



Freezing all EU funds to Hungary:

A legal analysis of why a 100% suspension is
"proportionate" and "appropriate" under Regulation
2020/2092 on a general regime of conditionality for the
protection of the Union budget

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HUNGARY: Why a suspension of **100% of EU Funds** is necessary



NATURE

Legal instability applies across the board.



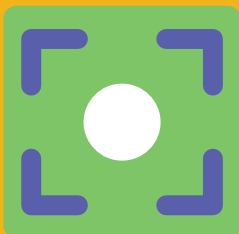
DURATION

Hungary's track record of mismanagement of EU funds dates back over a decade.



GRAVITY

The oversight of the entire system of spending public funds is not meaningfully independent.



SCOPE

All EU-funded programmes are affected by the comprehensive and transversal nature of rule of law violations.



100% suspension necessary to protect EU budget

Executive summary

On 27 April 2022 the Commission, under Article 6(1) of Regulation (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget, announced it had formally triggered this “Rule of Law Conditionality Regulation” against Hungary by sending it a Written Notification. Already in November 2021, when it sent both the governments of Hungary and Poland requests for information pursuant to Article 6(4) of the Regulation, the Commission had signaled that it was considering acting against both of them. The eventual decision to formally trigger the new legal instrument against only Hungary came a little over two months after the European Court of Justice (CJEU), on 16 February 2022, upheld its legality by rejecting the annulment actions against the Regulation brought by the governments of Hungary and Poland.

A previous report already documented the overwhelming case for triggering the Conditionality Regulation vis-à-vis Hungary because of problems with the transparency in the indirect and shared management of EU funds by Hungary, major problems with Hungarian prosecution in case of evident mismanagement and serious challenges with independence of Hungarian courts in case such files would reach them.¹ Evidence also suggests major irregularities with EU funds implemented in direct management by the Commission in Hungary, including auctioning of state lands falling under the Common Agricultural Programme and persistent procurement irregularities in the distribution of Cohesion Funds. Indeed, *all* types of EU funding to Hungary are affected by these rule of law breaches. It is therefore a welcome development that the Commission has now chosen to challenge Hungary

on each of these rule of law elements laid down in the Regulation. However, that Report did not examine the vital question that both the Commission and the Council will now soon have to confront:

precisely what financial consequences could follow for a Member State with such fundamental and widespread rule of law problems as are present in Hungary?

The Regulation contains specific pointers to answer that newly relevant question.

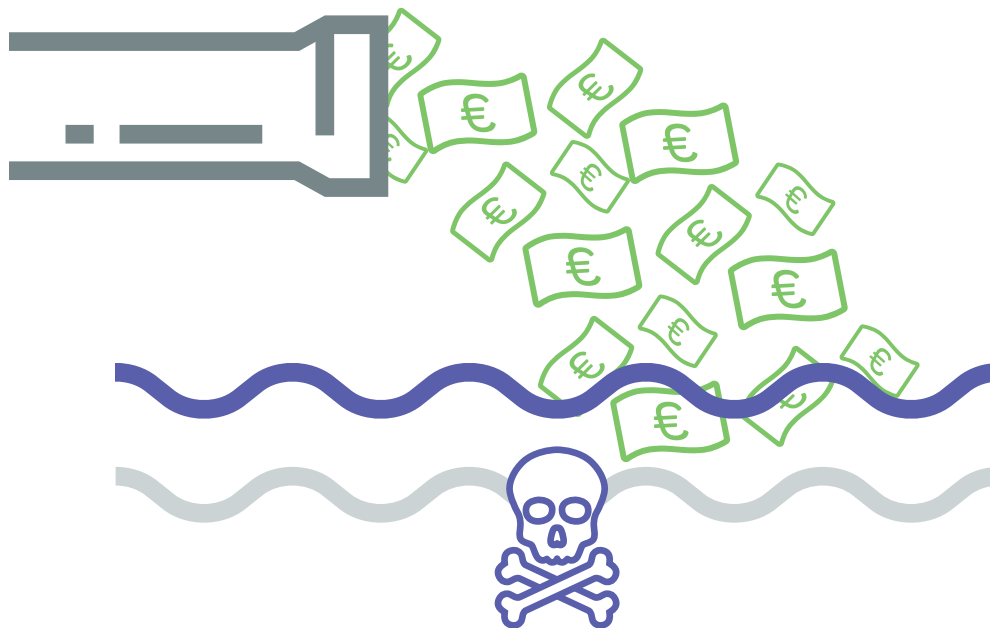
If, after triggering the Regulation, the Commission finds that any remedial measures proposed by the Member State do not adequately address the findings in its Written Notification, the Commission shall subsequently propose a set of “appropriate measures” (Article 6(9)) to address the risk to the EU budget posed by the rule of law breaches. These measures must be “proportionate.” To assess what would constitute “appropriate” and “proportionate” measures, the Commission needs to rely on information and guidance from available sources, including decisions, conclusions and recommendations of Union institutions, other relevant international organisations and other recognized institutions (Article 6(8) and Article 6(3)). The centrality of the question of the proportionality of any measures to be imposed is underlined by the fact that a targeted Member State is given the opportunity to submit its observations on the proportionality of envisaged measures (Article 6(7)). The European Parliament, when continuing to discuss this file with the Commission, including under the structured dialogue on the Written Notification (Article 6(2)), has the opportunity to discuss the proportionality of any measures to be

¹ Scheppele, Kim, John Morijn, and R. Daniel Kelemen, “The EU Commission has to Cut Funding to Hungary: The Legal Case, 7 July 2021. Study Commissioned by the Greens/EFA Group of the European Parliament. Available at: https://danielfreund.eu/wp-content/uploads/2021/07/220707_RoLCR_Report_digital.pdf

imposed too. The Commission has already produced Guidelines² that include criteria it would use to assess proportionality, such as the scope, severity, and duration of rule of law breaches. Based on this legal framework set out in the Regulation, this Report analyzes the meaning of the requirement that measures should be both “appropriate” and “proportionate”.³

The central finding of this report is that, for rule of law breaches covered by the Regulation that are so fundamental, frequent or widespread that they represent a complete failure of the budgetary implementation and monitoring system in a Member State, the only measures in response that could be considered both appropriate and proportionate, would be suspensions, reductions and interruptions of 100% of the flow of EU funds. Withholding 100% of the funds is warranted because systemic breaches by necessity put at risk the legality and regularity of all EU expenditure concerned. This interpretation follows from other instruments of EU financial law, guidelines and criteria developed based on it that include the possibility of 100% suspensions in this specific scenario, as well as the rule-of-law case law of the Court of Justice.

Partial suspension, reduction or interruption of EU funds may be possible as a way to protect the EU budget in cases where rule of law problems are less fundamental and/or can be isolated to specific budgetary areas. However, such partial suspensions are clearly not appropriate or proportionate in cases where rule of law breaches covered by the Regulation are so fundamental, frequent or widespread that they represent a complete failure of the budgetary implementation and monitoring system in a Member State. An analogy with plumbing is instructive here: all drinking water that flows through lead pipes must be deemed contaminated. Delivery of that water for human consumption should be suspended until the poisonous lead pipes are replaced. When there are systemic rule of law breaches involving the public services that must prosecute corruption, the judiciary that must adjudicate cases involving public expenditure, and the audit offices that track expenditures, these organs become contaminated by the very corruption that they are supposed to be controlling. They function like lead pipes, contaminating any EU money flowing through them into a Member State. As a consequence, the EU's budget and financial interest can only be protected in such cases by suspending 100% of the flow of funds until the “lead pipes” are replaced.



² 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, C(2022) 1382 final, 2 March 2022.

³ See supra, note 1.

There is in fact nothing new about linking financial corrections to Member-State-level rule of law issues as defined in the Conditionality Regulation. Indeed, though the governments of Poland and Hungary objected to the Rule of Law Conditionality Regulation, they had previously themselves, on many occasions, agreed to measures providing for financial corrections in the case of deficiencies of management and control systems governing EU funds. These methods, including suggestions for 100% suspensions, reductions, interruptions and recoveries in situations that cause the most serious threat to the EU budget and specific practices for decision-making on when to re-open the financial taps, contain elements that can be re-used in the application of the Rule of Law Conditionality Regulation.

There is therefore no need for new methodologies; for the Commission and the Council just building on existing methodologies and practices is sufficient.

The extremely serious and persistent threat that some of the Hungarian violations of rule of law principles mentioned in the Regulation pose to the Union budget - violations such as a constantly changing legal environment, failing budgetary management systems, drastically underperforming investigative authorities and prosecutors and courts lacking independence - are of the same nature as violations for which 100% suspensions of funds are already applied under other instruments.

Such rule of law problems are systemic and, by their nature, have the potential to affect the soundness of each and every financial flow. They can therefore be legally qualified as “a serious deficiency so fundamental, frequent or widespread that it represents a complete failure of the budgetary implementation and monitoring system”.

Therefore, in well-documented and serious situations that now present themselves with regard to Hungary in particular, the only measures logically flowing from existing (and wholly uncontroversial) Union law and case-law that would be both appropriate and proportional would be 100% suspensions, reductions, interruptions and recoveries.

1 | Introduction

On 27 April 2022 the Commission, under Article 6(1) of Regulation (EU, Euratom) 2020/2092 on a general regime of conditionality for the protection of the Union budget, announced it had formally triggered this so-called Rule of Law Conditionality Regulation against Hungary by sending it a Written Notification. Already in November 2021, when it sent the governments of both Hungary and Poland requests for information pursuant to Article 6(4) of

the Regulation, the Commission had signaled that it was considering sending Written Notifications to both of these Member States. The eventual decision to formally trigger the new legal instrument against Hungary only came a little over two months after the European Court of Justice (CJEU), on 16 February 2022, upheld its legality by rejecting the annulment actions against the Regulation brought by the governments of Hungary and Poland.⁴



In February 2022, the Court of Justice upheld the legality of the Rule of Law Conditionality Regulation in the case of two annulment actions brought by the governments of Hungary and Poland.

⁴ Case C-156/21, Hungary v. European Parliament and Council of the European Union (ECLI:EU:C:2022:97, 16 February 2022, provisional text) and Case C-157/21 Poland v. European Parliament and Council of the European Union (ECLI:EU:C:2022:98, 16 February 2022, provisional text).

A Report presented by the European Parliament to the Commission already in July 2021 documented the overwhelming case for triggering the Conditionality Regulation vis-à-vis Hungary because of problems with the transparency in the Hungarian management of EU funds, major problems with Hungarian prosecution in case of evident mismanagement, and serious challenges with the independence of Hungarian courts that would hear cases involving such mismanagement if such cases ever reached them.⁵ It is a welcome development that the Commission has now chosen to challenge Hungary on each of these rule of law elements laid down in the Regulation. However, the aforementioned July 2021 Report did not examine the vital question that both the Commission and the Council will now soon have to confront: precisely what financial consequences could and should follow for a Member State with rule of law problems directly affecting the sound financial management of the EU budget?

More particularly, what is meant when the Regulation calls for “appropriate measures” that are “proportional” to respond to the types of violation of the rule of law principles that can be identified in Hungary?

This report sets out to help the European Parliament answer that question.

- ▶ It will first recall the context and added value of the Conditionality Regulation (section 2).
- ▶ Second, the report will zoom in on what the Regulation requires in terms of the “proportionality” of any “appropriate measures” that can include suspensions, interruptions, and reductions of any EU funding (section 3).
- ▶ Third, the report will analyse the problems in Hungary from that perspective (section 4).
- ▶ Fourth, the analysis will highlight what other existing EU financial legislation and other guidance indicate as to what is legally considered “appropriate” and “proportional” in other contexts (section 5).
- ▶ Fifth, and finally, these findings will then be connected back to the Hungarian situation (section 6).

On this basis it will be concluded that there is a legal and practical necessity of proposing a 100% solution in cases such as Hungary where Member States have a serious deficiency so fundamental, frequent, or widespread that it represents a complete failure of the financial monitoring system (section 7).

⁵ Scheppele, Kim, John Morijn, and R. Daniel Kelemen, “The EU Commission has to Cut Funding to Hungary: The Legal Case, 7 July 2021. Study Commissioned by the Greens/EFA Group of the European Parliament. Available at: https://danielfreund.eu/wp-content/uploads/2021/07/220707_RoLCR_Report_digital.pdf

2 Background to the Conditionality Regulation and its added value

The Conditionality Regulation was designed to complement – rather than to replace or circumvent – existing instruments for protection of the rule of law and for protection of the Union budget. As was explained in an earlier study⁶ and recently affirmed by the CJEU,⁷ the Conditionality Regulation complements general rule of law protection instruments such as infringement actions (Article 258 TFEU) and the Article 7 TEU procedure (recital 14). The Regulation is also supplementary to specific procedures laid down in Union financial legislation (recital 17) to ensure the protection of the EU budget itself. These include *ex ante* checks and monitoring of Member States budgetary management and control systems and individual beneficiaries, including through the Early Detection and Exclusion System under the Financial Regulation⁸ (recital 90, Article 63(2) and Articles 135-144). They also include

the possibility to act on the notion of ‘systemic irregularities’ in spending by economic operators under the Common Provisions Regulation.⁹

In addition, many EU financial instruments also include conditions and procedures to guarantee that the Union budget is spent in line with other goals of EU integration, including many that have direct or indirect links to the rule of law. Examples include the enabling condition that refer to the need to design and implement the funds covered by the Common Provisions Regulation in line with the Charter of Fundamental Rights (Article 9)¹⁰ and the European Social Fund Plus Regulation (Article 6 & 8).¹¹ Other tools to reach this goal include Commission policy guidance to implement European Structural and Investment Funds in line with the Charter of Fundamental Rights.¹²

6 Scheppelle, Kim, John Morijn, and R. Daniel Kelemen, “The EU Commission has to Cut Funding to Hungary: The Legal Case, 7 July 2021. Study Commissioned by the Greens/EFA Group of the European Parliament. Available at: https://danielfreund.eu/wp-content/uploads/2021/07/220707_RoLCR_Report_digital.pdf

7 Case C-156/21, Hungary vs European Parliament and Council of the European Union (ECLI:EU:C:2022:97, 16 February 2022, provisional text) and Case C-157/21 Poland vs. European Parliament and Council of the European Union (ECLI:EU:C:2022:98, 16 February 2022, provisional text).

8 Regulation 2018/1046 of 18 July 2018 on the financial rules applicable to the general budget of the Union [...], OJ L193/1, 30 July 2018. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32018R1046>

9 Regulation (EU) 2021/1060, PE/47/2021/INIT, OJ L 231, 30.6.2021, p. 159–706, Articles 2(33), and 103) Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1060>

10 Regulation (EU) 303/2013 of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (consolidated version November 2020). The latest version is available as Council document 6180/21, Common Provisions Regulation – Analysis of the final compromise text with a view to agreement, 25 February 2021.]

11 Council document 6182/21, European Social Fund Plus (ESF+) Regulation – Analysis of the final compromise text with a view to agreement, 25 February 2021. Available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1057>.

12 Commission notice, Guidance on ensuring the respect for the Charter of Fundamental Rights of the European Union when implementing the European Structural and Investment Funds (‘ESI Funds’), OJ C 269/1, 23 July 2016

Also, it is notable that linking country specific recommendations and the issuance of EU funds has an established track-record. According to Articles 15 and 96 of the Common Provisions Regulation, the use of European Structural and Investment Funds should be linked to the objectives of the European Semester and, particularly, to the Country Specific Recommendations.¹³ For example, the country-specific recommendations to Hungary on its 2020 Convergence Programme included a recommendation that “emergency measures be strictly proportionate, limited in time, in line with European and international standards . . .”¹⁴ More recently, the Recovery Fund Regulation¹⁵ contains ex ante conditionality vis-à-vis country specific recommendations, that, although not mentioned as such, de facto include rule of law related elements.

For Poland and Hungary these funds have not been released, reportedly for reasons that relate precisely to the rule of law record of these Member States.¹⁶ All of these requirements can lead to interruption, suspension, reduction, or correction of EU funding. Some of these options have already been used as the Commission has enforced other regulations. The EU has suspended billions in Euros of funding over the years due to concerns over corruption and financial irregularities in a number of member states, including, for example, Romania, Bulgaria, Hungary, Poland, and Czech Republic.¹⁷

Against this background, the Regulation must be invoked when it is more effective in protecting the Union budget than any of these other procedures (Recitals 14 and 17, and Article 6(1) Regulation).

13 See also European Court of Auditors, Special Report: The European Semester – Country Specific Recommendations address important issues but need better implementation, 2020, page 25, point 41.

14 Council Recommendation on the 2020 National Reform Programme of Hungary and delivering a Council Opinion on the 2020 Convergence Program of Hungary, CON(2020)517 Final, 20 May 2020, Para. 4.

15 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, *OJ L 57*, 18.2.2021, p. 17–75

16 Lili Bayer and Zosia Wanat, Commission Questions Hungary and Poland on Corruption, Judiciary. *Politico.EU*, 20 November 2021 at <https://www.politico.eu/article/eu-commission-questions-hungary-on-corruption-judiciary/>.

17 Ahto Lobjakas, “Brussels Censures Romania, Bulgaria For Corruption,” Radio Free Europe/Radio Liberty, July 23, 2018, https://www.rferl.org/a/EU_Censures_Romania_Bulgaria_For_Corruption/1185730.html; Radio Prague International, “EU Criticizes Czech Republic for Inefficiently Drawing Funds,” Radio Prague International, November 14, 2012, <https://english.radio.cz/eu-criticizes-czech-republic-inefficiently-drawing-funds-8549599>; Euroactiv, “EU Suspends €890m for Polish Roads Pending Fraud Probe,” Euroactiv, January 31, 2013, <https://www.euractiv.com/section/regional-policy/news/eu-suspends-890m-for-polish-roads-pending-fraud-probe/>; Euroactiv, “EU Suspends Funding to Hungary over Weak Controls,” Euroactiv, August 15, 2013, <https://www.euractiv.com/section/central-europe/news/eu-suspends-funding-to-hungary-over-weak-controls/>; Marian Chiriac, “EU Suspends Funds For Romania Citing Fraud Concerns,” Balkan Insight, May 8, 2015, <https://balkaninsight.com/2015/05/08/romania-still-faces-problems-with-eu-funds/>; Le Point, “L’avertissement de Bruxelles à la République tchèque,” Le Point, March 23, 2012, https://www.lepoint.fr/economie/l-avertissement-de-bruxelles-a-la-republique-tcheque-23-03-2012-1444265_28.php.

In particular, it contains three characteristics that speak to its added value and potential effectiveness.

1 First, unlike other financial instruments, it authorises a *proactive, risk-based approach* that facilitates a strong and comprehensive EU-intervention, including specifically *before* disbursement of EU funds (Article 4). This necessitates not waiting to react to specific instances of fraud or abuse of EU funds in future, but instead acting to address serious risks of matters such as fraud or abuse created by existing breaches of rule of law principles. The Guidelines recognize this by asserting that: “a “serious risk” may be established in cases where the effect of the relevant breach of the principles of the rule of law, although not yet proven, can nevertheless be reasonably foreseen, since there is a high probability that they will occur. It must therefore be demonstrated that the risk has a high probability of occurring. . .”¹⁸

2 Second, the Regulation applies across all EU funds, including resources allocated through the Recovery Fund and loans and other instruments guaranteed by the Union budget, and therefore offers a *general and generalised* approach rather than one that is tailored to specific EU funds or targeted at specific final beneficiaries (Article 5 and recital 7). In particular, recital 15 indicates that the Regulation covers not only “individual breaches” but also “breaches that are widespread or due to recurrent practices or omissions by public authorities, or to general measures adopted by such authorities.”¹⁹ The Commission has clarified in its Guidelines that this means the Regulation covers both individual and systemic breaches and that it can assess “both actions or failures to act by the public authorities.”²⁰

3 Third, it provides for a *clear and transparent procedure with short deadlines and involvement of the European Parliament* (Article 6). Such involvement could include a frank dialogue on the type of measures that the Commission could propose to the Council as “appropriate measures” (Article 6(2)).

It should be noted that the Commission, by sending letters to both Hungary and Poland in November 2021 under Article 6(4), and by sending a Written Notification to Hungary on 27 April 2022, triggering the Conditionality has already concluded that acting through other legal and political instruments alone no longer suffices to protect the EU’s financial interests. It has therefore already acknowledged the need to apply the Conditionality Regulation. In

that context the next three sections, using Hungary as an example, will explore the guidance that the Conditionality Regulation itself as well as other financial legislation and rules give us to determine the extent of the interruption, suspension or correction that would stand in a reasonable relation to the breach of principles of the rule of law laid down in the Regulation.

¹⁸ Guidelines, at para 31, referring to Case C-156/21, para. 262.

¹⁹ Conditionality Regulation

²⁰ Guidelines at para. 13.

3 | The Conditionality Regulation's standard of proportionality

Given that the Commission has now triggered the Conditionality Regulation vis-à-vis a Member State with rule of law problems, a crucial question has arisen: *precisely how much of the EU's funding to these Member States should be suspended, reduced, interrupted or recovered pursuant to the Regulation?* If the Commission finds any remedial measures proposed by a Member State in response to its Art. 6(1) Written Notification inadequate, the Commission shall then propose to the Council a set of "appropriate measures". These measures can be proposed and implemented where breaches of the principles of the rule of law affect or risk affecting the sound financial management of the Union budget or the protection of the Union's financial interests.

But how extensive should these interruptions, suspensions, interruptions or financial corrections be according to the Regulation? The European Parliament raised this crucial question already in July 2021.²¹ It asked the Commission to clarify the criteria for determining appropriate measures in the case of rule of law breaches, "for instance those affecting the functioning of the justice

system, the independence of judges and of the judiciary or the neutrality of public authorities, or the proper functioning of entities with a mandate to prevent and fight corruption, fraud, tax evasion and conflicts of interest, or violating the principle of non-regression [which] have in general a sufficiently direct impact on the proper management, spending and monitoring of Union funds."²²

What would constitute a proportional response to that, and what considerations would have to be taken into account to assess that? The Regulation itself introduces various factors. Firstly, Article 5(3) states:

The measures taken shall be proportionate. They shall be determined in light of the actual or potential impact of the breaches of the principles of the rule of law on the sound financial management of the Union budget or the financial interests of the Union. The **nature, duration, gravity and scope** of the breaches of the principles of the rule of law shall be duly taken into account. The measures shall, insofar as possible, target the Union actions affected by the breaches.



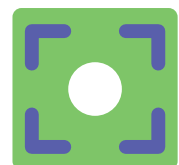
NATURE



DURATION



GRAVITY



SCOPE

²¹ European Parliament resolution of 8 July 2021 on the creation of guidelines for the application of the general regime of conditionality for the protection of the Union budget (2021/2071(INI)), P9_TA(2021)0348.

²² Id., at para 23.

Article 6(8) and 6(3) Regulation add that the Commission, in assessing the proportionality of measures to be imposed, is to take into account information and guidance from available sources, including decisions, conclusions and recommendations of Union institutions, other relevant international organisations and other recognized institutions. Article 6(7) illustrates the centrality of proportionality in the Regulation in that, if the Commission intends to propose to the Council that an implementing decision should be considered vis-à-vis a Member State to impose appropriate measures, a Member State is to be given the opportunity to submit its observations, “in particular” on the proportionality of envisaged measures.

Recital 18, which is to be taken into account in interpreting all of these articles, states:

The principle of proportionality should apply when determining the measures to be adopted, in particular taking into account the **seriousness of the situation, the time which has elapsed since the relevant conduct started, the duration and recurrence of the conduct, the intention, the degree of cooperation of the Member State concerned in putting an end to the breaches of the principles of the rule of law, and the effects on the sound financial management of the Union budget or the financial interests of the Union.**

Notably, Article 5(3) and recital 18 do not use the same criteria for assessing proportionality. Nor is it immediately clear how the different elements introduced in each relate to one another.

The Guidelines prepared by the Commission to interpret the Regulation dedicate a section to how proportionality should be understood.²³ The Commission defines proportionality of measures as meaning that they must be suitable and necessary to address the issues found, without going beyond what is required to achieve their aim. This is a conventional definition, borne out by the treaty text as well as numerous other guidance documents.²⁴ The Guidelines do contain some important pointers as to how the Commission intends to apply the Regulation. For example, it is stated that, “a systemic breach of the principles of the rule of law affecting in a cumulative manner and/or for a significant period of time the sound financial management of the Union budget or the financial interests of the Union may justify proposing measures entailing a significant financial impact for the Member State concerned”.²⁵ It is also stated that, even if the Regulation requires measures to target, insofar as possible, the ‘Union actions affected by the breaches’ (Article 5(3)), it is possible to contemplate measures also targeting *additional* programmes and funds, “in cases where [measures targeting those programmes or funds affected by the breaches of the principles of the rule of law] is not possible, including in case where the breach of the principles of the rule of law has an impact on the collection of the Union’s own Resources, the Conditionality Regulation permits the adoption of measures relating to Union actions *other* than those affect by the breach of the principles of the rule of law”.²⁶

23 Guidelines, para. 44-53.

24 See, for example, the EU Glossary: “[The principle of proportionality] seeks to set actions taken by EU institutions within specified bounds. Under this rule, the action of the EU must be limited to what is necessary to achieve the objectives of the Treaties. In other words, the content and form of the action must be in keeping with the aim pursued”, at: <https://eur-lex.europa.eu/summary/glossary/proportionality.html> See also European Data Protection Supervisor, Assessing the necessity of measures that limit the fundamental right to the protection of personal data: A Toolkit (2017), p.6: Proportionality in a broad sense encompasses both the necessity and the appropriateness of a measure, that is, the extent to which there is a logical link between the measure and the (legitimate) objective pursued. ... Necessity implies the need for a combined, fact-based assessment of the effectiveness of the measure for the objective pursued and of whether it is less intrusive compared to other options for achieving the same goal”, at: https://edps.europa.eu/data-protection/our-work/publications/papers/necessity-toolkit_en.

25 Guidelines, para. 50.

26 Guidelines, para. 52, emphasis added.

4 The case of Hungary through the prism of the Conditionality Regulation proportionality criteria

Hungary is the Member State whose past track record raises the most serious questions about its overall compliance with rule of law principles in the spending of EU funds.

The Hungarian government's history of misspending EU funds in the last two EU budget cycles and its persistent unwillingness to correct the problems that EU institutions have identified indicates that Hungary has systemic rule of law problems that persist to this day. This systemic nature of the problems in Hungary is reflected in the fact that

Hungary now has the lowest score of any EU Member State in the World Justice Project's Rule of Law Index²⁷ and was the first EU Member State to be categorized as an autocratic regime by the Varieties of Democracy (V-Dem) Institute²⁸ as well as by Freedom House.²⁹ It is also reflected in the fact that Hungary has had the highest rate of "corrections" of EU funds in the last budget cycle, ending in 2020.³⁰ In 2019 alone, for example, Hungary had roughly 10 times the EU average in the rate of financial corrections, according to OLAF.³¹

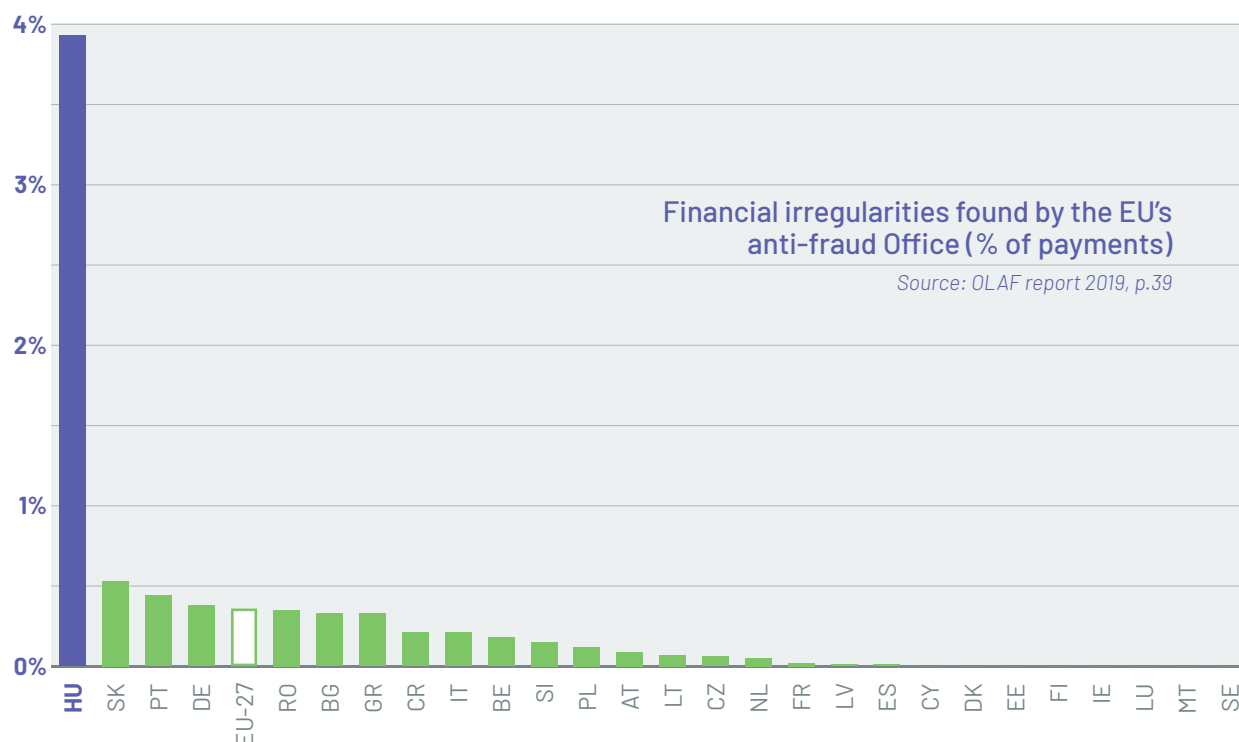
27 World Justice Project Rule of Law Index 2020, World Justice Project, Washington, DC. Available at https://worldjusticeproject.org/sites/default/files/documents/WJP-ROLI-2020-Online_0.pdf.

28 V-Dem downgraded Hungary from a democracy to the category of "electoral autocracy" in 2019, explaining, "Hungary is no longer a democracy, leaving the EU with its first non-democratic Member State." See Varieties of Democracy Institute, *Democracy Report 2020. Autocratization Surges – Resistance Grows*, available at https://www.v-dem.net/media/filer_public/de/39/de39af54-0bc5-4421-89ae-fb20dcc53dba/democracy_report.pdf, at p.4. Hungary remained in the "electoral autocracy" category in 2020, see Varieties of Democracy Institute, *Democracy Report 2021. Autocratization Turns Viral*, available at https://www.v-dem.net/media/filer_public/c9/3f/c93f8e74-a3fd-4bac-adfd-ee2cfbc0a375/dr_2021.pdf.

29 Freedom House, *Nations in Transit 2020: Dropping the Democratic Façade*, available at https://freedomhouse.org/sites/default/files/2020-04/05062020_FH_NIT2020_vfinal.pdf. Freedom House downgraded Hungary from a democracy to a "transitional/hybrid regime" in 2020, explaining (p.2) that, Hungary's decline has been the most precipitous ever tracked in Nations in Transit; it was one of the three democratic frontrunners as of 2005, but in 2020 it became the first country to descend by two regime categories and leave the group of democracies entirely.

30 Commission Staff Working Document Country Report, Hungary 2020. Accompanying the Document: Communication From The Commission to the European Parliament, The European Council, The Council, The European Central Bank and the Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011 at p. 43, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1584543810241&uri=CELEX%3A52020SC0516>

31 The OLAF report 2019, available at https://ec.europa.eu/anti-fraud/sites/default/files/olaf_report_2019_en.pdf, page 39.



Now that the Commission has triggered the Conditionality Regulation vis-à-vis Hungary, the question may soon arise as to how to “weigh” the different rule of law failures in that Member State with a view to establishing their (financial) consequences under this new instrument. The Regulation in Article 5(3) provides a checklist of the major elements to examine in determining proportionality of cuts to Member States’ funding which specifies that, “[t]he nature, duration, gravity and scope of the breaches of the principles of the rule of law shall be duly taken into account.” Hungary’s failures in the domain of the rule of law touch on each of the elements of the framework that the Regulation mentions. We therefore address “nature, duration, gravity and scope” in turn:

The Nature of the Rule of Law Violations

The Conditionality Regulation defines the rule of law as adherence to, among other things, “principles of legality implying a transparent, accountable, democratic and pluralistic law-making process; legal certainty; [and] prohibition of arbitrariness of the executive powers. . . .”³² From the beginning of the present government’s tenure in 2010, different international actors have commented on the government’s instrumental use of law to achieve its goals,³³ as well as the government’s frequent changes of laws without observing that the rule of law requires a “transparent, accountable, democratic and pluralistic law-making process.”³⁴



³² Conditionality Regulation. Article 2(a).

³³ For example, the Venice Commission, assessing the Fourth Amendment to Hungary’s constitution in 2013 said that it was “the result of an instrumental view of the Constitution as a political means of the governmental majority and is a sign of the abolition of the essential difference between constitution-making and ordinary politics.” Venice Commission, Opinion on the Fourth Amendment to the Fundamental Law of Hungary, Adopted by Venice Commission at its 95th Plenary Session, 14-15 June 2013. Opinion 720/2013. CDL-AD(2013) 012 at para. 147.

³⁴ Conditionality Regulation, Article 2(1). But Freedom House’s Freedom in the World Report for Hungary 2021, available at <https://freedomhouse.org/country/hungary/freedom-world/2021>, noted that “Fidesz continues to dominate governance through a parliamentary supermajority that it acquired in problematic elections. Prime Minister Orbán, the party’s leader, exerts considerable influence over the legislature. The ability of the opposition to check government activities remains limited.”

This has included enacting a new constitution in 2012 and adding nine major amendments in less than a decade, several of these rewriting whole sections of this new constitution on which the ink had barely dried, and all without permitting the participation of opposition parties or any groups outside the government's small inner circle.³⁵ The passage of dozens of "cardinal laws" and their frequent amendment by the government's two-thirds parliamentary majority has confirmed both the imperviousness of the government to opposition or public input and the ability of the government to change the law from one day to the next whenever the previous day's law becomes inconvenient.³⁶ Constitutional drafting and lawmaking have taken place for more than a decade in Hungary without any consultation outside narrow government circles and often without following the procedures outlined in the Law on Legislation³⁷ because many laws – including many of the most important laws – are raced through Parliament in expedited procedures.³⁸

Legal certainty has been shattered when all stakeholders in Hungary and in the EU institutions know that the law can be changed at any point with little notice to affected parties because it has already happened many times.

A world in which the law can be modified to fit a governing party's program on any given day is also a world that encourages and enhances arbitrary executive power. Since the present government's reelection on 3 April 2022 with another two-thirds majority in Parliament, the government still possesses the power to change all laws, up to and including the constitution, very quickly without any opposition support.

In the last two years, even this pretense of normal lawmaking has been abandoned in favor of nearly unlimited executive decree power. Since March 2020, Hungary has been in a state of emergency that was first announced by decree of the Prime Minister,³⁹ then confirmed by the Parliament which delegated extraordinary powers to the Prime Minister to continue to govern by decree,⁴⁰ then confirmed again when the Parliament passed a more comprehensive Enabling Act⁴¹ creating a legal framework for the Prime Minister's new declaration of emergency powers which has been continuously renewed until now.⁴² In the end, the Parliament amended the Basic Law to permit the Prime Minister to govern indefinitely by decrees that may override any law.⁴³ Nearly two years into this state of emergency, executive decrees drafted with no

35 The Fourth Amendment in 2013 added substantially to the length of the constitution by amending more than 20 of its articles, many substantially. The Ninth Amendment in 2020 amended 10 articles of the constitution and replaced the entire section of the constitution on states of emergency. As the Venice Commission noted about the most recent amendment, "the Ninth Amendment to the Fundamental Law was submitted to Parliament as part of a major package introducing several legislative amendments, during a state of emergency declared earlier on that same day. The whole package was adopted by Parliament a few weeks later, without any public consultation, and came into force after one week only . . ." Venice Commission, Opinion in the Constitutional Amendments Adopted by the Hungarian Parliament in December 2020, adopted by the Venice Commission at its 127th Plenary Session, 2-3 July 2021. Opinion 1035/2021, CDL-AD(2021)029 at para 12.

36 For example, the substantial package of amendments to the laws on the judiciary, passed in December 2020 and referenced below, went from proposal to enactment in just a few weeks under a state of emergency and over the holidays without any input from opposition parties or public consultation. See Venice Commission, Opinion on the Amendments to the Act on the Organization and Administration of the Courts and the Act on the Legal Status and Remuneration of Judges adopted by the Hungarian Parliament in December 2020, adopted by the Venice Commission at its 128th Plenary Session, 15-16 October 2021, CDL-AD(2021)036, para 19.

37 Act CXXXI of 2010 on Social Participation in the Preparation of Legislation.

38 As Freedom House's 2021 Freedom in the World report noted: "Major legislation is frequently rushed through the parliament, leaving citizens and interest groups little time to provide feedback or criticism. Important proposals are hidden in long omnibus bills, and the government tends to submit substantial bills overnight."

39 Government decree 40/2020 (III. 20).

40 Act XII of 2020 (III.30) On Protecting against the Coronavirus. For an English translation, see <https://hungarianspectrum.org/2020/03/21/translation-of-draft-law-on-protecting-against-the-coronavirus/>.

41 Act LVIII of 2020 (XI.10) on the Transitional Provisions related to the Termination of the State of Danger and on Epidemiological Preparedness.

42 Government Decree 484/2020 (XI.10) on the State of Emergency.

43 Ninth Amendment to the Hungarian Constitution, December 2020 available in English at [https://www.venice.coe.int/webforms/documents/default.aspx?pdffile=CDL-REF\(2021\)045-e](https://www.venice.coe.int/webforms/documents/default.aspx?pdffile=CDL-REF(2021)045-e).

consultation outside the cabinet and put into force immediately are still the main form of lawmaking in Hungary.⁴⁴ This is not new. The “health emergency” that began in 2020 was overlaid on top of a “migration emergency” declared in 2015 which is still in force in 2022, even though the factual predicate for that first emergency had long since disappeared.

The ordinary legislative process has been functionally made unnecessary in Hungary

during these extended emergencies and the new constitutional framework now allows ordinary lawmaking to be suspended and overridden without check by prime ministerial declaration at any time he declares an emergency.⁴⁵ After the 3 April 2022 election, the government announced that it would amend the constitution yet again to enable it to declare yet another state of emergency due to the war in Ukraine.⁴⁶

A Member State in a permanent state of emergency is a country not governed by the rule of law.

In addition, the government has created by law a number of permanent powers to manage in an *ad hoc* way specific publicly funded projects – including those paid for by EU funds – by exempting them

by decree from statutory conditions that would otherwise apply.⁴⁷ By declaring any particular project to be a matter of “national economic interest,” the government of Hungary can remove existing legal constraints from that specific project. The power has been used to exempt publicly funded projects, including EU-funded projects, from regulatory and environmental review. The law now even gives the government of Hungary the power to change the specific authorities managing publicly funded projects, up to and including the substitution of a new government-appointed “commissioner” (*kormány megbízott*) to supervise the project. The power to exempt by decree particular actors and their projects from laws of general application or regulatory scrutiny extends to the activities of private actors. Most recently, the government issued a decree declaring that the recent market-concentrating acquisitions of the AiG telecoms company⁴⁸ are exempt from review by the competition authority and competitors may not challenge the mergers because they are of “national strategic importance.”⁴⁹

With an unstable legal framework that can be changed by sudden non-transparent legislation, that can be overridden by emergency decrees and that

44 In 2021 alone, during the state of emergency, the Prime Minister issued 832 decrees (rules with normative force) and 2012 decisions (determinations in individual cases). Those figures do not include the decrees and decisions of individual ministries or of independent agencies functionally under government control.

45 Under the Ninth Amendment to the Basic Law, the government may suspend the operation of statutes so that it does not matter what new statutes Parliament may pass (new Article 53(1)) and only the government may end the emergency that it itself declared under new Article 53(4).

46 “More Power for the Orbán Cabinet? Minister Submits 10th Constitutional Amendment Proposal.” *Daily News Hungary*, 3 May 2022 at <https://dailynewshungary.com/more-power-for-the-orban-cabinet-minister-submits-10th-constitutional-amendment-proposal/>.

47 Act LII of 2006, as amended in 2012.

48 AiG recently acquired majority stakes in Antenna Hungária, making it the leading telecom company in Hungary, surging “from obscurity to the leading ITC in Hungary in a matter of years through lucrative state orders.” Hungary’s 4iG to Take Control of State-Owned Telecom Infrastructure Company Antenna Hungária, bne IntelliNews, 26 August 2021 at <https://www.intellinews.com/hungary-s-4ig-to-take-control-of-state-owned-telecom-infrastructure-company-antenna-hungaria-219086/>.

49 “A government decree published on Tuesday afternoon described the acquisition of ownership of the 4iG telecommunications and IT group in Antenna Hungária (AH) as ‘of national strategic importance’, writes Hvg.hu. Thus, the Hungarian Competition Authority will not be able to investigate the circumstances of the deal, nor will competing companies challenge the agreement.” Fresno, 4iG acquires Antenna Hungária Considered to be of National Strategic Importance, 22 February 2022 at <https://fresno24.com/4ig-acquires-antenna-hungaria-considered-to-be-of-national-strategic-importance/>.

is riddled with *ad hoc* exceptions to general laws for specific projects,

the Hungarian legal system no longer exercises a meaningful rule of law constraint on arbitrary executive action.

Turbulent legality and motivated exceptions are not confined to particular funding streams or particular sectors of regulatory activity.

This legal instability applies across the board, including to all laws that regulate the spending and oversight of EU funds from all sources and to the application and enforcement of EU law.

Duration

The present Hungarian government has a long track record of mismanaging EU funds without taking sufficient steps to curb the abuse.



At the conclusion of the 2007–2013 Multi-Annual Financial Framework, the Hungarian government was fined €1.5 billion in financial corrections. At the conclusion of the 2014–2020 MFF, the Commission fined Hungary €1.4 billion in financial corrections after having found “systemic irregularities, in particular related to discriminatory or restrictive exclusion, selection or award criteria, and unequal treatment of bidders.”⁵⁰ In the period from 2016–2020, OLAF recommended Hungary for the highest rate of financial corrections as a percentage of EU

payments in the Structural and Investment Funds as well as in Agricultural and Rural Development Funds.⁵¹ For more than a decade now, Hungary has had a problematic record in the sound management of EU funds across the board regardless of funding stream.

The situation has not improved with the new MFF. In its 2021 Rule of Law Report on Hungary, the Commission emphasized that, “[r]isks of clientelism, favouritism and nepotism in high-level public administration as well as risks arising from the link between businesses and political actors remain unaddressed. Independent control mechanisms remain insufficient for detecting corruption.”⁵²

Hungary’s management of EU funds to date has already raised serious concerns in EU institutions over a long period of time, and the Commission has previously struggled to deal with the scope and scale of abuse of funds in Hungary through its more narrowly tailored instruments. The Conditionality Regulation now enables and requires the Commission to look more systemically at the controls a Member State has in place to safeguard the EU budget to determine whether funds should continue to flow if the problems are structural and affect all EU funds.

Hungary’s track record of mismanagement of EU funds over more than a decade more than amply supports the view that the problems that Hungary has are not temporary or likely to change without more serious control measures.

HUNGARY’S TRACK RECORD OF MISMANAGEMENT OF EU FUNDS DATES BACK OVER A DECADE



⁵⁰ Commission Staff Working Document Country Report, Hungary 2020. Accompanying the Document: Communication From The Commission to the European Parliament, The European Council, The Council, The European Central Bank and the Eurogroup 2020 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011 at p. 43, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1584543810241&uri=CELEX%3A52020SC0516>.

⁵¹ The OLAF annual reports are available at https://ec.europa.eu/anti-fraud/about-us/reports/olaf-report_en.

⁵² Commission Staff Working Document, 2021 Rule of Law Report, Country Chapter on the Rule of Law Situation in Hungary accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021SC0714>.

Gravity

Persistently unstable law in Hungary has resulted in a long track record of abuse of EU funds, which speaks to the issue of gravity as well as to the systemic nature of abuses. But the absence of mechanisms in Hungary for correcting these abuses makes the violations even more grave.

The institutions that stand guard over proper spending of EU funds by Member States – the public prosecution authority, the judicial system, the public procurement system and the audit authority – are not performing properly in Hungary.



1. The Public Prosecutor

For a Member State to be able to guarantee the proper spending of all EU funds, the public prosecutor must take corruption allegations seriously and investigate fraud and mismanagement of these funds no matter where investigations lead. But Hungary's highly centralized public prosecutor's office, long criticized for failing to tackle corruption, has not been reformed in line with recommendations that have been made since 2015 by GRECO.⁵³ OLAF files recommending prosecution have been ignored by Hungary,⁵⁴ leading to the recent



CJEU decision⁵⁵ requiring disclosure of a file implicating the prime minister's son in a far-reaching corruption case involving dozens of EU-funded contracts to provide LED lighting to Hungarian municipalities.⁵⁶ The CJEU decided as it did precisely because the case had been closed by the prosecutor in Hungary.⁵⁷ After the Conditionality Regulation passed, however, and it became evident that potential funding cuts were possible, the public prosecutor launched a single, major high-level corruption case involving the deputy justice minister⁵⁸ and then, when the Commission triggered the Conditionality Regulation, the public prosecutor launched just one more.⁵⁹ But two cases, brought after the Conditionality Regulation was enacted and Hungary was already under examination by the Commission, barely changes the decade-long record of impunity for high state officials and their close associates. Despite his much-criticized record in dealing with corruption and despite the fact that GRECO had recommended a change in the law so that no prosecutor would be eligible for reelection, the Parliament nonetheless reelected the prosecutor again in 2019 with support of only the governing party.

The hierarchical, centralized, and discretionary control of the prosecutor's office in general, which were the features that GRECO indicated were particularly worrisome, have not yet been addressed.

53 GRECO Fourth evaluation round – Evaluation report of 27 March 2015, Greco Eval IV Rep (2014) 10E, available at <https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=09000016806c6b9e>.

54 European Anti-Fraud Office – OLAF, The OLAF Report 2017, p. 15. Available at https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf (discussing judicial recommendations sent to the General Prosecutor of Hungary in connection with public lighting infrastructure projects co-financed by the European Structural and Investment Funds. The Prosecutor ultimately declined to pursue prosecutions in connection with this clear case of fraud against the EU budget.)

55 Case T-517/19 Homoki v. Commission, 1 September 2021 (General Court).

56 The file can be found at https://tasz.hu/a/files/Final_Report_OCM201726804_redacted.pdf.

57 Lili Bayer, EU pursues Orbán son-in-law case despite Hungary ending probe. *Politico.EU*, 8 November 2018 at <https://www.politico.eu/article/istvan-tiborcz-viktor-orban-olaf-eu-pursues-orban-son-in-law-case-despite-hungary-ending-probe/>.

58 Péter Cseresnyés, Völner Case: Thousands of Page of Wiretap Transcripts and Months of Investigation, *Hungary Today*, 8 December 2021 at <https://hungarytoday.hu/volner-case-thousands-of-pages-of-wiretap-transcripts-and-months-of-investigation/>.

59 Júlia Tár, PM's Office Department Head Arrested on Suspicion of Corruption. *Hungary Today*, 9 May 2022 at <https://hungarytoday.hu/corruption-charges-finance-ministry-hungary-hungarian-politics-orban-government-govt/>.

2. The Judiciary



Since 2010, the Hungarian government has attacked the independence of the judicial system from top to bottom. The campaign to undermine judicial independence began by changing the rules for the election of Constitutional Court judges so that the governing party could pack the court with its own loyalists.⁶⁰ Within a few years, the Constitutional Court was captured and has no longer been a constraint on the government.⁶¹ In 2016, the Constitutional Court ruled that the Hungarian constitution may supersede EU law whenever the Court says it does, denying EU law supremacy, and placing in doubt whether EU law will be enforced when the government finds it disadvantageous.⁶²

With regard to the ordinary courts, the Hungarian government in 2011 suddenly lowered the judicial retirement age, effective immediately and effectively firing 427 judges – including many court leaders. This process was not stopped or reversed by the Commission's subsequent successful infringement action at the Court of Justice.⁶³ The centralization of the judicial selection process that replaced those judges and all other subsequent judges has been criticized ever since the new National Office of the Judiciary (NOJ) was created in 2011 and filled with

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JUDGES EFFECTIVELY FIRED

a political appointee close to the government who has the nearly unlimited power to control judicial careers.⁶⁴ In 2019, the weak National Judicial Council rebelled against the president of the NOJ when she repeatedly abused her power to appoint into key positions temporary judges who had been rejected by their fellow judges. The National Judicial Council requested that the Parliament remove the president of the NOJ from office, but the Parliament backed its political appointee and rejected the evidence of the judges.⁶⁵ A judge on the National Judicial Council who later referred questions to Luxembourg was threatened with a disciplinary procedure for raising the question of the independence of the Hungarian judiciary before the CJEU. The CJEU has since condemned the practice⁶⁶ but the structure that produced this result, in which

temporarily appointed court presidents can launch disciplinary procedures against their peers and subordinates, has not changed.

Twice in the last decade, the Hungarian government has changed the law to allow it to install a particular Supreme Court president whose qualifications for office were adjusted in an irregular way to allow the appointment of a particular individual, most recently in selecting the Supreme Court president who took office in 2021 so that he did not have to go through

2 
LAW CHANGES
IN THE LAST DECADE TO ALLOW THE GOVERNMENT TO INSTALL A PARTICULAR SUPREME COURT PRESIDENT

60 Act of 2010 (VI.20) on the Election of Constitutional Judges. This was followed by an amendment of the inherited constitution to change the number of judges from 11 to 15, giving the governing party just enough seats to fill to gain a majority.

61 Hungarian Helsinki Committee, Hungary's Government Has Taken Control of the Constitutional Court. 25 March 2015 at <https://helsinki.hu/en/hungarys-government-has-taken-control-of-the-constitutional-court/>.

62 Decision 22/2016 (XII. 5.) AB. For an English translation, see http://hunconcourt.hu/uploads/sites/3/2017/11/en_22_2016.pdf.

63 Case C-286/12, Commission v. Hungary (judicial retirement age).

64 In its 2021 report on the new laws regulating the judiciary, the Venice Commission noted that many of its most important criticisms of the concentration of powers in the president of the National Judicial Office made first ten years earlier had still not been addressed. Among other things, the powers of the president of the NOJ to cancel searches and appoint temporary judges into vacant positions when she and the National Judicial Council disagreed "should be removed." And the "supervision of judges by chairs and division heads of courts . . . should be removed." Venice Commission, Opinion on Amendments to the Act on the Organization and Administration of Courts, 15-16 October 2021 at para. 18.

65 Hungarian Helsinki Committee, A Constitutional Crisis in the Hungarian Judiciary, 9 July 2019 at <https://helsinki.hu/wp-content/uploads/A-Constitutional-Crisis-in-the-Hungarian-Judiciary-09072019.pdf>.


66 Case C-594/19, IS, CJEU (Grand Chamber), 23 November 2021.

a vetting procedure involving judges.⁶⁷ Recent changes in the system of case assignment, not automated but instead controlled directly by court presidents in Hungary, now mean that

this new Supreme Court president can assign any case to a hand-picked panel of judges.

He was given this power after he was permitted to enlarge his own court by 23% and given the power to select the new judges himself.⁶⁸

**SUPREME COURT
ENLARGED BY
23%**



Irregular appeals have been widely legalized throughout the Hungarian legal system. A legal action created by law in 2019 now permits the government to take any case which it has lost directly to the packed Constitutional Court to get a ruling on whether the government's "rights" have been violated.⁶⁹ A new "complaint for the unification of jurisprudence" action allows the Supreme Court with its new hand-picked president to issue interpretations of law that are binding on all courts. Because the Supreme Court president also has the power to choose the judges

on such panels, he has the power to practically dictate the result.⁷⁰ A newly created "appeal in the interests of the law"⁷¹ permits a public prosecutor to leapfrog a judgment of a lower court judge directly to the Supreme Court to challenge the legality of the lower court judge's rulings. It was this procedure that gave the Supreme Court the opportunity to chastise a referring judge for sending questions to Luxembourg that, in the view of the Hungarian Supreme Court, were unnecessary. The Court of Justice judgment that resulted from this case condemned the practice as a violation of EU law.⁷² Given that these irregular appeals take cases immediately to the two courts that have been most politically manipulated over the last decade, these irregular appeals can be expected to result in politically tainted rulings.

In short,

the independence of the judiciary in Hungary has been severely compromised, so that it cannot guarantee – and in fact has already shown an unwillingness at the highest levels to ensure – the correct implementation of EU law.

67 For the first change in qualifications to remove the sitting Supreme Court President see, *Baka v. Hungary*, app. no. 0261/12 (Grand Chamber), 6 June 2016 in which the ECtHR found that the previous president of the Court had been fired for criticizing the government under the guise of a neutral rules change in qualifications for office that affected only him. The Hungarian government has not yet complied with the ruling to bolster the protection of judges when they make decisions and/or criticisms that the government doesn't like. In a hearing in September 2021, the Committee of Ministers of the Council of Europe noted "a continuing absence of safeguards in connection with *ad hominem* constitutional-level measures terminating a judicial mandate" and pressed the Hungarian government to adopt "effective and adequate safeguards against abuse when it comes to restrictions on judges' freedom of expression." Supervision of the Execution of the European Court's Judgments, H46-16 *Baka v. Hungary* (App. No 0261/12), 14-16 September 2021 at point 3, CM/Del/Del(2021)1411/H46-16 at https://search.coe.int/cm/pages/result_details.aspx?objectid=0900001680a3c123. In the most recent case of creating apparently neutral rules to reach a specific person in a specific case, government changed the qualifications for ordinary court judges in Act CXXVII of 2019 to permit constitutional judges, for the first time, to parachute from their positions on the Constitutional Court – for which there is no judicial vetting by the National Judicial Council – directly into a judgeship in any ordinary court, even if the constitutional judges have had no experience in the ordinary judiciary and thus did not otherwise meet the minimum qualifications set for those positions. In 2021, the governing party's parliamentary supermajority elected a constitutional judge as the current president of the Supreme Court over the unanimous objection of the National Judicial Council.

68 Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021, p. 4, https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf.

69 Act CXXVII of 2019.

70 Act CXXVII of 2019. For an analysis of this provision see Contributions of Hungarian NGOs to the European Commission's Rule of Law Report, March 2021. Testimony submitted to the European Commission in the framework of the targeted stakeholder consultation the European Commission launched in relation to its 2021 Annual Rule of Law Report. Available at https://transparency.hu/wp-content/uploads/2021/03/HUN_NGO_contribution_EC_RoL_Report_2021.pdf.

71 Article 667(1) of the Hungarian Code of Criminal Procedure.

72 The facts of the case are given Case C-594/19, *IS*, CJEU (Grand Chamber), 23 November 2021,

3. The Public Procurement System



The European Commission has criticized Hungary's public procurement system dating back to the 2014 country-specific recommendations.⁷³ After Hungary changed its public procurement law in 2015 to comply with the 2014 EU Procurement Directives,⁷⁴ a study conducted for the European Commission noted in 2016:

Hungary distinguished itself from other Member States for its significant use of negotiated procedures without publication, accelerated negotiated and accelerated restricted procedures, which are considered among the least conducive to openness and competition. They also have one of the highest rates of procedures that involve only a single bidder.⁷⁵

This report noted that Hungary at that time was second among Member States in the percentage of respondents reporting that giving a gift or doing a favor is an acceptable practice in order to get a government service, which puts Hungary "far above EU norms."⁷⁶ Bid rigging was reported as the most common form of public procurement corruption and "a high number of contracts have been awarded to a relatively small

number of companies in recent years, which may be an indicator of insufficient competition or potential corruption."⁷⁷ In addition, "direct award of contracts continues to be broadly used, often without sufficient justification . . . [and] the extensive use of negotiated procedures leads to higher costs and a distortion in the functioning of the market by excluding potential contractors."⁷⁸

A March 2022 study by the Corruption Research Center Budapest dug deeper into the Commission's observations that a high number of contracts was awarded to a small number of companies and found that

Political favoritism is ... evident in the use of EU funds. From 2011 to 2021, in the Orbán Regime, the crony companies benefited from a large and increasing share of EU subsidies. These 42 companies owned by politically connected owners are among the most important beneficiaries of EU subsidies. These 42 firms alone won 21 percent of the net value of EU-funded contracts from 2011 to 2021 (without framework agreements) and 12 percent with framework agreements.⁷⁹

⁷³ Council Recommendation of 8 July 2014 on the National Reform Programme 2014 of Hungary and delivering a Council Opinion on the Convergence Programme of Hungary, 2014. 2014/C 247/15 at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014H0729%2815%29>.

⁷⁴ Act CXLIII of 2015 on Public Procurement.

⁷⁵ European Commission, Public Procurement: Study on An Administrative Capacity in the EU: Hungary Country Profile, p. 100 at https://ec.europa.eu/regional_policy/en/newsroom/news/2016/04/14-04-2016-public-procurement-a-study-on-administrative-capacity-in-the-eu.

⁷⁶ Id at 103.

⁷⁷ Id.

⁷⁸ Id at 106.

⁷⁹ Corruption Research Center, Budapest, Corruption Risk and the Crony System in Hungary: A Brief Analysis of EU-funded Contracts in Hungarian Public Procurement 2005-2021" 7 March 2022, p. 4 at https://www.crcb.eu/wp-content/uploads/2022/03/2022_research_notes_03_220307_02.pdf.

The Commission's 2021 Rule of Law Report for Hungary noted that "the perception of public sector corruption ... remains high."⁸⁰ The Commission noted that the narrowing of the scope of public procurement rules under the law establishing and regulating the public interest asset management foundations⁸¹ (about which, more below) was problematic because it removed a whole swath of publicly awarded contracts from regulation under both public procurement and conflict of interest rules.

In addition, the Commission noted

... the Hungarian authorities frequently withdraw projects from EU funding when OLAF issues a financial recommendation, or sometimes when the authorities become aware that an OLAF investigation has been opened. Furthermore, it appears that amounts due are not systematically recovered from the economic operator who committed the irregularity or fraud. In such cases, the EU subsidy is simply replaced by national funds, with a negative impact on the deterrent effect of an OLAF investigation and higher risks for the national budget.⁸²

The financial corrections applied to Hungary in the last MFF cycle were the highest in the EU, even after the Hungarian government had developed the practice of simply withdrawing challenged projects from EU funding and therefore taking those projects out of the statistics. As a result, the extraordinarily large corrections applied to Hungarian spending of EU funds were applied on a substantial understatement of the irregularities found in the public procurement system.

4. The Audit Office



The primary audit office in charge of overseeing the use of EU funds is EUTAF, the Directorate General for Audit of European Funds. But this office itself has no stable basis in Hungarian law nor is it structurally independent. The office was created by a decree of the Prime Minister shortly after his government was elected in 2010,⁸³ which means that a subsequent decree of the Prime Minister could change the office and anything about it without parliamentary approval or any other public consultation process. EUTAF sits institutionally within the Finance Ministry, which is itself one of Hungary's key managing authorities.⁸⁴ A decree of the Finance Ministry governs EUTAF's internal operations and requires the Director General of EUTAF to report directly to the Deputy State Secretary of the Finance Ministry, a political appointee who is not a career civil servant. The Finance Minister himself has the power to dismiss the Director General of EUTAF.⁸⁵ But the regulation gives no guidance, procedure, or standards for determining when the Director General may be fired. In short, the audit office that controls European funds is created by prime ministerial decree, regulated by a decree of the finance minister who is a member of the same cabinet, and the Director General of this audit office can be fired at any time by the finance minister.

The independence of the office is guaranteed neither by law nor by its institutional position, nor is the tenure of its head protected by law in any way.

It is hard to conclude that this is truly an independent audit office.

80 European Commission, Country Chapter on the Rule of Law Situation in Hungary, accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions [2021 Rule of Law Report] at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021SC0714>.

81 Act VIII of 2021 amending higher-education and certain related laws.

82 Rule of Law Report 2021 at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021SC0714#footnoteref119>.

83 Government Decree 210/2010 (VI. 30.)

84 For a list of Hungary's managing authorities, see https://ec.europa.eu/regional_policy/en/atlas/managing-authorities/.

85 9/2019 (VI.28) Finance Ministry regulation, as amended through 7/21. Section 13(1).

Without a structurally independent public prosecutor, judiciary, public procurement system, or audit office, it is hard to ensure the proper spending of EU funds across the board. The evident malfunctioning of these institutions as seen in Hungary's past record of financial mismanagement raises serious doubts about whether these institutions are properly doing their jobs.

The fact that oversight of the entire system of spending public funds is not meaningfully independent of the government seriously risks affecting the EU's budget and financial interests.

Scope

If a Member State violates EU law in the way it handles one particular EU funding stream, then a proportional response might involve cutting the funds to that particular program. But when a government's rule of law problems implicate general institutions that cut across the entirety of public spending, including EU funds, then cutting 100% of all EU funding streams is the appropriate and proportionate response.

As this analysis has demonstrated, unstable lawmaking, the prolonged use of emergency powers, the legal ability of the government to exempt any project from regulation, as well as its long-standing record of corruption and the lack of independence of general institutions that govern all EU programs – the prosecutor, judiciary, the procurement system and audit office – demonstrate that the scope of problems affecting sound management of the EU budget in Hungary is extremely wide. In fact,

all EU-funded programs are affected one way or another by the comprehensive and transversal nature of the violation of basic rule of law principles in Hungary that comes from failure to ensure independent institutions.

Two important case studies can illustrate how all of these elements come together to directly threaten the sound management of EU funds:

1. Starting in 2019, the Hungarian government repurposed an existing legal form, the *közérdekű vagyonkezelő alapítványok* or, literally, public interest asset management foundations. These “public interest foundations” are structured in such a way that they can escape oversight as they spend public funds. Public interest foundations are regulated under the Hungarian Civil Code⁸⁶ and are thus private institutions. But a set of sudden and unanticipated legal changes in late 2020 and early 2021, during a state of emergency and made without opposition input or social consultation, altered how these institutions work. The Ninth Amendment to the Basic Law in December 2020 designated the law creating the public interest foundations as “cardinal” (that is, the law now requires a two-thirds vote of the Parliament for any modification). The Ninth Amendment at the same time defined “public funds” in Hungarian law to exclude all assets of these public interest foundations because they are now held in “private” hands. Under a new law on these foundations that passed immediately afterwards,⁸⁷ Parliament can create new foundations at a moment's notice and transfer state assets to them, which then become the private property of the foundations and their boards, unreachable through public audits or freedom of information requests. Through this legal sleight of hand, all but a few of Hungary's public universities were suddenly privatized, and taken out of the jurisdiction of both public procurement rules and conflict of interest rules as noted above. Given that the new EU Recovery Fund's priorities would predictably result in the widespread availability of EU funds for universities and university-based research, the Hungarian government had devised a way through a few non-transparent and sudden legal changes to allow EU funds to flow into an accountability void. The EU might decide, in reaction to this

⁸⁶ Act V of 2013, Hungarian Civil Code.

⁸⁷ The 2021 Act on Public Interest Asset Management Foundations (Act IX of 2021).

change, that only public universities should receive EU funds from now on, avoiding these newly privatized universities. But under this new legal structure it would take only a few days for these public funds to suddenly find themselves in private hands if the Hungarian Parliament suddenly decided to turn a university into a public interest foundation after it had received EU funds. As long as such sudden transformations of the legal foundations of final beneficiaries are possible in Hungarian law – and not only possible but used repeatedly – it is not possible to guarantee that EU funds are safe from having their management structures and accountability mechanisms altered in midstream even if the EU takes care to ensure that funds are allocated through proper accountability channels at the start. As we have seen, this sort of arbitrary and sudden legal change can appear out of thin air and change virtually anything. Such legal changes have a theoretically limitless scope.

2. Another example of a substantive policy area in Hungary where rule of law breaches put at risk the EU's financial interests and the EU budget concerns the auctioning of state lands falling under the Common Agricultural Programme (CAP). As has been widely reported by, inter

alia, the European Parliament,⁸⁸ scholars,⁸⁹ and international media⁹⁰, agricultural subsidies and rural development funding disbursed in the framework of the CAP in Hungary have been channeled to a small number of large-scale land buyers and lessees closely associated with the governing party. This small cohort of government-connected individuals secured the vast majority of arable land distributed by the government during the 2015 land privatization, and thereafter received the vast majority of EU CAP subsidies associated with control of that land.

As these examples illustrate, the risk that EU funds will be misdirected are not only exceptionally high but those risks run right across the major streams of EU funding, from the cohesion funds through to agricultural funds and beyond. The reason these irregularities are found across the board in Hungarian spending of EU funds is because the core institutions that preside over all EU spending are not functioning as they should. Like the lead pipes that contaminate all water that passes through them, Hungarian public institutions responsible for the distribution, management and accountability of EU funds contaminate all of the money that Hungary receives from the EU.

88 Extent of Farmland Grabbing in the EU, Report by DG for Internal Policies, Policy Department B: Structural and Cohesion Policies, 2015. Available at: [https://www.europarl.europa.eu/RegData/etudes/STUD/2015/540369/IPOL_STU\(2015\)540369_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2015/540369/IPOL_STU(2015)540369_EN.pdf)

89 Ángyán, József. "Állami földprivatizáció – intézményesített földrablás," Study prepared for Greenpeace Hungary, 5 December 2016, available at: https://www.greenpeace.org/static/planet4-hungary-stateless/2018/10/62f29d48-62f29d48-angyan-jelentes_foldarveresek_fejer.pdf; Gonda, Noémi, "Land grabbing and the making of an authoritarian populist regime in Hungary", *The Journal of Peasant Studies*, 46:3, (2019), pp.606-625, DOI: 10.1080/03066150.2019.1584190, <https://doi.org/10.1080/03066150.2019.1584190>

90 Gebrekidan, Selam, Matt Apuzzo, and Benjamin Novak, "The Money Farmers: How Oligarchs and Populists Milk the E.U. for Millions," *New York Times*, 3 November 2019.

5 Guidance on “proportionality” from other EU financial instruments

The analysis so far may give the impression that, even if general criteria for what is to be taken into account regarding “proportionality” are clear and problems in Hungary are evident, the Commission will have a lot of slow-going work to do to connect the two. However – *and this is the central argument of this study* – that effort would amount to reinventing the wheel and would be totally unnecessary. There are numerous examples in existing EU financial legislation and guidance that lay down in considerable detail under which conditions and circumstances EU funding should be suspended, reduced, interrupted, or recovered, and by what percentage. In particular,

there is firm precedent that in case of (a) serious deficiency(ies) so fundamental, frequent or widespread that it/they represent a complete failure of the system of Member State level monitoring of the spending of EU funds, a 100% suspension should be the result

until the time such deficiencies are fully remedied. In accordance with Articles 6(8) and 6(3) Regulation, the Commission is obliged to build on such current practice. This section and the next will show this.

Various EU financial instruments, and measures implementing these, already contain extensive guidance on situations and percentages relating to financial corrections, as well as methods to assess when problems that justified suspending, reducing, or interrupting payments are sufficiently solved to lift any restrictions. It concerns, in particular, the Common Provisions Regulation (CPR), Commission Implementing Regulation (EU) 2017/656, Commission Decision C(2019)(3452), and the Financial Regulation. These will be discussed in turn.

Article 104(1) of the CPR states that the Commission is to make financial corrections by reducing support to a programme in cases of (a) serious deficiency in the Member State’s conduct in implementing the EU budget. In such cases the Commission is to act in accordance with Annex XXV of the CPR. Said Annex, under point 2, lays out elements for consideration when applying a flat rate correction. In this regard it mentions the gravity of the serious deficiency(-ies) in the context of the management and control system as a whole, the frequency and extent of the serious deficiency(-ies), and the degree of financial prejudice to the Union budget. For present purposes the key part is point 3 that distinguishes different scenarios with different percentages, as follows:

"3. The level of flat rate financial correction is determined as follows

(a) where the serious deficiency(-ies) is **so fundamental, frequent or widespread that it represents a complete failure of the system that puts at risk the legality and regularity of all expenditure concerned**, a flat rate of 100 % is applied;

(b) where the serious deficiency(-ies) is **so frequent and widespread that it represents an extremely serious failure of the system that puts at risk the legality and regularity of a very high proportion of the expenditure concerned**, a flat rate of 25 % is applied;

(c) where the serious deficiency(-ies) **is due to the system not fully functioning or functioning so poorly or so infrequently that it puts at risk the legality and regularity of a high proportion of the expenditure concerned**, a flat rate of 10 % is applied;

(d) where the serious deficiency(-ies) is **due to the system not functioning consistently so that it puts at risk the legality and regularity of a significant proportion of the expenditure concerned**, a flat rate of 5 % is applied."

Point 3 of Annex XXV also contains further instructions as to method and automaticity:

"Where, due to a failure of the responsible authorities to take corrective measures following the application of a financial correction in an accounting year, the same serious deficiency (-ies) is identified in a subsequent accounting year, the rate of correction may, due to the persistence of the serious deficiency(-ies) be increased to a level not exceeding that of the next higher category.

Where the level of the flat rate is disproportionate following consideration of the elements listed in section 2, the rate of correction may be reduced."

This is by no means the only example of detailed guidance. In Commission delegated regulation 2017/646⁹¹, the Commission put in place a methodology to calculate by what percentage funding should be suspended in implementing the annual clearance of accounts procedure and the implementation of the conformity clearance in the area of Regulation 514/2014. That Regulation lays down general provisions on the Asylum, Migration and Integration Fund and on the instrument for financial support for police cooperation, preventing and combating crime and crisis management. This implementing regulation, which applies in an area with clear rule of law elements, includes very specific criteria for applying and determining the level of financial corrections. Mirroring the logic of Annex XXV of the CPR to a considerable extent, article 3(b) lays down criteria for applying and determining the level of financial corrections. Its paragraph 3 reads:

91 COMMISSION IMPLEMENTING REGULATION (EU) 2017/646 of 5 April 2017 amending Implementing Regulation (EU) 2015/378 laying down rules for the application of Regulation (EU) No 514/2014 of the European Parliament and of the Council with regard to the implementation of the annual clearance of accounts procedure and the implementation of the conformity clearance, OJ [2017] L 92/36, at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R0646&from=NL#d1e34-39-1>

"The level of correction shall be determined as follows:

(a) where the irregularity or irregularities or the system deficiency or deficiencies is/are **so fundamental, frequent or widespread that it/they represent(s) a complete failure of the system that puts at risk the legality and regularity of all the expenditure concerned**, a flat rate of 100 % shall be applied;

(b) where the irregularity or irregularities or the system deficiency or deficiencies is/are **so frequent and widespread that it/they represent(s) an extremely serious failure of the system that puts at risk the legality and regularity of a very high proportion of the expenditure concerned**, a flat rate of 25 % shall be applied;

(c) where the irregularity or irregularities or the system deficiency or deficiencies is/are **due to the system functioning partially, poorly or infrequently so as to put at risk the legality and regularity of a high proportion of the expenditure concerned**, a flat rate of 10 % shall be applied;

(d) where the irregularity or irregularities or the system deficiency or deficiencies is/are **due to the system functioning inconsistently so as to put at risk the legality and regularity of a significant proportion of the expenditure concerned**, a flat rate of 5 % shall be applied.

..."

Other instruments of EU financial regulation also contemplate 100% correction measures. Yet, these do not describe in general terms the scenarios in which this can be applied, but rather the specific instances and problems that justify such measures. An example is Commission Decision C(2019)(3452)⁹² and its annex⁹³, which lays down guidelines for determining financial corrections in case of irregularities with regard specifically to public procurement. The extensive annex to that Decision lists various cases where a 100% correction is justified, e.g. when the contract notice is not published, when there is no paper trail, and in case of conflict of interests. Arguably, these scenarios closely mirror those laid down in Article 4(2) of the Conditionality Regulation. This Commission Decision therefore provides further evidence that in case of an exceptionally fundamental problem for spending EU money, a 100% suspension, reduction

or interruption is already seen as proportional, and therefore appropriate.

Apart from guidance on how to assess what proportionality requires in defining the appropriateness of measures, there are also pointers as to what would be required to remedy the situation in order to get EU funds flowing again. As explained above, the Financial Regulation (as of Article 135) contains extensive rules on how to deal with individuals or companies that have been detected to be involved in fraud with EU monies, the so-called Early Detection and Exclusion System. In a recent report the dedicated panel to ensure fair treatment in such cases reflected as follows on how to deal with the situation when it suspended individuals or companies and now needs to decide whether to let them re-enter the marketplace:

92 C(2019) 3452 final, COMMISSION DECISION of 14.5.2019 laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement, available at: https://ec.europa.eu/regional_policy/en/information/publications/decisions/2019/commission-decision-of-14-5-2019-laying-down-the-guidelines-for-determining-financial-corrections-to-be-made-to-expenditure-financed-by-the-union-for-non-compliance-with-the-applicable-rules-on-public-procurement

93 C(2019) 3452 final ANNEX, ANNEX to the COMMISSION DECISION laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement, available at: https://ec.europa.eu/regional_policy/en/information/publications/decisions/2019/commission-decision-of-14-5-2019-laying-down-the-guidelines-for-determining-financial-corrections-to-be-made-to-expenditure-financed-by-the-union-for-non-compliance-with-the-applicable-rules-on-public-procurement

The Panel specified that, even if an entity has adopted measures that have the potential effect of preventing future wrongdoing as part of strong internal-control systems, it is indispensable that the entity also takes: (i) all the concrete technical and personnel measures appropriate to correct the conduct and prevent its further occurrence; or (ii) measures to address the underlying problems raised in the decision of exclusion. In other words, the person or entity concerned must be able to convince the Panel, and the authorising officer responsible, that the remedial measures are effective, well implemented, and – where entities are concerned – embedded in the corporate culture of the company.⁹⁴

Such considerations about whether and when sufficient remedial measures have been put in place, and how the burden of proof should be understood to have shifted after a finding justifying the discontinuing of handling of EU monies, are effectively the flipside of proportionality considerations. Arguably, this reasoning can be made directly applicable to considering when appropriate measures against a Member State under the Conditionality Regulation can be lifted (Article 7).

What emerges from a combined reading in this analysis is that, under current legislation and guidelines, certain fundamental, frequent or widespread issues that represent a complete failure of the system of management of EU funds by Member States are considered to threaten the regularity and legality of EU budget itself and therefore explicitly warrant 100% suspension, reduction, interruption, and recovery. In such cases, 100% suspension is considered both “appropriate” and “proportionate”.

Fortunately, these situations are likely to be exceptional. In situations where the deficiency is not seen as so fundamental that it represents a complete failure of the financial management system, suspensions, reductions, interruption, and recoveries of less than 100% will likely be proportionate and appropriate. But the other guidance also shows that, in case a problem is not at a certain stage, immediately of such a fundamental nature as to represent a complete failure of the system, a Member State not properly remedying it may risk facing a 100% suspension later on. Likewise, if the Commission recommends and the Council adopts a 100% suspension, and the member state in question later remedies the offending situation in part (though not completely), the Commission can then “submit to the Council a proposal for an implementing decision adapting the adopted measures.”⁹⁵

94 COMMISSION STAFF WORKING DOCUMENT, SWD (2021)259, Early Detection and Exclusion System (EDES) – Panel referred to in Article 143 of the Financial Regulation (Accompanying the document REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL 32nd Annual Report on the protection of the European Union’s financial interests – Fight against fraud – 2020, September 2021, p. 14, at: <https://op.europa.eu/en/publication-detail/-/publication/9ecb65f7-19f3-11ec-b4fe-01aa75ed71a1/language-en>

95 Guidelines, at para. 84.

6 Consequences of existing definitions of “proportionality”:

The specific systemic/structural nature of fundamental, frequent or widespread violations of rule of law principles in Hungary

The Regulation, in Articles 2, 3 and 4(2), lays down, respectively, a definition of the rule of law, the type of breaches of rule of law principles that this legislative instrument applies to, and the specific scenarios in which breaching this sub-set of rule of law principles affects or seriously risk affecting the implementation of the EU budget by Member States: proper and transparent management of EU funds avoiding corruption and fraud, effective national prosecution of any cases of misspending of EU money and independent and impartial judges looking into any such cases brought.

The key insight is that

when, like in Hungary, consistent violation takes place of the three types of rule of law issues earmarked in the Regulation as of special relevance to implementation of the budget, by definition this will constitute a serious deficiency so fundamental, frequent or widespread that it represents a complete failure of the Member-State-level financial monitoring system.

As a matter of common sense, it is hard to see how consistent problems with each of these listed items could happen in isolated or incidental fashion, and that therefore that their actual or potential impact on the budget would be coincidental or limited.

It is simply hard to think of a situation where widespread corruption only happens with national and not EU money, where only in relation to national and not EU money there is no independent prosecution of fraud and corruption, and where judges are not independent and impartial only in areas relating to national financial interests and not EU ones.

While some might be tempted to read the requirement that measures under the Regulation target Union actions affected by rule of law breaches “insofar as possible” (Art 5(3)) as a serious limitation on appropriate measures under the Regulation, this would be a misreading. Rather,

when rule of law breaches are fundamental, frequent or widespread in nature, then – like lead pipes – they poison everything that flows through them.

All Union actions seriously risk being affected by such systemic rule of law breaches in a Member State, and it will generally be impossible to target measures more narrowly.

In other words, the type of breaches of rule of law principles that were explicitly and deliberately chosen to be laid down in the Regulation are by their nature of specific significance to protecting the budget. Fundamental, frequent or widespread problems with them will lead to “lead poisoning” of any EU spending in the Member State concerned, representing a complete failure of the budgetary monitoring system. In such a scenario there will be a significant/genuine risk that each and every budgetary stream into that Member State will be become affected. In such circumstances, common instructions to assess the proportionality of any appropriate measures to protect the integrity of EU spending could and should be followed. As other EU legislation and guidance describes that in case of such rare systemic issues 100% suspension, reduction, interruption, or recovery of EU funds is warranted, this has to be considered both “appropriate” and “proportional” by the EU legislator and executive. Anything less than 100% would not accomplish the stated aim of the Regulation: the protection of the Union budget in the case of breaches of the principles of the rule of law in the Member States (Article 1).

It should be noted, finally, that nothing in the recent CJEU rulings on the Conditionality Regulation in any way calls into question this conclusion. The Court did emphasise the need to establish a sufficiently direct, “genuine” link between a breach of one of the principles of the rule of law and a serious risk to the EU budget.⁹⁶ While these might seem restrictive conditions on the surface, in fact the decisions have not in any way prejudged the extent or amount of any measures to be “appropriate” and “proportional”. In particular, the ECJ’s rulings in no way distract from observation that the Regulation lays down breaches of rule of law principles which by their nature are

systemic and will lead to “lead poisoning” of any EU spending in the Member State concerned. If the Council, under Article 6(10) or 6(11) were to adopt an implementing decision containing appropriate measures, and the targeted Member State were to challenge it, it will be up to the Court to be the final arbiter on proportionality. What is laid down in other EU financial instruments and guidance documents will then likely be extremely important indicators for the Court, and as such it is hard to imagine the Court would object to the proportionality of any 100% suspension, reduction or interruption of funds undertaken in keeping with the guidance and practice associated with existing instruments.

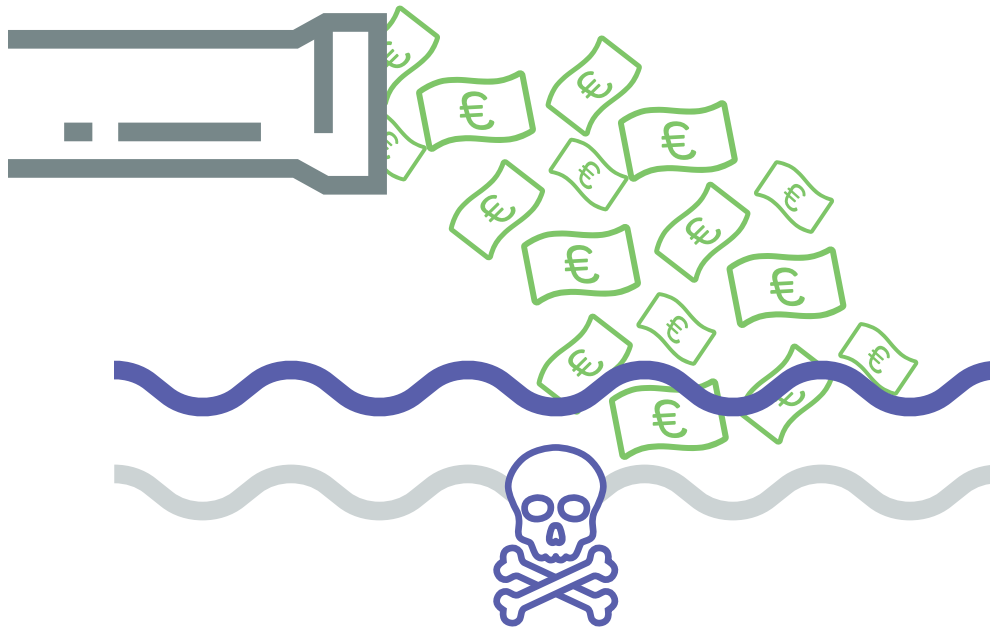
The many violations of EU law in the management of EU funds by Hungary over the last decade, violations that have been repeatedly confirmed by EU institutions, both separately and as a whole, indicate why 100% of the funds flowing to Hungary must be cut. Given where and how corruption works in Hungary, all of the major pipes through which EU funds flow that are contaminated by profound breaches of the basic principles of the rule of law.

It is impossible to isolate the Recovery Funds, the Agricultural Funds, the Structural and Investment Funds, or any other major program from the effects of unsound financial management that ripple through the entire legal system as well as the management and control systems in Hungary. All EU funds flow through the same corrupted lead pipes into Hungary for distribution to final beneficiaries, and the flows through non-independent, arbitrary and non-transparent institutions in Hungary contaminate the way that the funds can be used.

⁹⁶ Case C-156/21, Hungary vs European Parliament and Council of the European Union (ECLI:EU:C:2022:97, 16 February 2022, provisional text, at paras, 147, 176, 244, 267) and Case C-157/21 Poland vs. European Parliament and Council of the European Union (ECLI:EU:C:2022:98, 16 February 2022, provisional text, at paras 165, 299).

The absence of independent accountability institutions means that there is no way for the poison in the procurement and funds management systems to be filtered out. Given the criteria for determining proportionality laid out above, in which the nature of the violations of the rule of law as well as their duration, gravity and scope must be taken into account, the case for cutting 100% of

Hungary's EU funds is overwhelming. As with other EU fund-cutting mechanisms that have a schedule indicating what cuts would be proportional, a 100% cut is justified where the violations in the system are fundamental, frequent, and widespread and show signs that the institutions protecting the integrity of EU funds have totally failed.



7 Conclusions

In the case of persistent and widespread breaches of any of the rule of law principles mentioned in the Regulation which is currently the case in Hungary, only 100% suspension, reduction, interruption, or recovery of EU funds until each and any of these breaches are fully remedied would meet the stated aim of the Regulation – the protection of the Union budget.



This conclusion can be drawn:

- a. from the context and the wording of the Conditionality Regulation, including from the fact that its nature vis-à-vis other EU financial instruments is subsidiary and supplementary (recital 17)
- b. from interpreting the Regulation's instruction that "appropriate measures" be "proportional" (recital 18 & articles 5(3), 6(8) & 6(3) Regulation) with the help of other EU financial legislation and sector-specific and financial rules, which instruct that in case of systemic and structural problems 100% suspension, reduction, interruption or recovery should follow, and
- c. from the fact that the Regulation has selected a subset of breaches of rule of law principles that are specific in that they are of a structural and systemic nature. If any of these aspects are faulty, they act like "lead pipes" channeling the flow of all EU monies into a Member States, and "contaminating" the integrity of such spending in a way that risks seriously affecting the sound financial management of these EU monies in a sufficiently direct way.

Existing EU law provides the methodology to deal with such scenarios. The proportionality test in the Conditionality Regulation calls for no new analysis.

All that is required is for the EU institutions to act in line with law and practice as it already existed, uncontroversially, before the Conditionality Regulation was introduced.

In case of systemic rule of law problems in a Member State such as Hungary – where there are major problems with the management system of EU funds, where there is a great lack of investigation and prosecution of any financial malpractice, and where any such case would in any event face courts that are not independent in a context in which the law can be (and often is) changed overnight –

only 100% suspensions, reductions, interruptions, and recoveries will sufficiently protect the EU's financial interests.

Only by proposing and adopting such an approach, and by insisting that any financial flow would only be re-started once each and all of these problems are completely and fully solved, can the Commission and Council properly apply the Regulation.

