditionality for the protection of the EU budget provided by the Regulation 2020/2092 and confirmed both the legal basis of the Regulation and its compliance with the procedure of Article 7 TEU. Importantly, the Court stated that the EU's budget is a highly important instrument for giving practical effect to the principle of solidarity according to Article 2 TEU. The implementation of this principle through the EU budget is based on mutual trust between the Member States as regards the responsible use of the common resources contained in this budget.²¹

The Court of Justice made clear that conditionality is not imposed as a sanction, but as a measure to protect the EU budget. It is not to 'penalize breaches of the rule of law' but rather 'to protect the budget in the event of a breach of the principles of the rule of law'.²²

¹⁸ Regulation 2020/2092, Art. 4.

¹⁹ *Ibid.*, Art. 5.

²⁰ Regulation 2021/241, Art. 8.

²¹ C-156/21, para. 129; C-157/21, para. 147.

²² C-156/21, para. 171; C-157/21, para. 210.

This also means that the sole violation of rule of law principles in a Member State would not suffice to trigger the mechanism because the scope of the Regulation only covers those rule of law violations that explicitly affect the Union's budget in a *sufficiently direct way*. Accordingly, the scope of the Regulation is limited to protect the sound financial management of the EU budget, and the Union's financial interest and this link to the Union's budget or the Union's financial interest is indispensable.²³

More in particular, the Court pointed out that for the horizontal conditionality mechanism to apply, there must be a 'genuine link' between violations of the principles of the rule of law, on the one hand, and the impact or serious risk of impact on the sound financial management or the protection of the EU's financial interests, on the other hand.²⁴ A breach of the principles listed in Article 2(a) of the Regulation must also concern a situation or conduct attributable to a public authority of a Member State and be relevant to the sound financial management of the EU budget. Particularly, this breach must affect or seriously risk affecting, in a sufficiently direct way, that sound financial management.²⁵ In addition, a sufficiently 'direct link', namely a *genuine link*, must be established between a breach of one of the principles of the rule of law and that serious risk.²⁶ The ECJ also stressed that the measures must be strictly proportionate to the impact of the breaches of the rule of law principles on the EU budget.²⁷

Several commentators have already analysed the shortcomings²⁸ and possible benefits of the Regulation in light of EU law, however, there has been less analysis on how its actual application conditioned on the core link (sufficiently direct link between rule of law violations and the EU's financial interests) will be operationalized in Poland and in Hungary.

Even though, the design of the Regulation resembles a new form of EU governance²⁹ and fits into a broader trend of EU policies using EU funds to achieve broader EU policy and enforcement objectives,³⁰ its design seems to have been

²³ C-156/21, para. 176; C-157/21, para. 215; *see also* Kirst, *supra* n. 17.

²⁴ C-156/21, para. 244; C-157/21, para. 165.

²⁵ C-156/21, para. 253; C-157/21, para. 174.

²⁶ C-156/21, para. 267; C-157/21, para. 299.

²⁷ C-156/21, para. 271; C-157/21, para. 302.

²⁸ Kirst, *supra* n. 17; Sarah Progin-Theuerkauf & Melanie Berger, *ECJ confirms Validity of the Rule of Law Conditionality Regulation*, European Law Blog (11 Mar. 2022); Justyna Lacny, *The Rule of Law Conditionality Under Regulation no 2092/2020 – Is It All About the Money?*, 13(1) Hague J. Rule L. 79–105; Antonia Baraggia & Matteo Bonelli, *Linking Money to Values: The New Rule of Law Conditionality Regulation and Its Constitutional Challenges*, 23(2) Ger. L.J. 131–156; Friedrich Heinemann, *Going for the Wallet? Rule-of-Law Conditionality in the Next EU Multiannual Financial Framework*, 53(6) Inter Econ. 297–301.

²⁹ Baraggia & Bonelli, *supra* n. 28, at 142.

³⁰ *Ibid.*, at 141.

engineered with an eye on the situation in Hungary, where an illiberal state is arguably kept in life through EU money.³¹

Therefore, the application of the Regulation is especially evident in Hungary, where corruption is deeply engrained in the legal, political and economic governance of the country.³² Systemic abuse of the public procurement system and EU funds is the result of government behaviour that tolerates and in certain cases even supports such irregularities, for example, by frequent changes in the legal framework.³³ Corruption is closely intertwined with the destruction of the rule of law, it seriously undermines economic development, and is closely interlinked with the colonization of the media along political interests.³⁴

'[S]ystemic irregularities in the tendering processes' have, in fact, been already indicated in the 2019 European Semester, the annual EU cycle of economic and fiscal policy coordination, in the country-specific recommendations for Hungary,³⁵ and continue to be mentioned. For example, in the 2022 country-specific recommendations as part of the European Semester, the lack of competition in public procurement has been frequently pointed out.³⁶ Corruption in Hungary continues to worsen, according to the latest results of the Corruption Perceptions Index.³⁷ Accordingly, the Commission has also called upon Hungary to reform its public procurement laws and prevent systemic fraud before billions of euro from the EU pandemic recovery fund become available.³⁸ To make its messages hard, the Commission has finally sent a notification letter to Hungary formally activating the conditionality procedure end of April.

However, one may wonder how establishing the link between the protection of EU funds and rule of law deficiencies in Poland could be well argued and established. For example, the annual report for 2020 of OLAF, the EU anti-fraud office, shows

³¹ <https://www.nytimes.com/2022/01/03/world/europe/hungary-european-union.html>; R. Daniel Kelemen & Kim Lane Scheppele, *How to Stop Funding Autocracy in the EU*, *VerfBlog* (10 Sep. 2018), <https://verfassungsblog.de/how-to-stop-funding-autocracy-in-the-eu/>.

³² OECD, <https://www.oecd.org/economy/surveys/Hungary-2021-OECD-economic-survey-overview.pdf>, at 55–56.

³³ <https://www.euractiv.com/section/justice-home-affairs/news/citing-systemic-fraud-commission-pushes-hungary-to-change-procurement/>.

³⁴ <https://rm.coe.int/fourth-evaluation-round-corruption-prevention-in-respect-of-members-of/1680a062e9>; https://transparency.hu/wp-content/uploads/2022/02/TI_Hu_Black_Book_II_ENG.pdf.

³⁵ It is argued that public procurement framework has improved in recent years but obstacles to competition remain. These include the use of procedures with limited publicity and systemic irregularities in the tendering processes, in particular related to inadequate selection and award criteria and unequal treatment of tenderers. *Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Hungary and Delivering a Council Opinion on the 2019 Convergence Programme of Hungary* (2019/C 301/17), [op.europa.eu/en/publicationdetail/publication/421552ebcfd11e9b4bf01aa75ed71a1/languageen/formatPDFa2A](https://ec.europa.eu/en/publicationdetail/publication/421552ebcfd11e9b4bf01aa75ed71a1/languageen/formatPDFa2A), para. 18.

³⁶ https://ec.europa.eu/info/system/files/2022-european-semester-country-report-hungary_en_0.pdf, at 13.

³⁷ <https://transparency.hu/en/news/corruption-in-hungary-continues-to-worsen/>.

³⁸ *Supra* n. 9.

Hungary on the top of the list (together with Romania) with a number of recommendations for recovery of EU funds.³⁹ Poland is at the lower end of the list. At the same time, the rule of law breaches as laid down by Article 3 of the Regulation seem to have had more ‘inspiration’ from the Polish scenarios of rule of law backsliding, foremostly the undermining of independence of the judiciary. In the context of the European Semester, the 2020 country-specific recommendations for Poland do not mention corruption or risks to sound financial management. Instead, the only rule of law element mentioned is the need to safeguard judicial independence, notably for enhancing the investment climate.⁴⁰ The Commission guidelines on the application of the conditionality mechanism find an opening to establish a link with the sound financial management in the Court’s statements that adoption of appropriate measures is not limited to cases of proven effects on the sound financial management or the financial interests of the EU, but can also be taken in cases where those effects can be reasonably foreseen, since there is a high probability that they will occur.⁴¹ And the Commission guidelines give as an example of such high probability as the situation where:

certain acts of national authorities implementing Union funds through public procurement, or collecting the Union’s own resources, or carrying out financial control, monitoring and audit of Union funds, or investigating allegations of fraud, corruption or other breaches of Union law in the implementation of Union funds or revenue, cannot be effectively reviewed by fully independent courts,

as ‘this may entail a serious risk insofar as the Union funds and the financial interests of the Union are concerned’.⁴²

At the same time, the Hungarian government over the past twelve years has used a variety of rule-making strategies to restructure numerous sectors of the economy and to override market mechanisms in plain sight. The intentional use of various legal and regulatory measures was used by the Hungarian government to circumvent the public procurement system⁴³ and to exempt economic activities in often strategically important sectors of the economy from the pressures of competition.⁴⁴

³⁹ https://ec.europa.eu/anti-fraud/system/files/2021-12/olaf_report_2020_en.pdf, at 46.

⁴⁰ COM(2020) 521 final, *Recommendation for a Council Recommendation on the 2020 National Reform Programme of Poland and Delivering a Council Opinion on the 2020 Convergence Programme of Poland*, point 4.

⁴¹ C-156/21, para. 262.

⁴² Commission guidelines, C (2022) 1382 final, point 31.

⁴³ *Supra* n. 34, https://transparency.hu/wp-content/uploads/2022/02/TI_Hu_Black_Book_II_ENG.pdf, at 48.

⁴⁴ State intervention and increasing state ownership further reduced competition and increased state control over strategic sectors and resources including finance and banking, land and water management. M. Varju & M. Papp, *The Crisis, Economic Patriotism in Central Europe and EU Law*, in *Highs and Lows of European Integration: Sixty Years After the Treaty of Rome* (Springer 2018).

The exemption of various sectors and practices from the control of competition law, for example, neutralize a crucial control mechanism of collusive practices in public procurement procedures and as such contribute to the lack of transparent management of EU funds.⁴⁵

Politicizing the economic governance of markets by differentiated, selective and non-enforcement of laws in order to support national economic interests has been widespread practice of the Hungarian government since winning the elections in 2010.⁴⁶ The drastic transformation of the constitutional system has fabricated a framework for economic regulation where accumulation of political power steadily leads to accumulation of economic power in the hands of a few.⁴⁷ This 'new' economic governance systematically undermined key legal rules and independent institutions of the functioning Hungarian market economy.⁴⁸

The rate and scope of constitutional re-engineering of Hungary's economic governance could certainly be addressed by the Conditionality Regulation but it must take place in a way that takes serious account of what has been coined by Batory as Hungary's 'creative compliance'⁴⁹ with EU obligations, notably by seemingly following and complying with EU norms while in fact not giving up its original political objectives.⁵⁰

Concerning Poland, the Commission seems to take a different strategy. Despite the opening in the guidelines above, the difficulty remains that the use of the new instrument requires proof that the violations concerned make it highly probable that misuse of EU budget will follow. In the case of institutionally corrupt countries such as Hungary, this approach can and should succeed. In contrast, where EU money is still correctly administered – as in Poland – application of the mechanism can prove

⁴⁵ <https://www.oecd.org/daf/competition/sectors/48315205.pdf>KJ, K. J. Cseres, *EU Competition Law and Democracy in the Shadow of Rule of Law*, in *The Evolving Governance of EU Competition Law in a Time of Disruptions: A Constitutional Perspective* (C. Colombo, M. Eliantonio & K. Wright eds, Hart Publishing 2022 forthcoming); Amsterdam Law School Research Paper No. 2022-05, Amsterdam Centre for European Law and Governance Research Paper No. 2022-01, Available at SSRN, <https://ssrn.com/abstract=4032499>.

⁴⁶ M. Papp & M. Varjú, *The Crisis, National Particularism and EU Law: What Can We Learn from the Hungarian Case?*, CMLR 1661 (2016); K. J. Cseres, *Rule of Law Challenges and the Enforcement of EU Competition Law, a Case-Study of Hungary and Its Implications for EU Law*, *Competition Law Review* (2019).

⁴⁷ Policy Solutions, *Hungarian Politics in 2021* (2022), Ch. 4, https://www.policysolutions.hu/userfiles/Policy_Solutions_Hungarian_Politics_2021_web.pdf.

⁴⁸ As the OECD recently acknowledged, '[t]he pro-competitive regulatory framework is little used. The competition authority is not sufficiently active in sectors with high risk of collusion, with few market studies and decisions'. OECD, *supra* n. 32, at 11–12.

⁴⁹ Agnes Batory, *Defying the Commission. Creative Compliance and Respect for the Rule of Law in the EU*, 94(3) *Pub. Administration* 685–699 (2016).

⁵⁰ <https://bridgenetwork.eu/2021/02/22/new-chapter-rule-of-law-crisis/>.

much more difficult.⁵¹ Furthermore, at the time of writing there is no ECJ ruling on the (lack of) independence of ordinary courts in Poland, which makes it more difficult to argue that there it is highly probable that allegations of fraud or corruption will not be reviewed by an independent court.⁵² However, the use of disciplinary proceedings continues against Polish judges who apply EU law, increasing the probability that there is no independent review.⁵³ However, even in that case, application of the mechanism is not obvious. There remains always a risk that the Polish government may use the start of a conditionality procedure to turn Polish public opinion against the Commission – especially under the current circumstances.

For the past twelve years, the Regulation is the first concrete and meaningful measure to address one of the biggest ongoing crises of the EU in political, legal and economic terms. The fact that the Commission has triggered its mechanism the past month also underlines its potential to finally address the rule of law crisis. Still, to achieve its ultimate goal – to protect EU money from fraud – the Commission currently depends on a multiple stage trajectory with a long-envisaged duration. Moreover, currently the application of the conditionality mechanism has only been activated vis-à-vis Hungary and seems unlikely to be started in the near future against Poland. Yet, the mechanism could prove to be a powerful tool in the hands of the Commission to restore the legal, political and economic balance of European integration.

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Post scriptum: The editorial went to press before the Polish Parliament passed a draft law to drop the judicial disciplinary chamber for judges at the Supreme Court, apparently in an attempt to clear the way for reimbursement of the RFF money. Commentators warned, however, that the draft law is not ending the rule of law problems. Despite these warnings on the existence of serious rule of law shortcomings, on 1st June, the Commission has decided to approve Poland's recovery plan. The approval is with conditions, as the money will only be paid when the requested reforms of the judicial system are put in place.

⁵¹ Piotr Buras, *Why the EU's Rule of Law Mechanism Won't Resolve Its Democratic Crisis*, European Council on Foreign Relations, <https://ecfr.eu/article/why-the-eus-rule-of-law-mechanism-wont-resolve-its-democratic-crisis/>.

⁵² Joined cases C-858/18, C-624/18 and C-625/18 concern the Disciplinary Chamber of the Supreme Administrative Court.

⁵³ Katarzyna Gajda-Roszczyńska & Krystian Markiewicz, *Disciplinary Proceedings as an Instrument for Breaking the Rule of Law in Poland*, Hague J. Rule L. 451–483 (2020).

