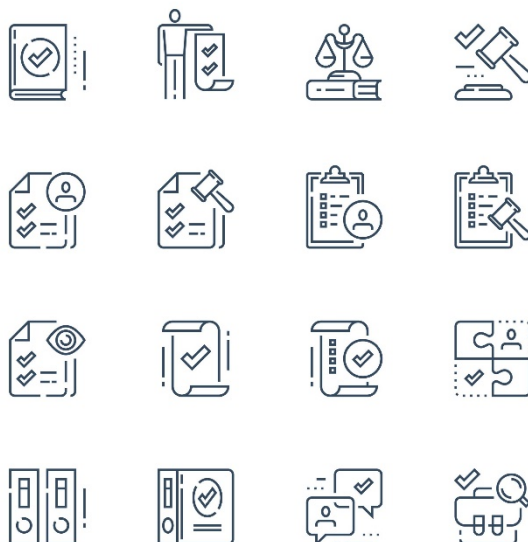


STUDY

Requested by the BUDG committee



The tools for protecting the EU budget from breaches of the rule of law: the Conditionality Regulation in context



Policy Department for Budgetary Affairs
Directorate-General for Internal Policies
PE 747.469 - April 2023

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The tools for protecting the EU budget from breaches of the rule of law: the Conditionality Regulation in context

Abstract

The rule of law Conditionality Mechanism is a new instrument that entered into force in January 2021. It allows the EU to take measures in cases of breaches of the rule of law principles that affect or seriously risk affecting the sound financial management of the EU budget or the EU's financial interests in a sufficiently direct way. This study discusses the potential scope of application of this new mechanism. In particular, it analyses how it can be used either as an alternative to, or in combination with, other tools and mechanisms aimed at protecting the EU's financial interests.

This document was requested by the European Parliament's Committee on Budgets.

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LIST OF ABBREVIATIONS

AFCOS	National anti-fraud coordination service
AMIF	Asylum, Migration and Integration Fund
BMVI	Border Management and Visa Policy Instrument
CAP	Common Agricultural Policy
CF	Cohesion Fund
CID	Council Implementing Decision
CJEU	Court of Justice of the European Union
CONT	European Parliament's Committee on Budgetary Control
CPR	Common Provisions Regulation
CSR	Country Specific Recommendation
DG	Directorate-General
DG AGRI	Directorate-General on Agriculture and Rural Development
DG BUDG	Directorate-General on Budget
DG ECFIN	Directorate-General on Economic and Financial Affairs
DG EMPL	Directorate-General on Employment, Social Affairs & Inclusion
DG GROW	Directorate-General of Internal Market, Industry, Entrepreneurship and SMEs
DG HOME	Directorate-General on Migration and Home Affairs
DG JUST	Directorate-General on Justice and Consumers
DG MARE	Directorate-General on Maritime Affairs and Fisheries
DG REGIO	Directorate-General on Regional and Urban Policy
DG RTD	Directorate-General on Research and Innovation
EAFRD	European Agricultural Fund for Rural Development
EAGF	European Agricultural Guarantee Fund
EC	European Commission
ECA	European Court of Auditors
EDES	Early Detection and Exclusion System
EIB	European Investment Bank
EFC	Council Economic and Financial Committee
EMFAF	European Maritime, Fisheries and Aquaculture Fund

EP	European Parliament
EPPO	European Public Prosecution Office
ERDF	European Regional Development Fund
ESF+	European Social Fund Plus
ESIF	European Structural and Investment Funds
EU	European Union
FR	Financial Regulation
GNI	Gross National Income
GRECO	Group of State against Corruption
ISF	Internal Security Fund
IT	Information and Technology
JTF	Just Transition Fund
LIBE	European Parliament's Committee on Civil Liberties, Justice and Home Affairs
MAR	Making Available Regulation
MFA	Macroeconomic Financial Assistance
MFF	Multiannual Financial Framework
NGEU	Next Generation EU
NRRP	National Recovery and Resilience Plan
OA	Operational Arrangements
OLAF	European Anti-fraud Office
PIF	Protection of the Union's Financial Interests
QM	Qualified Majority
REA	Research Executive Agency
RRF	Recovery and Resilience Facility
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TOR	Traditional Own Resources
UN	United Nations
UNCRPD	United Nations Convention on the rights of persons with disabilities
VAT	Valued-Added Tax

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EXECUTIVE SUMMARY

The rule of law Conditionality Mechanism – also known as ‘Conditionality Regulation’ – is a new instrument that entered into force in January 2021. The mechanism allows the EU to take measures in cases of breaches of the rule of law principles that affect or seriously risk affecting the sound financial management of the EU budget or the EU’s financial interests in a sufficiently direct way.

As the Conditionality Regulation was only adopted recently, some questions are left open on its potential scope of application. The European Commission has published guidelines, but without sufficient jurisprudence to go on they leave some room for interpretation. The fact that the Regulation has so far only been applied once makes it difficult to draw definitive conclusions on how it will be applied in the future.

This study discusses the potential scope of application of this new mechanism, in particular by analysing how it can be used either as an alternative to, or in combination with, other tools and mechanisms aimed at protecting the EU’s financial interests. To this end, the study:

- Provides an overview of the institutional setup and processes linked to the application of the mechanism.
- Describes and analyses the European Court of Justice (Court) rulings and the Commission’s Guidelines, focusing on the aspects most linked to scope and application of the Regulation;
- Maps the various tools that already exist to protect the Union’s financial interests (‘layers of protection’) and describes their scope of application and effectiveness through the presentation of anonymised real case studies of their use.
- Constructs a typology of hypothetical situations of breaches of the rule of law affecting the Union’s financial interests that could fall within the scope of the Conditionality Regulation.

Procedure and institutional setup

Rather than being a one-off procedure, the Conditionality Mechanism is a continuous exercise through which all 27 Member States are constantly monitored and assessed by the Commission services. The Commission’s Directorate-General for Budget is at the centre of the process, coordinating input from other Directorates-General and institutions and requesting further information where necessary. The European Anti-Fraud Office (OLAF) and European Public Prosecutors’ Office (EPPO) also play an important role, as both can bring any irregularities or other relevant issues to the attention of the Commission during the procedure. The Conditionality procedure runs in parallel to the data collection and analysis carried out for the purpose of the annual Rule of Law Reports, led by the Directorate-General for Justice¹. The two processes inform each other, even if the scope differs considerably: Rule of Law Reports provide general assessments and include chapters on media pluralism and freedom, or the system of checks and balances, whereas the rule of law Conditionality Mechanism is focused on breaches of the principles of rule of law that affect the sound financial management of the EU budget.

Another important feature of the mechanism is that it requires a case-by-case appraisal. The need to tailor the approach stems from both country and case-specific dimensions that make a one-size-fits-all process impossible.

¹ See details [here](#)

Other 'layers of protection' of the EU budget

The Conditionality Regulation stipulates that the Commission can only trigger the rule of law Conditionality Mechanism if it considers that other procedures set out in EU legislation would not allow it to protect the Union budget more effectively. These other procedures, referred to as 'other layers of protection', cover different types of risks. Some of them (the Early Detection and Exclusion System) protect the EU budget from risks of insolvency, negligence, fraud or irregularity committed by private actors (potential beneficiaries of EU funds). From the point of view of the study, however, the most relevant layers of protection are those applied to EU funds managed by national authorities (cohesion funds, 'Home Funds' and Common Agricultural Policy funds, Recovery and Resilience Facility (RRF)) and protecting the EU budget from actions or omissions by public authorities as they can partly overlap with the Conditionality Mechanism.

Most of these procedures are designed to deal with deficiencies affecting national authorities in charge of managing and controlling specific EU programmes, and thus are ill-equipped to deal with systemic deficiencies. They are also ineffective in protecting the EU's financial interests from the malfunctioning of public authorities not directly involved in the management or control of EU funds. In many cases, the Commission first needs to prove that a risk to the EU budget has materialised before some of these procedures can be applied, when the harm has already been done.

Some procedures, however, are applied in a more forward-looking way and can be used in response to general changes in EU laws or nationwide administrative decisions indicative of breaches of the rule of law principles. This is the case for the horizontal enabling condition, which ensures respect of the EU Charter of Fundamental Rights in the implementation of cohesion and 'Home Funds'. This enabling condition is very powerful and partially overlaps with the Conditionality Regulation, even if it has a narrower scope of application and only allows to suspend payments or the approval of programmes, while the Conditionality Regulation offers a greater number of measures.

Finally, through the establishment of RRF milestones related to rule of law issues, the EU can encourage national governments to adopt reforms in the area of judicial independence, the fight against corruption or anti-money laundering. The real effectiveness of this instrument has not yet been tested at the moment of writing this study.

The 'complementarity test' – when would the Conditionality Mechanism be more effective?

The Conditionality Mechanism can be used as an alternative to the other layers of protection when there is a risk to the EU budget not (or insufficiently) covered by existing provisions. It can also be deployed alongside or after the adoption of other provisions, if the Commission concludes that cumulative application will protect the EU budget more effectively.

The assessment of its relative effectiveness will depend on the specific circumstances but, in general terms, the new mechanism offers several advantages compared with other instruments in protecting the EU budget. It is the only procedure protecting the EU's financial interests from the malfunctioning of public prosecution and judicial authorities. It can also be used preventively, to respond to risks to the EU budget without having to prove that the risks have materialised. As long as it complies with the principle of proportionality, it allows for a considerable level of flexibility on the measures to be adopted. It has more comprehensive coverage of risks stemming from changes in national laws or nationwide administrative decisions that breach the rule of law principles.

Nonetheless, the Conditionality Mechanism might not always be the most effective solution. In some cases, the Commission may conclude that the Regulation would not provide an appropriate response, either because there is a need for a quick response, or because there are no clear remedial and monitorable actions that can be imposed on the Member State concerned to address the situation.

The thorny issue of the ‘sufficiently direct link’

To trigger a procedure under the Conditionality Regulation, a breach of the rule of law must affect or seriously risk affecting the EU budget in a sufficiently direct way. While the Court has repeatedly reiterated in its judgments that this condition requires a ‘genuine’ link to be established between the breach of rule of law and the EU budget, it does not go into further detail on *when* such a link is genuine. Without any jurisprudence to go on, there are different interpretations of what would constitute a link that would allow this mechanism to be triggered.

In many cases, the link can be presumed in a relatively straightforward manner: for instance, when the breach results from the actions of public authorities in charge of managing and controlling the use of EU funds. In cases where the breach stems from the actions of public authorities not directly involved in the management or control of EU funds, the method of establishing this link is subject to debate. A ‘restrictive’ interpretation would require this direct link to be demonstrated by hard evidence, such as proof that certain judges were barred from working on cases directly related to the use of EU funds. A broader reading would contend that such hard facts are not always necessary. For example, it could be argued that where there is strong evidence of total absence of independence in the judiciary, there is a serious risk that cases of fraud and corruption in the use of EU funds will not be properly investigated and condemned. This debate has important practical repercussions on the application of the mechanism and makes the concept central to the uncertainties still surrounding the Regulation.

A typology of hypothetical situations falling within the scope of the Regulation

The analysis of the Conditionality Regulation, the Court rulings and the Commission’s guidelines, as well as the assessment of the various other layers of protection, allow various hypothetical situations that may fall within the scope of the Regulation to be identified.

These are situations in which actions or omissions by public authorities are indicative of breaches of rule of law having relevance to the EU budget or the EU’s financial interests, and in which the Regulation would likely be more effective than existing layers of protection in addressing the situation. Whether or not these situations result in the mechanism being triggered will depend very much on the Commission’s capacity to prove the existence of a ‘sufficiently direct link’ and of a ‘serious risk’ to the EU budget.

The analysis and discussion of these various hypothetical situations prove that the use of the mechanism should not necessarily be limited to cases of systemic and recurrent breaches of rule of law principles. The Regulation can be used in response to individual and/or occasional breaches insofar as it proves to be more effective than existing layers of protection in dealing with these situations.

Another aspect to consider is that the use of the mechanism does not necessarily require proof of public authorities’ clear and explicit intention to breach the rule of law principles. Neither the Conditionality Regulation nor the Court rulings require this. Our case studies show situations in which the breach does not come from a single, intentional decision taken at the central level – such as the adoption of a new law endangering the independence of the judiciary – but rather from a systemic failure by the central level to prevent or sanction arbitrary or unlawful decisions made by lower-level administrative bodies.

Conclusions: a new addition to the toolbox to protect the EU's financial interests

To conclude, our study intends to dispel the image of the Conditionality Regulation as a sort of new 'nuclear option', as it is often portrayed in academic literature and the press. Treating it as a means of last resort and only in cases of major and systemic threats to the rule of law risks converting it into a toxic instrument, with a very high threshold of application and considerable political costs attached. This study aims to deconstruct this image, presenting it instead as another instrument to protect the EU's financial interests. The mechanism works alongside other ones and may be used to support the Commission's continuous monitoring of the rule of law situation in all 27 Member States.

1 INTRODUCTION

The protection of the European Union's financial interests is the shared responsibility of the EU and its Member States. In recent years, the introduction of new flexibilities and the creation of new instruments to address first the COVID-19 crisis and then the effects of Russia's invasion of Ukraine have created new challenges for the prevention of, and fight against, EU fraud and corruption. In particular, the introduction of the Recovery and Resilience Facility (RRF) has resulted in a significant increase in the amount of EU funds to be spent at the national level in the coming years, adding pressure on national management and control systems (Rubio, 2021)². In response, the EU has strengthened its anti-fraud architecture with improvements in instruments and procedures to enhance transparency and reinforce existing sectoral-level procedures to protect the EU budget³. The recent creation of the European Public Prosecutor's Office (EPPO) in charge of investigating and prosecuting crimes against EU financial interests also forms part of these efforts. In parallel to these developments, there have been growing concerns about the respect of the rule of law principles in the Union. This has led the European Commission to create a new instrument, the European Rule of Law Mechanism, with the annual Rule of Law Report at its centre. Its aim is to develop a stronger awareness and understanding of rule of law developments in all Member States and help prevent any problems in this regard.

As part of its efforts to address these two challenges, the EU has set up a new general regime of conditionality for the protection of the EU budget (hereinafter referred to as the 'Conditionality Mechanism'). The mechanism aims to protect the EU budget from breaches of the principles of the rule of law. It entered into force in January 2021, and allows the EU to take measures in case of breaches of rule of law principles that affect, or seriously risk affecting, the sound financial management of the EU budget and the financial interests of the EU in a sufficiently direct way.

The novelty of the mechanism means that there are still some questions left open on its application and the possibilities offered by it. The Commission has published guidelines explaining how it intends to apply the Conditionality Regulation, but they leave some room for interpretation. Moreover, the fact that the Regulation has so far only been applied once makes it difficult to draw definitive conclusions on how it will be applied in the future.

One of the issues that remain open to discussion is how this new mechanism will interact with the various other instruments and mechanisms available to the Commission to protect the Union's financial interests. The Regulation stipulates that the new mechanism can only be used if other procedures set out in EU legislation do not allow the Union budget to be protected more effectively but, as noted in the Commission's guidelines, it can be used either as an alternative to, or in combination with, these other mechanisms.

The aim of this study is to help clarify the potential scope of application of the Conditionality Mechanism, in particular by analysing how it can be used as an alternative to, or in combination with, other tools and mechanisms aimed at protecting the EU's financial interests. To this end, the study:

- Describes the institutional setup and processes linked to the application of the Conditionality Mechanism.
- Provides a more detailed understanding of the new instrument through an analysis of Court rulings and of the Commission's guidelines.

² Rubio, E. (2021), *Balancing urgency with control: How to prevent fraud in the use of the EU recovery funds without delaying their implementation*, Policy paper 262, Jacques Delors Institute, April.

³ OLAF (2021), *32nd Annual Report on the protection of the European Union's financial interests: Fight against fraud 2020*.

- Maps the various tools that already exist to protect the Union’s financial interests (‘layers of protection’) and describes their scope of application and effectiveness through the presentation of anonymised real case studies of their use.
- Constructs a typology of hypothetical situations of breaches of the rule of law affecting the Union’s financial interests that could fall within the scope of the mechanism.

In doing so, the study brings considerable added value to the policy discussion. First, it provides an inventory of the various tools at the disposal of the EU institutions to protect the Union’s budget from such risks. Second, it analyses how these tools relate to the Conditionality Mechanism, including overlaps and effectiveness in achieving their intended objectives. Third, it describes the types of situations where this new tool could be more effective than other mechanisms in protecting the Union budget, and how these various mechanisms could be combined.

The study relies on extensive desk research of relevant reports and legal and policy documents. In addition, interviews were conducted with the institutions involved in the process set up by the Conditionality Mechanism, as well as with key experts on the rule of law. The triangulation of the data collected through these activities also benefited from legal analysis of the Treaties, the text of the Conditionality Regulation, the two judgments of the Court of Justice of the European Union (CJEU) on actions for its annulment, and other relevant EU case law. The figure below summarises the data collection and analytical activities undertaken for this study.

Figure 1: Overview of methodology



Source: Authors’ methodology.

2 BACKGROUND

Chapter summary

The Conditionality Mechanism forms part of a broader group of instruments aimed at ensuring the protection of the EU's financial interests. Its particularity is that it addresses the effects, or risk of effects, on the EU budget of breaches of the rule of law principles. By design, the mechanism requires a case-by-case appraisal and tailored approach to reflect country and case-specific dimensions.

Rather than being a one-off procedure, the Mechanism functions as a continuous exercise, whereby all 27 Member States are constantly monitored and assessed by the services of the European Commission. The Commission's Directorate-General for Budget is in the driving seat of the process of implementing the mechanism, coordinating input from other directorates-general and institutions such as the European Court of Auditors, and requesting further information where necessary. The European Anti-Fraud Office (OLAF) and European Public Prosecutor's Office (EPPO) also play an important role, as both can bring any irregularities or other relevant systemic issues to the attention of the Commission during the procedure.

2.1 A new 'layer of protection of the EU budget'

The idea of systematically linking access to EU funds to respect for the rule of law started to gain ground in the broader rule of law debate, and has attracted considerable media and academic attention (Baraggia and Bonelli 2022, Halmai 2019, Heinemann 2018, Selih et al 2017⁴). In contrast, gearing up the EU budgetary framework to offer a set of tools to protect the financial interests of the Union has, with the exception of the Conditionality Mechanism, stayed out of the limelight. It was not until the beginning of the current Multi-Financial Framework (MFF) 2021-2027 that the EU budget became a powerful instrument to enforce the values enshrined in Article 2 of the Treaty on the European Union (Fiscaro, 2022⁵). So it was in this context that the Conditionality Regulation was, after contentious negotiations (Nguyen 2020, Rubio 2020⁶), adopted on 16 December 2020⁷. Figure 2 below shows the evolution of the scope of the Conditionality Regulation throughout these negotiations. In particular, the notion that violations of the rule of law must 'affect or seriously risk affecting' the EU budget or the Union's financial interests 'in a sufficiently direct way' – which is central for the application of the mechanism as this study will also show – was introduced at the end of the negotiations whereas the reference to 'generalised deficiencies' was dropped.





⁴ Baraggia, Antonia and Bonelli, Matteo (2022), Linking Money to Values: The New Rule of Law Conditionality Regulation and Its Constitutional Challenges, in *German Law Journal*, vol. 23 pp. 131-156; Halmai, Gábor (2019) The Possibility and Desirability of Rule of Law Conditionality, in *Hague Journal on the Rule of Law*, vol 11, pp 171-188; Heinemann, Friedrich (2018), Going for the Wallet? Rule-of-Law Conditionality in the Next EU Multiannual Financial Framework, *Intereconomics*, Vol. 53, Iss. 6, pp. 297-301; Selih, Janna, Bond, Ian and Dolan, Carl (2017), Can EU funds promote the rule of law in Europe?, Centre for European Reform, November 2017

⁵ Fiscaro, Marco (2022), Beyond the Rule of Law Conditionality: Exploiting the EU Spending Power to Foster the Union's Values, *European Papers*, Vol. 7, No. 2, pp. 697-719.

⁶ Nguyen, Thu (2020), The EU's new rule of law mechanism: How it works and why the 'deal' did not weaken it, Jacques Delors Centre, Policy brief December 2020; Rubio, Eulalia (2020), Rule of Law conditionality: What could an acceptable compromise look like?, Jacques Delors Institute, Policy brief October 2020

⁷ Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget

Figure 2: Scope and activation of the Conditionality Regulation: evolution of the text

COM proposal (2018)	EP position (2019)	Council presidency (2020)	Trilogue agreement
<p>(1) Generalised deficiencies as regards the rule of law,</p> <p>(2) which affect or risk affecting [the Union budget and EU's financial interests]</p> <p>Activation when the Commission considers that the conditions are fulfilled</p>	<p>(1) Generalised deficiencies as regards the rule of law,</p> <p>(2) which affect or risk affecting [the Union budget and EU's financial interests]</p> <p>Activation when the Commission considers that the conditions are fulfilled</p>	<p>(1) Breaches of the rule of law,</p> <p>(2) which affect in a sufficiently direct way [the Union budget and EU's financial interests]</p> <p>Activation when the Commission considers that the conditions are fulfilled</p>	<p>(1) Breaches of the rule of law,</p> <p>(2) which affect or seriously risk affecting [the Union budget and EU's financial interests] in a sufficiently direct way</p> <p>Activation when the Commission considers that the conditions are fulfilled, unless it considers that other procedures set out in Union legislation would allow it to protect the Union budget more effectively</p>
			

Source: own elaboration

Since its adoption, and even before that, the Conditionality Regulation has been the object of broad discussion. Besides being contested by Hungary and Poland, also other EU Member States, EU institutions and academics questioned the utility and effectiveness of the new instrument⁸. In March 2021, Hungary and Poland submitted two actions for annulment under Article 263 TFEU of the Regulation, which are discussed in detail in Section 3.1. On 16 February 2022, the European Court of Justice (CJEU) confirmed the legality of the Regulation and dismissed both actions in the two cases of Hungary v Parliament and Council (C-156/21) and Poland v Parliament and Council (C-157/21). Following the Court ruling, the Commission published a set of **guidelines on the application of the Conditionality Regulation on 2 March 2022⁹ (hereafter, 'Guidelines')**. With these Guidelines, the Commission provided some clarification on specific aspects of the Conditionality Mechanism, partly grounded on the CJEU rulings.

Notwithstanding the CJEU rulings and the EC guidelines, some elements of the Regulation remain open. For instance, it leaves discretion to the Commission on aspects such as the procedure and methodology for the assessment of the situation leading to the activation of the mechanism or the criteria to determine the type of response proposed in case the mechanism is activated (which can range from an interruption or suspension of payments to the reduction of commitments or a prohibition to enter into new agreements as established in Article 5 of the Conditionality Regulation).

⁸ See, for instance: Opinion No 1/2018 of the European Court of Auditors (2018/C 291/01); [Joint Declaration of the Prime Minister of Poland and the Prime Minister of Hungary](#); Coman, Ramona (2022), "Ten Years on, What Then Is the Outcome? Consensus, Dissensus and Contestation over the Rule of Law. In: *The Politics of the Rule of Law in the EU Polity*. Palgrave Macmillan; Staudinger, Isabel (2022), "The Rise and Fall of Rule of Law Conditionality", *European Papers*, 7(2), pp. 721-737.

⁹ 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

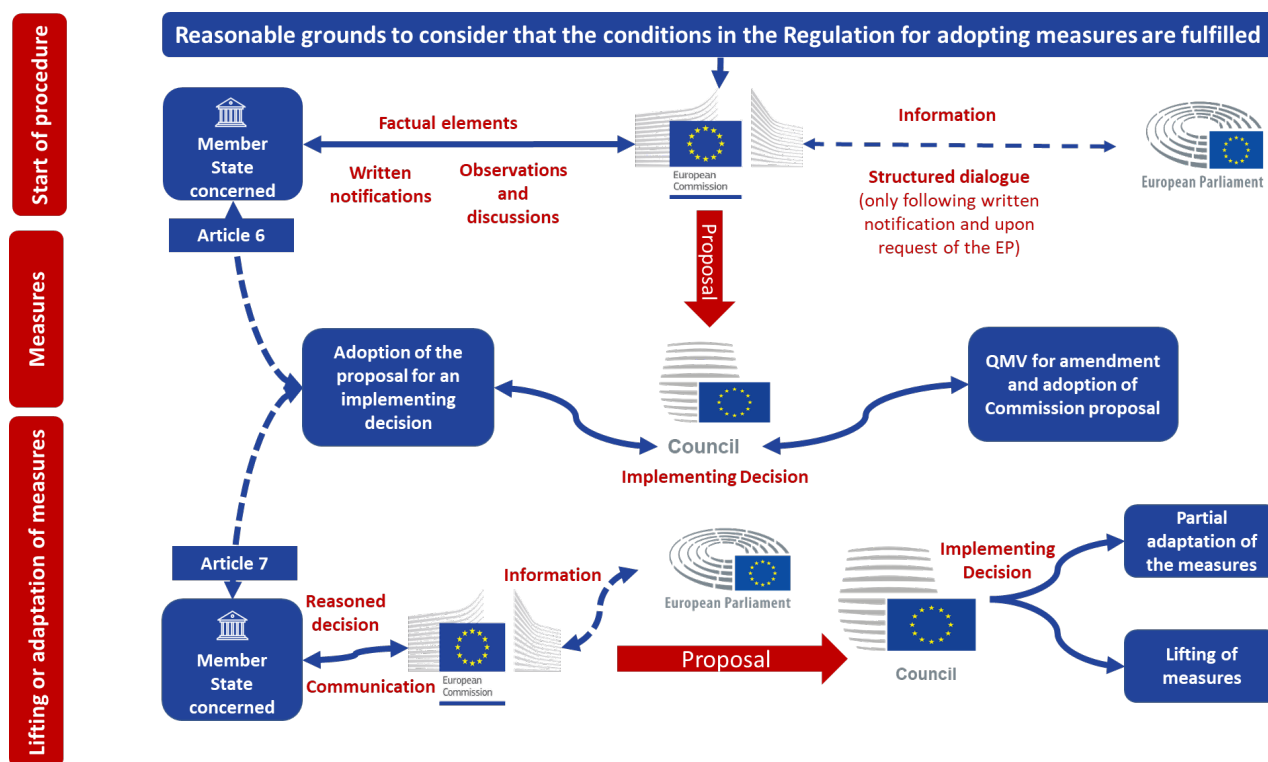
2.2 The institutional setup: who does what?

Understanding the institutional setup responsible for implementing the Conditionality Mechanism offers preliminary answers to some of the uncertainties raised above. This is particularly true for the methodology of the assessment, as well as the sources of information considered in the process. It frames the discussion in other chapters.

2.2.1 Overview of the procedure

The process to be followed under the Conditionality Mechanism is described in the Regulation¹⁰, with the Guidelines providing more detail on some of the specific steps. The visual below shows the most critical elements.

Figure 3: The procedure set out in the Conditionality Regulation



Source: own elaboration

The procedure starts when the Commission services find that there are reasonable grounds to consider that there has been a breach of the principles of the rule of law and that these ‘affect or seriously risk affecting the sound financial management of the Union budget or the protection of the financial interests of the Union in a sufficiently direct way’¹¹. This assessment ‘should be objective, impartial and fair, and should take into account relevant information from available sources and recognised institutions’¹² such as, inter alia, the judgments of the European Court of Justice, the reports of the Court of Auditors, the Commission’s annual Rule of Law Report or reports of the European Anti-Fraud Office (OLAF) and the European Public Prosecutor’s Office (EPPO). Besides the interactions between EU institutions and other relevant bodies, the Commission may also be in contact with the Member State

¹⁰ Under Article 6.

¹¹ Article 4(1) Conditionality Regulation.

¹² Recital 16 of the Regulation.

concerned, although these contacts are not mandatory. This interaction can help the Commission to ensure the objectivity criterion mentioned above, although there are also procedural steps set to protect the defence rights of the Member State concerned.

Based on the information assembled, if the Commission concludes that conditions are met to trigger the Conditionality Mechanism, and unless it considers that other procedures set out in EU legislation would protect the EU budget more effectively, it sends a written notification to the Member State concerned, starting the procedure and explaining factual elements and specific grounds on which it has based its findings.

In its response, the Member State is asked to provide the required information and may propose or adopt remedial measures to address the Commission's findings. If the Commission still finds the conditions for the application of the Regulation are met and the proposed remedial measures are not adequate to solve the issue, it can propose the adoption of measures to the Council.

Once measures are adopted by the Council, the Commission regularly monitors the developments in the country in question. The methodology, principles and sources of information relevant to the preceding stages apply here as well.

If at any stage the Commission considers that the situation has been remedied, it submits a new proposal to the Council to lift measures. If there are further remedial measures adopted after the Council implementing decision, which only partially address the issue, the Commission can also propose to partially lift or adapt the measures. In theory, it is possible that measures may be lifted or adapted as soon as the Union budget is no longer affected, even when breaches of the principles of the rule of law persist.

2.2.2 The preliminary phase and proposal of measures

From the point of view of this study, the first two parts of the process are the most relevant. The first is the 'preliminary' phase i.e., before launching a procedure against a Member State. In practice, this includes a screening of issues that may be relevant for the application of the general regime of conditionality and any action possibly taken before sending a written notification under Article 6(1). The second is the beginning of the procedure, which starts with the written notification and concerns the period during which the Commission is preparing a proposal for a Council decision.

It is in these phases that information exchanges take place on the nature of the breach of the principles of rule of law, on whether it falls within the scope of the Regulation and whether other (more proportionate) means to remedy the situation exist. Against this background, two general remarks regarding the nature of the process can be made.

A first important observation is that, as will be discussed in Chapter 3, the assessment requires a case-by-case appraisal. This inherent need to tailor the approach to reflect country and case specificities has a bearing on virtually all aspects within the scope of this study. However, it is especially pertinent to the discussion on the institutional setup as these specificities are by and large what determine the actors involved in a case.

Second, the Conditionality Mechanism is more than a one-off procedure that is launched on an *ad hoc* basis as it pops up on the European Commission's agenda. It is in fact a continuous exercise where all 27 Member States are constantly monitored and assessed by Commission services. In particular, this activity runs in parallel to the data collection and analysis for the annual Rule of Law Reports¹³.

¹³ See details [here](#)

Therefore, the two processes mutually inform each other¹⁴. However, the scope of the two exercises differs considerably. The Rule of Law Reports provide general assessments and include chapters on media pluralism and freedom of the system of checks and balances. The procedure linked to the Conditionality Mechanism is, in contrast, purely focused on breaches of the principles of rule of law that affect the sound financial management of the EU budget. Notwithstanding that, when screening the situation in the Member States, particular attention is paid to those for which persistent shortcomings have been identified in the Rule of Law Reports that may also be relevant for the application of the Conditionality Regulation.

The European Commission's Directorate-General for Budget (DG BUDG¹⁵) is at the centre of the process of implementing the Conditionality Mechanism. It conducts the continuous monitoring of Member State activities that could constitute breaches of the rule of law affecting the EU budget. It coordinates input between other DGs and institutions and requests further information where necessary. This information exchange is generally taking place between DG BUDG and the Commission service in charge of the policy or fund that is the subject of inquiry. Therefore, while the Secretariat-General and DG JUST¹⁶ – both in charge of the annual Rule of Law Reports – are important contact points, other DGs may play a prominent role depending on the nature of the problem. For instance, DG GROW¹⁷ is consulted on matters related to public procurement, DG HOME¹⁸ provides data linked to anti-corruption, while DGs in charge of implementing funds¹⁹ are consulted on instrument-specific issues.

Institutions outside the European Commission can, where appropriate, also be consulted, but these exchanges are, so far, less frequent²⁰. Nonetheless, reports and studies published by, for instance, the European Court of Auditors, form part of the European Commission's data collection activities used for the monitoring, as well as the evidence base for launching and assessing a case²¹.

¹⁴ See Recital 16 of the Conditionality Regulation.

¹⁵ Namely the 'Coordination, partnership with Member States, EDES' (BUDG.D.1) unit

¹⁶ Justice and Consumers

¹⁷ Internal Market, Industry, Entrepreneurship and SMEs

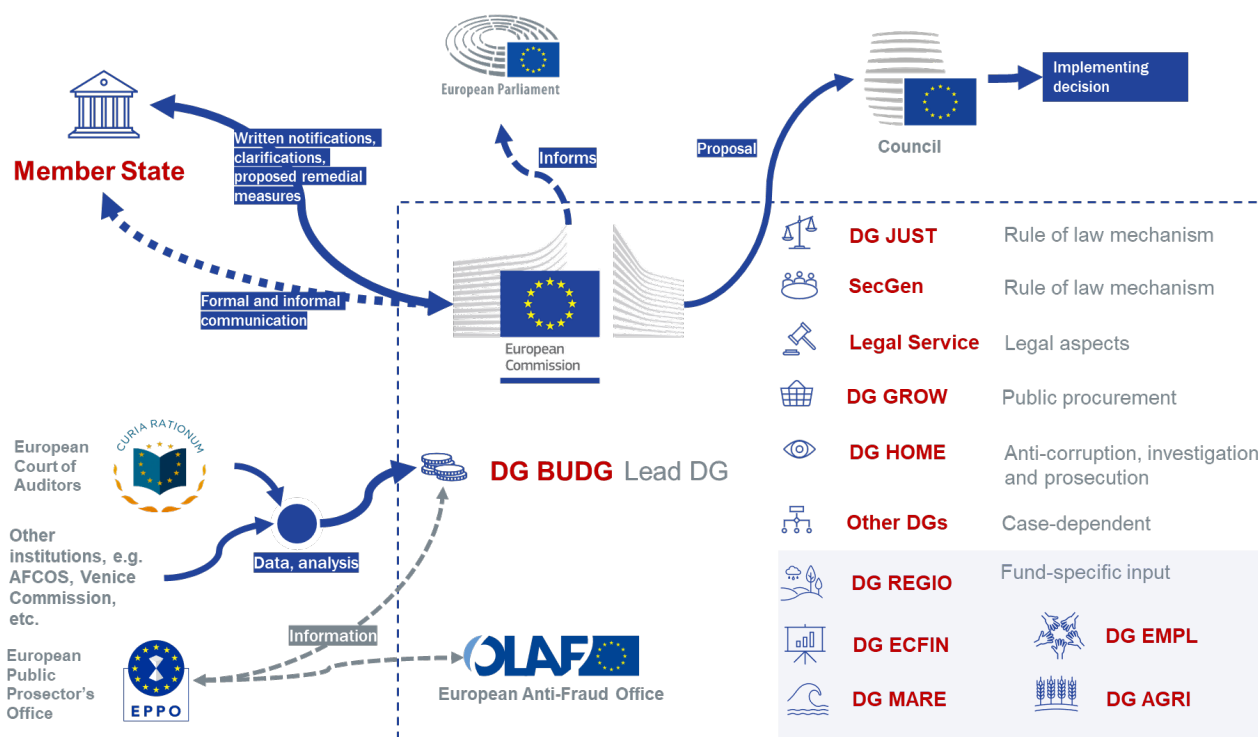
¹⁸ Migration and Home Affairs

¹⁹ As a matter of example, some of the DGs in charge of implementing funds are REGIO/ EMPL (ESIF), AGRI (CAP) and ECFIN (RRF) together with SG RECOVER.

²⁰ With the short time elapsed since the introduction of the Regulation, definitive statements on the frequency of such interactions cannot be made as practice is only now being established.

²¹ Other institutions and sources of information are described in more detail under section 3.2 on the Guidelines

Figure 4: Institutional setup during the preparatory phase



Source: own elaboration

2.2.3 The role of OLAF and EPPO

The Conditionality Regulation, when listing the specific situations that constitute a breach of the principles of the rule of law within its scope, specifically refers to Members States failing to ensure 'effective and timely cooperation'²² with the European Anti-fraud Office (OLAF) and the European Public Prosecutor's Office (EPPO), subject to the participation of the Member State therein²³. It is therefore important to understand the role of the two institutions in the overall framework.

Both OLAF and EPPO play a crucial role in protecting the EU's financial interests within their respective mandates. The EPPO is an independent public prosecution office responsible for investigating and prosecuting crimes against the EU financial interests in the participating Member States, while OLAF is entrusted with carrying out independent investigations on fraud affecting the financial interests of the Union.

From an administrative point of view, OLAF is an integrated service of the European Commission but enjoys operational independence and thus benefits from a degree of autonomy in the execution of its tasks. The outcomes of its administrative investigations result in recommendations to both EU and national public authorities. Along with other Commission DGs, it participates in the preparation of the annual Rule of Law Report and provides specific input based on issues identified during the course of its investigations. Similarly, it forms part of the ongoing Conditionality Mechanism process through the identification of fraud or other serious irregularities which it can bring to DG BUDG's attention.

²² What such a cooperation should denote in practice is described in Paragraph 21 of the Guidelines on the application of the Regulation, as well as the EPPO and OLAF regulations

²³ Article 4(2) (g): 'effective and timely cooperation with OLAF and, subject to the participation of the Member State concerned, with EPPO in their investigations or prosecutions pursuant to the applicable Union acts in accordance with the principle of sincere cooperation'

Operational as of June 2021, the EPPO is a newcomer to the institutional setup described above. To complement the functions stipulated by OLAF's mandate, the EPPO was set up for criminal law-based investigation and prosecution of crimes affecting the financial interest of the Union²⁴. Unlike OLAF, the EPPO is an independent public prosecution office, which is embedded in the national judicial systems of the 22 participating Member States²⁵ through the presence of European Delegated Prosecutors, having the same powers as national prosecutors.

While not all Member States participate in the EPPO, in accordance with Article 325 TFEU, the protection of the Union budget is an obligation for all Member States. Therefore, non-participating Member States must cooperate with the EPPO based on existing EU and international instruments of judicial cooperation and in accordance with the principle of sincere cooperation.

Due to the difference in institutional configuration, the cooperation mechanism between the Commission and the EPPO is not considered internal as in the case of OLAF. Therefore, in the [working arrangement](#)²⁶ between the EPPO and the European Commission it is specified how the cooperation established in the Conditionality Regulation should take place: 'EPPO may send to the Commission, via the contact points specified in Annex I, information on individual or systemic issues that may be relevant for the purpose of the regulation'. EPPO should inform DG BUDG and copy DG JUST and OLAF.

While the introduction of the Conditionality Mechanism had an impact on the toolbox available to the EU to better protect the EU budget, it is difficult to assess the implications for the operating practices of the two bodies at this stage. While OLAF introduced a new case management system to allow for a more systematic assessment of rule of law issues – reportedly triggered by the Regulation – this can hardly be construed as a considerable shift. EPPO, on its end, only became operational after the adoption of the Regulation.

²⁴ Art. 86 of the Treaty on the Functioning of the European Union and Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO')

²⁵ The following are EPPO's participating EU Member States: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czechia, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Romania, Slovakia, Slovenia, and Spain. Hungary has a [working arrangement](#) on cooperation with EPPO. However, negotiations with Poland for a similar arrangement [were unsuccessful](#).

²⁶ Agreement establishing the modalities of cooperation between the European Commission and the European Public Prosecutor's Office; Article 14 of the Conditionality Regulation

3 UNDERSTANDING THE REGULATION: THE TWO COURT RULINGS AND THE COMMISSION GUIDELINES

Chapter summary

The two CJEU rulings on the actions for annulment brought by Poland and Hungary against the rule of law Conditionality Regulation help to clarify its scope of application. The Court dismissed both actions in their entirety and gave some guidance on how to interpret the articles determining situations that may fall within the scope of the regulation. The Court also clarified the criteria to consider when determining the impact of breaches of rule of law on the EU budget, and when defining the type and nature of measures to be imposed.

The guidelines issued by the Commission explain how it intends to apply the Regulation, focusing on five aspects: 1) the conditions for adopting measures; 2) the 'complementarity test', i.e. assessing whether the Regulation would be more effective than other procedures in protecting the EU budget; 3) the measures to be adopted (and their proportionality); 4) the procedure and methodology for the assessment process; and 5) the protection of the rights of the final recipients.

The guidelines largely build on the Court rulings, providing additional information on specific points such as the criteria to be used when carrying out the complementarity test. However, they leave room for interpretation. Moreover, given the case-by-case approach that is inherent to this mechanism, as well as the fact that the Regulation has so far only been applied once, it is difficult to draw definitive conclusions on how it will be applied in the future.

3.1 The Court judgements

On 16 February 2022, the European Court of Justice confirmed the legality of Regulation 2020/2092 and dismissed the actions for annulment by Hungary and Poland in the two cases of Hungary v Parliament and Council (C-156/21) and Poland v Parliament and Council (C-157/21). The objective of this section is to analyse the European Court of Justice rulings in the two cases for action for annulment of the Conditionality Regulation. In particular, it will examine the consequences for the scope of application of the Regulation.

3.1.1 Summary of the judgments

Both Hungary and Poland brought an action for annulment of Regulation 2020/2092 before the Court, which were both dismissed in their entirety. A brief summary of the applicants' claims and the Court's reasoning can be found in the table below and is elaborated in more detail in this section. The cases are analysed jointly.

Table 1: Summary of the CJEU rulings

Pleas in law	Argument of the applicants	Court finding
Lack of a legal basis	Art. 322(1)(a) TFEU inappropriate. Instead, Art. 311(3) or 312(2) TFEU would be appropriate.	Horizontal Conditionality mechanism, which subjects a Member State's receipt of EU funding to adherence to the rule of law, can fall within the powers conferred by the Treaties on the Union to establish financial rules relating to the implementation of the Union budget
Circumvention of Article 7 TEU	Art. 7 procedure is exclusive for the protection of values in Art. 2 TEU	Conditionality Regulation does not circumvent the procedure of article 7 TEU as it has a different aim: rather than allowing for the penalization of serious and persistent breaches of the EU's common values as under article 7 TEU, the objective of the Conditionality mechanism is to protect the budget and only applies where a rule of law breach affects or seriously risks affecting the Union budget
Breach of Protocol No 2	Protection of the EU budget is not exclusive competence of the Union so the proposal should have been sent to national parliaments	Subsidiarity principle does not apply to the protection of the EU budget which is an exclusive competence of the Union since it regards financial rules determining the procedure to be adopted for establishing and implementing the Union budget. Since this is about EU functioning, the principle of subsidiarity cannot apply
Infringement of Article 296 TFEU	The reasons for adopting the Regulation are not apparent from the statement of reasons set out in the proposal	The plea's line of reasoning is ineffective since the action seeks to annul the Regulation and not the proposal
Infringement of the principle of conferral	The Regulation touches upon areas where competence is exclusively national and the 'spillover effect' logic used to adopt the Regulation does not hold	Regulation allows only for the assessment of situations and conduct of authorities relating to the implementation of the Union budget or the protection of the Union's financial interest
Breach of the principle of equality	References to the Venice Commission's recommendations are discriminatory since they distinguish between 'old' and 'new' democracies	Under Art.6(1) to (9) of the Regulation, Commission is mandated to follow an evidence-based approach and to respect the principles of objectivity, non-discrimination and equal treatment of Member States before the Treaties when conducting proceedings
Breach of the principle of legal certainty	Regulation grants too much discretion to the EC and Council on account of the lack of precision of 1) the concept of the rule of law in Art. 2 of the Regulation 2) criteria in Art. 3 and 4(2); 3) source of information on which EC formulates its assessment	The fact that a law confers discretion on the authorities responsible for implementing it is not in itself inconsistent with the requirement of foreseeability. The Court also argued that the principles of rule of law set out in the Regulation had been sufficiently developed in its case law and are also rooted in the constitutional traditions of the Member States, which is why their content and requirements could be determined with sufficient precision by the latter
Breach of the principle of proportionality	There are other provisions of EU law intended to protect the EU budget	No evidence was brought to annul the Regulation on the basis of this plea

Source: own elaboration

3.1.1.1 Lack of competence

Both Poland and Hungary claimed that the European Union lacked the competence to adopt the Conditionality Regulation. They argued that article 322(1)(a) TFEU does not constitute an appropriate legal basis; that the Regulation exceeds the competences set out in Article 322(1)(a) TFEU; and that it constitutes a circumvention of Article 7 TEU. Among others, the applicants argued that Article 322(1)(a) TFEU does not allow the EU to create a mechanism through secondary law, which would deprive the European Council of its exclusive power to determine a breach of rule of law under Article 7 TEU and that the Regulation undermines the institutional balance as established in Article 7 TEU, Article 13(2) TEU and Article 269 TFEU by granting new powers to the Council, the Commission and the Court.

The Court rejected the pleas. It found the objective of the Regulation not to be to sanction Member States for rule of law breaches, as asserted by Poland and Hungary, but to protect the Union budget from adverse effects stemming from such breaches. This objective is in line with the EU financial rules under Articles 310 and 315 to 317 TFEU, which are intended, inter alia, to ensure sound financial management of the Union budget, including by Member States, and falls within the scope of Article 322(1)(a) TFEU. The Court also did not consider the Conditionality Mechanism to constitute a circumvention of Article 7 TEU. It argued that the EU institutions may establish additional procedures relating to EU values as long as those procedures are different, both in terms of their aims and their subject matters, from the procedure laid down in Article 7 TEU. It found this to be the case for the Conditionality Mechanism. The Court also noted that because the Regulation does not confer any powers on the European Council and because the conferral on the Council of a power to adopt measures is duly justified, the Regulation does not undermine the institutional balance.

3.1.1.2 Infringement of Protocol No° 2

Poland and Hungary claimed that the adoption of the Conditionality Regulation infringed the obligation to consult national parliaments under Protocol No° 2 on the application of the principles of subsidiarity and proportionality. They argued that the protection of the Union budget is not an exclusive competence of the European Union and hence falls under the principle of subsidiarity.

The Court rejected the plea. It found the Regulation to fall within the exclusive competence of the EU, to which the principle of subsidiarity does not apply.

3.1.1.3 Infringement of duty to state reasons

Poland and Hungary claimed that the Regulation infringed the duty to state reasons for its adoption under Article 296 TFEU as the statement of reasons, as set out in the proposal, was insufficiently clear as to why it was necessary to adopt the Regulation.

The Court rejected the plea as ineffective on the ground that the claim was made in relation to the proposal rather than the contested Regulation itself. In any event, even if it had related to the Regulation, it would have had to be rejected, as the Court considers the duty to state reasons fulfilled by the Regulation.

3.1.1.4 Infringement of the principle of conferral and infringement of the duty to respect Member States' essential functions

Poland and Hungary argued that the Regulation touches upon areas where competence is exclusively national and the 'spillover effect' logic used to adopt the Regulation infringed the principle of conferral under articles 4(1) and 5(2) TEU as well as the duty to respect the Member States' essential functions provided for in the second sentence of Article 4(2).

The Court rejected the plea on the ground that the Regulation allows only for the assessment of situations and conduct of authorities relating to the implementation of the Union budget or the protection of the Union's financial interests. Moreover, the Court recalled that Member States must comply with EU law even when exercising their competences in their reserved areas.

3.1.1.5 Breach of the principle of equality of Member States and non-respect for their national identities

Poland, supported by Hungary, claimed that the application of the Conditionality Regulation would breach the principle of equality between Member States and their national identities for three reasons: the Commission's taking into account opinions from the Venice Commission; the lack of precision in the criteria for initiating the procedure and for determining the measures to be adopted; the voting rule governing the Council's decisions under Article 6(11) of the Regulation. The arguments presented in this section partially overlap with those in the next.

The Court dismissed the plea as unfounded. It argued that it is for the Commission to ensure that the information it uses for its assessment is reliable and that, in any event, Member States retain the possibility to challenge the merits of the Commission's assessments in the context of an action brought against a Council decision adopted under that Regulation. The Court equally rejected the argument of lack of precision of the criteria laid down in the Regulation as firstly, the principles of the rule of law referred to in Article 2(a) of the regulation are recognised in the legal order of the EU. Secondly, the situations and conduct laid down in Article 4(2) are sufficiently precise and, in any event, the Commission is obliged to follow an evidence-based approach and to respect the principles of objectivity, non-discrimination and equal treatment of Member States before the Treaties when conducting proceedings. It also confirms that the qualified majority voting procedure under Article 6(11) of the Regulation does not violate the principle of equality between Member States and is in line with the value of democracy enshrined in the Treaties.

3.1.1.6 Breach of the principle of legal certainty

Poland and Hungary claimed that the Regulation does not meet the requirements of legal certainty and legislative clarity because the concept of 'rule of law' cannot be precisely defined but is rather in constant evolution. Secondly, they claimed a lack of a precise definition of the criteria in Articles 3 and 4(2), which result in too wide discretion for the Commission and the Council in applying the Regulation. Thirdly, they claimed that the relationship between Articles 2(a), 3 and 4(2) of the Regulation cannot be clearly determined and that their joint application could not rule out measures even in situations not related to the sound financial management of the EU budget.

The Court rejected the pleas as unfounded. It stated that Article 2(a) of the Regulation is not intended to give an exhaustive definition of the rule of law but merely sets out the most relevant principles related to the protection of the Union budget and, in doing so, does not exceed the limits of the rule of law concept itself. Neither does the Commission's discretion in applying the Regulation breach the principle of legal certainty as it is, in its assessment, bound by a number of procedural requirements under Articles 6(1) to (9) of the Regulation, including a duty to carry out a diligent qualitative assessment, which is objective, impartial and fair, should respect the principles of objectivity, non-discrimination and equality of Member States before the Treaties and should be conducted according to a non-partisan and evidence-based approach. It also finds that there is sufficiently precise links between Articles 2(a), 3 and 4(2) of the Regulation.

3.1.1.7 Breach of the principle of proportionality

Poland and Hungary claimed that the Regulation breaches the principle of proportionality, which requires that acts of the EU institutions do not go beyond what is necessary to achieve its objectives, as it does not explain the need for its adoption.

The Court rejected the claim as no evidence was put forward that could demonstrate that the EU legislature exceeded its broad discretion when considering the Regulation necessary to alleviate adverse effects on the Union budget resulting from rule of law breaches.

3.1.2 Overview of arguments linked to the scope of application of the Regulation

In this part, the Court's findings relating to the scope of application of the Regulation will be analysed. The most relevant articles in this regard are Articles 2, 3 and 4 of the Conditionality Regulation. They build upon one another in a three-step test:

- Article 2 first gives broad definitions, particularly on the concept of the rule of law for the purpose of the Conditionality Regulation.
- Article 3 then refers to situations that may be indicative of breaches of the principles of the rule of law, to facilitate the application of the Regulation.
- Article 4 lays out when the conditions to adopt measures are fulfilled (Art. 4(1)) as well as the situations or conduct of authorities that must be concerned by the breaches (Art. 4(2)).

Once it is established that a situation falls within the scope of application of the Regulation the question of the scope of measures imposed arises, which is dealt with in Article 5 of the Regulation. Regarding the relationship between these articles, the Court states that Articles 2(a), 3, 4(2) and 5(1) of the Regulation together are constituent elements of the mechanism in Article 4(1) by laying down the definitions necessary for its implementation, specifying its scope and prescribing the measures to which it may lead.

In general, the Court stresses at several points in the judgments that the objective of the Conditionality Regulation is not to penalise breaches of the rule of law by the Member States but to protect the EU budget against such breaches. It thereby delineates the outer boundaries of the scope of application of the Regulation in general.

3.1.2.1 Definition of 'the rule of law' and 'government entities' under Article 2

Article 2 of the Regulation defines 'the rule of law' by referring to the Union values enshrined in Article 2 TEU. It includes the principles of legality implying a transparent, accountable, democratic and pluralistic law-making process; legal certainty; prohibition of arbitrariness of the executive powers; effective judicial protection, including access to justice, by independent and impartial courts, also as regards fundamental rights; separation of powers; and non-discrimination and equality before the law.

The Court rejects the applicants' argument that the concept of the rule of law can, as a rule, not be given a universal definition. It states that Article 2(a) of the Regulation is not intended to define the concept exhaustively but rather to set out the most relevant principles which it covers for the sole purpose of the Regulation. This can include principles that are mentioned separately from the rule of law in Article 2 TEU – such as protection of fundamental rights or principles of non-discrimination and equality – as they form part of the concept as developed in the Court's own case law based on common values of the Member States.

'Government entity' in turn is defined by the Regulation as a public authority at any level of government, including national, regional and local authorities, as well as Member State organisations within the meaning of the EU Financial Regulation.

3.1.2.2 Situations indicative of breaches of the rule of law under Article 3

Once a situation falls within the concept of the rule of law under Article 2, then Article 3 of the Regulation gives a list of situations, which may be indicative of *breaches* of the principles of the rule of law. This includes endangering the independence of the judiciary; failing to prevent, correct or sanction arbitrary or unlawful decisions by public authorities as well as withholding financial and human resources affecting their proper functioning or failing to ensure the absence of conflicts of interest; and

limiting the availability and effectiveness of legal remedies or the effective investigation, prosecution or sanctioning of breaches of the law.

The Court makes clear that the purpose of this article is to facilitate the application of the Regulation. To do so, it merely lays out possible breaches of the rule of law but does not set out specific obligations for the Member States. It does not provide an exhaustive list of situations that constitute breaches. Such a list, according to the Court, may not be needed as requirements to access EU funds are defined in other legislation. There is no need for a specific definition of the concept of ‘breach’ for the purpose of the Regulation in the Court’s view, so it also does not further define the scope of application in this regard.

What should be also noted is that the Court does not explicitly mention the need for ‘intention’ when breaching the rule of law principles. Article 5(3) in conjunction with Recital 18 specify that, in determining measures to be adopted, the principle of proportionality should apply and the intention of the Member State concerned in putting an end to the breach of the principles of the rule of law is one of the elements to take into consideration when assessing the proportionality of the measures (see section d). However, the Court clarifies in its judgment that the reference to the ‘intention... of the Member State concerned’ is to the intention to ‘[put] an end to the breaches’ found, not to the intention to breach the rule of law principle.

3.1.2.3 Conditions for the adoption of measures in cases of breaches of the rule of law under Article 4

Following Article 4 of the Regulation, breaches of the rule of law fall within the scope of the Conditionality Mechanism when two conditions are met. Firstly, they should affect or seriously risk affecting the sound financial management of the Union budget or the protection of the financial interests of the EU in a sufficiently direct way. Secondly, they must concern at least one of the specific situations or instances of conduct referred to in Article 4(2) of the Regulation. When these two conditions are met, the Commission may trigger the conditionality procedure if the so-called ‘complementarity test’ is passed, that is, if it concludes that other procedures set out in Union legislation for the protection of the Union budget would not allow it to protect the Union budget more effectively, as established by Article 6(1) of the Conditionality Regulation.

As regards the first condition set out in Article 4, it is interesting to note that, in contrast to Article 7 TEU, no serious or persistent breaches of the rule of law are required under the Mechanism; a simple isolated breach suffices as was also highlighted by the Court. The Court also reiterates that any adverse effects or risk of adverse effect on the EU budget must be linked in a sufficiently direct way to the rule of law breaches to trigger the Mechanism and that this link should be ‘genuine’ but it does not go into further detail *when* such a link is genuine. Poland and Hungary had claimed in their actions that the general wording of Articles 3 and 4(2) of the Regulation results in such discretionary assessment by the Commission and Council when deciding on measures that the decision whether such a link exists would become a matter of political discretion. The Court dismisses these claims by simply stating that such a link could not be determined automatically anyway and refers to the Commission’s obligation to use an evidence-based approach and to respect the principles of objectivity, non-discrimination and equality of the Member States when examining possible measures.

The Court also briefly sheds light on the notion of ‘risk’ in this context and whether its inclusion in Article 4(1) of the Regulation might allow for arbitrary penalties to be imposed in uncertain or unproven situations. While it does not give examples of what might be considered a legitimate risk to trigger the application of the mechanism, it does emphasize that there must be a ‘serious’ risk of an adverse effect on the budget. This in turn requires a demonstration that the risk has a high probability of occurring in relation to the situations referred to in Article 4(2) but does not limit the adoption of measures to cases

of proven effects of breaches on the Union budget as this would be incompatible with the requirements of sound financial management and protection of the Union budget. Overall, however, and considering the importance of the question of when a genuine link between the breach of rule of law and the Union budget exists, the Court remains remarkably vague on it.

As regards the second condition from Article 4, the Court explains that under Article 4(2) the breaches of the rule of law must concern the situations or conduct of the listed authorities in so far as they are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union. It does not go into detail about all situations mentioned in the article but deals with those terms contested by Poland and Hungary, who claimed a lack of precision in the Regulation. The terms are shown in the table below.

Table 2: Key terms defined by the judgements in relation to the scope of the Regulation

Term	Definition given by the Court
'Authority'	Public authorities at any level of government, including national, regional and local authorities, and bodies governed by public law, or even bodies governed by private law with a public service mission which are provided with adequate financial guarantees by the Member State. In addition, Article 4(2) also refers to specific authorities itself.
'Services'	Investigation and public prosecution services.
'Proper functioning' of public authorities implementing the Union budget and responsible for supervising, monitoring and conducting financial audits, as well as investigative and public prosecution services, referred to in Article 4(2)(a) to (c)	Refers to the ability of those authorities properly and effectively to execute their relevant functions for the sound financial management of the Union budget or the protection of the financial interests of the Union.
'Effective and transparent financial management and accountability systems'	Understood as defined in the Financial Regulation as the implementation of the budget in accordance with the principles of economy, efficiency and effectiveness.
'Financial accountability'	Financial control, monitoring and audit obligations mentioned in Article 4(2)(b).
'Effective and transparent ... systems'	Implies the establishment of an ordered set of rules which ensure in an effective and transparent manner financial management and accountability.
'Effective judicial review by independent courts'	Clarified in Recitals 8-10 and 12 of the Regulation as well as the Court's own case law on Articles 19 TEU and 47 of the Charter of Fundamental Rights. It includes, among others, the requirement to guarantee the independence and impartiality of the judiciary and to endow them with sufficient financial and human resources and procedures to act effectively and in respect of the right to fair trial.
'Effective and timely cooperation with OLAF'	A requirement stemming from the EU financial rules which includes the obligation to grant OLAF the rights and access necessary for it to comprehensively exert its competences, such as the right to carry out investigations, including on-the-spot checks and inspections.
'Other situations or conduct of authorities'	According to the judgements, these terms in Article 4(2)(h) aim to have an exhaustive definition when read jointly with Art. 4(1) and (2)(a-g). The said provisions already bring up details concerning the authorities referred to in Article 4(2)(h). The term "authorities" is included within the definition of "government entities", meaning that these other situations that may put at stake the rule of law can only be caused by such bodies.

Source: Hungary v Parliament and Council ([C-156/21](#)) and Poland v Parliament and Council ([C-157/21](#)).

3.1.2.4 Scope of the measures imposed




Under Article 5(3) of the Regulation, measures taken under the mechanism must be strictly proportionate and reflect the actual or potential impact of the rule of law breaches on the Union budget. This means that the Commission, in proposing the measures, must consider the nature, duration, gravity and scope of the breaches of the principles of the rule of law and carry out a diligent assessment of the facts. The Court interprets this to mean that the proportionality of the measures is, in the first instance, determined by the impact of the rule of law breaches on the Union budget. The other criteria are, in turn, used to determine the extent of the impact. The Court finds that the use of the expression ‘insofar as possible’ in the fourth sentence of Article 5(3) of the Regulation does not sever the link between the breach and the measure, thereby affecting the proportionality of the latter. It also makes possible, by way of derogation, to apply measures to protect the EU budget to actions other than those affected by the breach of the principle of the rule of law, where the protection of the budget cannot otherwise be achieved.

3.2 Guidelines on application: theory and practice

Following the two Court rulings, the European Commission issued its own Guidelines²⁷ on 2 March 2022 to clarify five aspects of the Conditionality Regulation. Concerning the development of the Guidelines, the Commission indicated that they 'have been prepared through a comprehensive process, including consultations with the European Parliament and EU Member States'²⁸. The Guidelines were used to inform the preparation and activation of the procedure against Hungary. However, without further practice to rely on in their development, an important caveat for their interpretation is that they are, in fact, considered to be work in progress rather than a finalised set of instructions (different to other guidelines, which are often developed based on decades of practice).

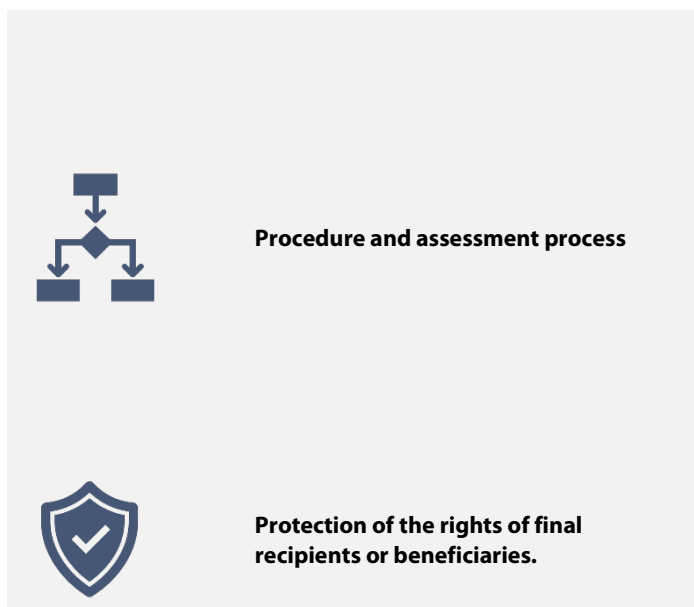
The table below summarises the content of each chapter of the Guidelines.

Table 3: Overview of the Commission Guidelines

Section	Main elements
 <p>Conditions for the adoption of measures</p>	<p>Explanation of how Articles 2 (definitions), 3 (indicative list of breaches of principles of rule of law) and 4(2) (situations that must be concerned by breaches of rule of law) should be understood.</p> <p>Explanation of how Article 4(1) on breaches of the rule of law affect, or seriously risk affecting, the sound financial management of the Union budget or the protection of the financial interests of the Union, in a sufficiently direct way, should be understood.</p>
 <p>Relation between the Conditionality Regulation and other procedures set out in Union legislation (i.e., ‘other layers of protection’)</p>	<p>Examples of different ‘layers’ of protection already existing in the EU budget, and indicative explanation of how the Commission may carry out its ‘complementarity test’, to decide whether to use or not the Conditionality Regulation procedure.</p>
 <p>Proportionality of the measures to be proposed by the Commission</p>	<p>Identification of the elements to be used by the Commission to carry out the proportionality assessment of the measures, and of additional elements that could also be used.</p>

²⁷ C(2022) 1382 final, available [here](#)

²⁸ While not explained in the text of the Guidelines directly, this is stated on the Commission website on ‘Rule of law conditionality regulation’, available [here](#)



Definition of the conditions to be followed by the Commission when carrying out the preliminary assessment.

Identification of the Commission's sources of information, distinguishing between general sources, already identified in the Regulation, and potential additional sources, such as complaints and information directly coming from Member States.

Explanation of the Conditionality Regulation process, as well as its guiding principles (Art. 6)

Explanation of the steps to be taken to ensure that, within the process, and in accordance with the guiding principles of the process, measures are lifted when the Member State complies with the Commission's requirements.

Explanation of how the Regulation affects the rights and obligations of the final recipients or beneficiaries of funds and of the Member States, as well as how to carry out reporting and information exercises.

Source: own elaboration

3.2.1 Scope of application

The first chapter of the Guidelines describes the conditions for initiating the procedure set out in Article 4. While many of these were clarified by the Court's rulings, this section brings together all these elements into a coherent understanding that relies on the Commission's interpretation of the Regulation and the Court rulings.

Following the Court's rulings, the Commission clarifies that **only breaches of rule of law principles that concern at least one of the situations or conduct of public authorities referred to in Article 4(2) fall under the scope of the Conditionality Mechanism**, and only insofar as those situations or conducts are relevant to the sound financial management of the Union budget or for the protection of the Union's financial interests. This relevance is presumed for actions or omissions of public authorities in charge of implementing, monitoring and auditing the use of EU funds - referred to in points (a) and (b) of Article 4(2) - but not for actions or omissions by the public authorities cited in Article 4(2), which have a general mandate such as investigation and prosecution services, judicial authorities or administrative authorities in charge of investigating and sanctioning fraud and corruption. Relevance is not presumed either for other actions or conducts mentioned in Article 4(2), such as the 'recovery of funds unduly paid'²⁹ or the 'effective and timely cooperation with OLAF and EPPO'³⁰ : breaches of rule of law principles concerning these conducts are relevant only if they affect the management of Union funds or the protection of EU financial interests³¹.

The Commission also recalls that **point (h) of Article 4(2) of the Regulation³² leaves the door open to other situations**. It illustrates this with an example of a case which could possibly fall within this residual category: a malfunctioning of the authorities in charge of land registries and of related controls on leasing and/or ownership of agricultural land, whose actions indirectly affect the eligibility of CAP

²⁹ Point (f) of Article 4(2) of the Regulation

³⁰ Point (g) of Article 4(2) of the Regulation

³¹ For instance, if public authorities in charge of the recovery of funds unduly paid infringe a rule of law principle, this action will fall within the scope of the Regulation only if it relates to the recovery of EU funds and not of national funds. Likewise, problems of cooperation with OLAF will only be relevant if they concern the investigation of fraud and corruption involving EU funds (OLAF fulfils other objectives, such as for instance the investigation of serious misconduct by EU staff and EU institutions).

³² 'Other situations or conduct of authorities that are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union.'

payments³³. Following the Court's judgments, the Commission also clarifies that a **'serious risk'** (which has to be established in cases in which the effects of the breach of the rule of law principle on the Union budget have not materialised or cannot be proved) **is a risk which has a high probability of occurring**³⁴. Finally, the Commission discusses the notion of a **'sufficiently direct link'**. It recalls that the Court requires this link to be 'genuine or real'³⁵. For the Commission, this requisite 'genuine' or 'real' characteristic means that the link should not be 'mere hypothetical, too uncertain or too vague'³⁶.

In the procedure against Hungary, the Commission justifies the activation of the Regulation mainly with the existence of breaches of the rule of law falling within points (a) and (b) of Article 4(2), namely malfunctioning of authorities implementing the Union budget and malfunctioning of the authorities controlling the use of EU funds. In particular, it considers that systemic and recurrent deficiencies in the application of public procurement rules and the prevention and detection of conflicts of interest constitute breaches of the principles of legal certainty and prohibition of arbitrariness of the executive powers, and raise concerns about the separation of powers. As the identified breaches are intrinsically linked to the procedures for the implementation and control of EU funds, the Commission does not need to prove the existence of a 'sufficiently direct link'. The Commission also considers that the malfunctioning of public procurement procedures partly stems from 'the constant failure to ensure that the regulatory framework and practice in public procurement avoid risks of corruption and other irregularities'. Since this is an omission by the legislative or the government rather than the authority in charge of implementing EU funds, it includes in its reasoning a breach of a rule of law principle falling within point (h) of Article 4(2), 'other situations (...) relevant to the sound financial management of the Union budget'. Finally, the Commission also finds deficiencies in the prevention and investigation of fraud and corruption, which falls within point (e) of Article 4(2)³⁷.

An element that is not mentioned in the Commission's Guidelines or the Commission's assessment of the Hungarian case is the Member State's intentionality to breach the rule of law principles. As in the Court's ruling, the Guidelines do not explicitly require intentionality in infringing the principles. Hence, one may deduce that this **intentionality is not required**. Another argument in favour of this interpretation is that some of the indicative breaches of rule of law principles listed in Article 3 do not necessarily require an element of intentionality (for instance, Article 3(b), 'failing to prevent, correct or sanction arbitrary or unlawful decisions by public authorities, including by law-enforcement authorities (..) or failing to ensure the absence of conflicts of interest'). A 'failure to' conduct a given action must not necessarily be intentional; it can also be the result of an inability to act. Besides, as stressed both by the Court's rulings and the Guidelines, the list in Article 3 is merely indicative and thus other actions or omissions of public authorities mentioned in Article 4(2) may be relevant under the Regulation.

3.2.2 The 'complementarity test': assessing the effectiveness of alternative procedures

Even if a breach of the rule of law principles fulfils the **conditions set out in Article 4, the Commission must prove that the Conditionality Regulation would allow for the protection of EU financial interests more effectively than other procedures set out** in Union legislation for the protection of the EU budget. This assessment, which the Commission calls **the 'complementarity test', is a necessary condition to trigger the Conditionality Mechanism**. The Guidelines indicate that the

³³ Paragraph 21 of the Guidelines

³⁴ Paragraph 31 of the Guidelines

³⁵ Paragraph 288 C.157/21

³⁶ Paragraph 33 of the Guidelines

³⁷ European Commission, proposal for a Council Implementing Decision on measures for the protection of the Union budget against breaches of the principles of the rule of law in Hungary, Brussels, 18.9.2022 COM(2022) 485 final, p. 15

Commission will use two indicative criteria to determine whether the Conditionality Regulation would be more effective than other existing EU procedures to protect the EU budget.

The first refers to the capacity of other instruments to cover the scope of the effect (or of the serious risk of effect), which the breach of the rule of law principle may entail for the EU's financial interests. Procedures applicable to specific spending programmes may be insufficient to cover the effect of systemic breaches of the rule of law. Other procedures require proof of already materialised effects on the Union budget and thus are not effective to react to breaches of the rule of law principles which create serious risks even in the absence of proof of loss for the Union budget. Examples of such breaches according to the Guidelines would be national laws that limit criminal liability for fraud or corruption, weaken the anti-fraud and anti-corruption legal framework or preclude an effective judicial review by independent courts of decisions by national authorities managing in whole or in part Union funds³⁸.

The second indicative criterion refers to the type of remedies that may be applied by the different procedures and their suitability to the given situation. The Guidelines note in this respect that the Conditionality Regulation provides a large variety of measures which can be applied cumulatively. This may make the application of the Regulation more effective in cases of widespread or recurrent effects. In these cases, 'suspensive or prohibitive measures under the Conditionality Regulation imposed cumulatively until the relevant breach of the principles of the rule of law is brought to an end might protect the Union budget more effectively'³⁹.

Finally, the Guidelines explain that the Conditionality Regulation should not necessarily be applied as a stand-alone instrument. In some situations, the Commission can apply it alongside or following the adoption of other EU procedures to protect the EU budget if it considers that this is the most effective way to protect the EU's financial interests. It also stresses the fact that the complementarity test is carried out on a case-by-case basis, varying the elements to be considered from one situation to another.

In the case of the procedure against Hungary, the European Commission devoted an entire section of its proposal to explaining why the Conditionality Regulation is the more effective mechanism within the EU legislation to be applied⁴⁰. From a broader perspective, the use of this procedure is justified by the 'need for constant, widespread and forward-looking action by the Commission to protect that [EU] budget'⁴¹ and by the fact that the 'issues identified are so widespread and serious that the overall financial risks for the Union budget and the Union's financial interests exceed the risks that can be addressed by other procedures set out in different sectoral instruments'⁴².

More precisely, as regards other mechanisms that would allow protecting the EU budget, financial corrections are considered less effective in this case because they are not 'preventive [in] nature', and do not always relate to 'systemic issues', respectively⁴³. Commission services' preventive audits have a pro-active approach but 'would remain limited to the specific funds concerned by the applicable sectoral rules'. Agreements, action plans and other instruments to improve the anti-fraud or investigation systems cannot be considered effective in this case because of the 'lack of evidence of

³⁸ Paragraph 42

³⁹ Paragraph 43

⁴⁰ European Commission, proposal for a Council Implementing Decision on measures for the protection of the Union budget against breaches of the principles of the rule of law in Hungary, Brussels, 18.9.2022 COM(2022) 485 final, p. 16-19.

⁴¹ Ibid, paragraph 59

⁴² Ibid, paragraph 66

⁴³ Ibid, paragraphs 60-64.

their effective implementation⁴⁴. When it comes to the enabling conditions of the CPR these can only be applied to expenditure already declared, while the Conditionality Regulation provides for more extensive possibilities, such as the 'suspension of approval of one or more programmes as well as the suspension of commitments under shared management', including pre-financing⁴⁵. Moreover, the scope of the enabling conditions that could be of relevance to the Hungarian case (public procurement and respect of the Charter of Fundamental Rights) is found to be more restrictive than the one of the Conditionality Regulation.

3.2.3 Proportionality

The Guidelines devote specific attention to how to determine the proportionality of measures to be proposed to the Council (under Art. 5(3) of the Regulation), stating that they should be 'suitable and necessary to address the issues found and protect the Union budget or the financial interests of the Union, without going beyond what is required to achieve their aim'. When deciding on the measures to be proposed, the Commission shall under the Regulation consider the nature, duration, gravity (or seriousness) and scope of the breaches⁴⁶.

As regards the **nature**, all types of breaches of the rule of law principles are relevant to the extent to which they have an impact or risk having an impact on the EU budget or the EU's financial interests. Those mentioned in Article 3 of the Regulation are particularly important but also those that are 'intrinsically or closely linked with the process under which Union funds are used by the Member State concerned'⁴⁷, as they are presumed to have a significant impact on the Union budget. Concerning the **duration**, *ceteris paribus* longer and more recurring breaches are to be considered to more adversely (risk to) affect the sound financial management of the EU budget. Concerning the **gravity and scope** of the violations caused by the breach, the Guidelines state that the breach may be more significant (and hence have a more significant impact) if it is the result of actions or omissions taken by significant parts of a Member State's public sector (such as the legislative branch or the judiciary), whose actions may have systemic or widespread effects on other national authorities, or if it affects multiple Union programmes or funds.

Other factors may be taken into account when deciding about the measures to be proposed. The Commission indicates in particular that the **degree of cooperation** of the Member State, or its intention to put an end to the problem at hand, are relevant for determining the duration and scope of a breach of the principles of the rule of law and thus to determine the type of measures needed. Besides, under Article 5(3), the measures proposed should target programmes or funds affected by the violations of the rule of law principles insofar as possible. However, the Guidelines also acknowledge that this will not be possible in all cases, such as in cases in which the breach has an impact on the collection of the Union's own resources. Furthermore, where the Conditionality Regulation is used in conjunction with other Union legislation, additionally or subsequently, the Commission must evaluate the overall impact of the measures used.

On the basis of the only available experience, the Hungarian case, the Commission clearly justifies each of the above elements and therefore the proportionality of the measures applied. Regarding the nature of the breaches targeted by measures, they fall within the scope of the Regulation (Article 3(b))

⁴⁴ Ibid

⁴⁵ Ibid, paragraph 68.

⁴⁶ Article 5(3)

⁴⁷ Paragraph 47

according to the Commission⁴⁸, due to the nature of the activities of the public authorities implementing the EU budget, in particular concerning the conflict of interests in the award of contracts financed by the EU budget. On duration, the Commission states that the issues 'are recurrent and with a long duration of over 10 years'⁴⁹. Finally, regarding the scope and the gravity, the Commission considers that when a breach of rule of law principles risks affecting multiple programmes it must be considered as being 'substantial'⁵⁰. The fact that deficiencies in the management of EU funds are coupled with weaknesses in the identification, investigation and prosecution of fraud and corruption renders the impact even more significant.

3.2.4 Procedure and methodology for the assessment process

The Guidelines also provide some clarification on how the Commission will identify and assess the existence of breaches of rule of law principles relevant to the Regulation. As explained in Chapter 2, the Commission will carry out a thorough qualitative assessment on a **case-by-case basis**, taking due account of the **specific circumstances and contexts**. The analysis must be objective, meaning that it shall be based on 'actual facts or evidence that the Commission has at its disposal'⁵¹ and may be supplemented with additional information requested from the Member State. While being attentive to each Member State's specific circumstances, the analysis shall also respect the **principle of equality between Member States**. This means that comparable situations must be treated alike unless a different treatment is objectively justified based on the specific circumstances characterising each concrete situation.

Finally, on several occasions, the Commission reiterates the **importance of ensuring a sincere dialogue and a good degree of cooperation** with the Member State concerned throughout the whole process. In particular, the Commission insists on **the preventive nature of the Regulation** and on the possibility to address concerns at an early stage of the process.

In the Hungarian case, the Hungarian government accused the Commission of non-respect of the principle of equality between Member States. It argued that other countries also received recommendations under the European Semester on strengthening the public procurement framework, establishing anti-corruption frameworks and ensuring the independence of the prosecution service but were not put under the Conditionality Mechanism. The Commission rejected this accusation arguing that, 'while it is true that when looking at single indicators, other Member States might in some instances perform worse than Hungary regarding certain aspects, the Commission's assessment is a comprehensive qualitative assessment, which takes into account the relevant legal and institutional context, bringing together information, indicators and observations from multiple sources to form a more complete picture of the situation in Hungary than single indicators could provide'⁵².

3.2.5 Sources of information

While it is of limited relevance to this study, the information sources used by the Commission to assess the cases can nevertheless shed light on the evidence base collected to analyse the points covered in the preceding sections.

⁴⁸ European Commission, proposal for a Council Implementing Decision on measures for the protection of the Union budget against breaches of the principles of the rule of law in Hungary, Brussels, 18.9.2022 COM(2022) 485 final, paragraph 128.

⁴⁹ Ibid, paragraph 129.

⁵⁰ Ibid, paragraphs 130-131.

⁵¹ Paragraph 56

⁵² Paragraph 74

The Guidelines note that the information used by the Commission should, to the extent possible, be relevant to fulfil the conditions for applying the Regulation, and that the sources should be reliable to carry out a thorough qualitative assessment⁵³. The list of sources should not be understood as exhaustive or compulsory. In fact, the Guidelines state that they should only be ‘considered based on the merits of each case, taking into account all the relevant circumstances’⁵⁴. Therefore, other sources can be used if needed, with the list in the Regulation⁵⁵ – complemented by other sources in the Guidelines⁵⁶ – being merely indicative.

This is well-evidenced by examining the sources used in the Council Implementing Decision (CID) on Hungary⁵⁷. The table below compares the lists in both the Regulation and Guidelines, with actual sources cited in the CID.

Table 4: Sources listed in the Regulation and the Guidelines and their take-up in the CID on Hungary

Sources in Regulation	CID on Hungary
Judgements of the CJEU	✓
Reports of the ECA	✗
Commission’s annual Rule of Law Report	✓
Commission EU Justice Scoreboard	✗
OLAF reports	✓
EPPO reports	✗
Conclusions and recommendations of GRECO	✓
Venice Commission rule of law checklist	✗
European networks of Councils for the Judiciary consultations	✗
European Union Agency for Fundamental Rights consultations	✗
Sources in the Guidelines	
Commission PIF reports and related EP’s annual resolutions	✗
Information on which EC, OLAF and EPPO reports are based	✓
Commission service audit reports	✓
Information coming from national authorities and stakeholders	✓
Judgment of national courts	✗
Decisions of national authorities	✗
National anti-fraud coordination service (AFCOS) information	✗
Complaints by third parties	✗
Contacts with the Member State concerned	✓

Source: own elaboration

To support its data collection and monitoring activities, the Commission has introduced a complaint form to allow for receiving information from any third party that may be aware of relevant information and evidence⁵⁸. The usefulness (and quality) of submissions received and data obtained through this form remains to be seen.

⁵³ Paragraph 62

⁵⁴ Paragraph 62

⁵⁵ Recital 16

⁵⁶ Under paragraph 64

⁵⁷ 2022/2506 of 15 December 2022, available [here](#)

⁵⁸ Paragraph 66; see form [here](#)

3.2.6 Protecting the rights of final recipients and beneficiaries

The Guidelines also make specific reference to the intention to limit the effect of the Regulation on final recipients and beneficiaries of EU funding. They clarify that the imposition of measures under the Regulation does not affect the obligation of government entities or the Member States to implement the programme or fund concerned.⁵⁹ This is true in particular for their responsibilities towards final recipients and beneficiaries, unless the Council implementing decision specifies otherwise. This could be the case, for instance, when a specific beneficiary was involved in a breach of the principles of the rule of law.

⁵⁹ For funds implemented under shared management, Member States concerned by measures adopted in the context of the Conditionality Regulation will have to report to the Commission every three months, which will verify their compliance with the obligations towards final recipients or beneficiaries (Article 5(2) Conditionality Regulation)

4 OTHER LAYERS OF PROTECTION OF THE EU BUDGET

Chapter summary

Various procedures exist to protect the EU budget from different types of risks. Some of these seek to protect the EU budget from risks caused by private actors (potential beneficiaries of EU funds). The most relevant ones for the purpose of this study, however, are those protecting the EU budget from actions or omissions made by national public authorities, as they may overlap with the Conditionality Regulation.

This chapter analyses the main procedures set out in the Common Provisions Regulation, CAP legislation, RRF Regulation and the Financial Regulation. Most of them are designed to deal with deficiencies affecting national authorities in charge of managing and controlling a specific EU programme and are thus ill-equipped to deal with systemic deficiencies. They are also ineffective in protecting the EU's financial interests from the malfunctioning of public authorities not directly involved in the management or control of EU funds, including public prosecution or judicial authorities. Furthermore, in many cases, the Commission first needs to prove that a risk to the EU budget has materialised before applying the procedure.

Some procedures, however, are applied in a forward-looking way and can be used in response to breaches of the rule of law principles. This is the case for the horizontal enabling condition, which ensures respect for the EU Charter of Fundamental Rights in the implementation of cohesion and "Home Funds". This enabling condition is very powerful and partially overlaps with the Conditionality Regulation, even if it has a narrower scope of application and only allows the suspension of payments or approval of programmes, while the Conditionality Regulation offers a greater number of measures.

Finally, through the establishment of RRF milestones related to rule of law issues, the EU can, in a one-off manner, prompt national governments to adopt reforms in the area of judicial independence, the fight against corruption or anti-money laundering. The real effectiveness of this instrument has not yet been tested at the moment of writing this study.

ⁱ Home Funds refer to AMIF, ISF and BMVI. CAP funds refer to European Agriculture Guarantee Fund (EAGF) and European Agriculture Fund for Rural Development (EAFRD).

As explained in the previous chapter, Article 6(1) of the Conditionality Regulation stipulates that the Commission can only trigger the rule of law Conditionality Mechanism if it considers that other procedures set out in EU legislation would not allow it to protect the Union budget more effectively.

This chapter explores which are these other 'layers of protection' of the EU budget – that is, other mechanisms in the hands of the Commission to protect the EU budget. It describes their scope of application and functioning, assesses their effectiveness and explores the potential complementarity between these tools and the Conditionality Mechanism, while keeping in mind that, according to the Commission's Guidelines, the Conditionality Mechanism can be used as an alternative but also alongside or after the application of these other mechanisms if considered ineffective to tackle the problem alone.

Before jumping into the analysis, it is worth clarifying what is covered in this chapter. We focus on procedures set out in the EU's Financial Regulation (FR)⁶⁰ or in sector-specific rules and endowing the Commission with powers to protect the Union's financial interests. This excludes infringement procedures, which are based on primary law (Art. 258 TFEU) and thus do not fit the definition in Article 6(1) of 'procedures set out in Union legislation'.

As the Conditionality Mechanism aims to protect the EU budget from actions or omissions by national public authorities, we pay specific attention to those 'layers of protection' covering areas of the EU budget in which public authorities of the Member States play a relevant role. This includes, first and foremost, EU funds under shared management (Cohesion policy funds, part of 'Home Funds' and CAP funds). In areas under shared management, it is mostly Member States' programme managing authorities which prepare EU tenders, select projects, verify payments and perform audit operations. They are also responsible for preventing and detecting fraud and corruption, as well as recovering fraudulently obtained amounts and imposing effective and dissuasive penalties (Art. 63(2) FR). In these areas, EU-level mechanisms act as an additional 'layer of protection', allowing the Commission to react in case of malfunctioning of the management and control systems in the Member States.

Member States' programme managing authorities also play a major role in the implementation of RRF funds. They are in charge of implementing, monitoring and auditing the national recovery and resilience plans (NRRPs) as well as preventing and detecting fraud and corruption by final beneficiaries. As in programmes under shared management, the RRF Regulation includes EU-level procedures to ensure that national control systems provide sufficient assurance and allow the Commission to step in, in case RRF national authorities malfunction or misbehave.

In the rest of the EU spending programmes, the role of national public authorities is more marginal. Some public bodies are recipients of directly managed EU funds, such as local authorities participating in EU-funded town twinning initiatives or public universities benefiting from Horizon Europe grants. National public organisations can also manage EU funds or budgetary guarantees on behalf of the Commission ('indirect management'). This is the case of national promotional banks under the InvestEU fund and of Erasmus+ national agencies. If they commit fraud or corruption and this is detected, or if they do not manage the EU funds according to pre-established principles and rules, the Commission has procedures to suspend the payments and terminate or reduce the grant agreement or the contract. Under certain circumstances, they can be blacklisted and excluded from future EU tenders. On top of that, all entities acting as implementing partners on behalf of the Commission are subject to a strict ex-ante assessment (referred to as 'Pillar assessment') to guarantee that they have appropriate internal control structures and procedures.

Member States can also receive financial assistance in the form of loans guaranteed by the EU budget. The Commission can request the early repayment of the loans if the beneficiary country commits fraud or corruption or any other illegal activity detrimental to the financial interests of the Union when using the proceeds from EU loans.

National public authorities are also responsible to collect, calculate and make available Own Resources to the EU Commission. The management and control procedures vary depending on each Own Resource but the Commission has procedures at its disposal to react in case national authorities do not properly fulfil their obligations.

Finally, it is worth mentioning the OLAF's investigative role in fraud and corruption and the EPPO's investigative role in crimes against the EU's financial interests. Rather than being 'layers of protection'

⁶⁰ Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union

on their own, the findings from OLAF and EPPO can feed into the other mechanisms thus reinforcing their effectiveness. For instance, OLAF's 'financial recommendations' can provide evidence to apply financial corrections, recoveries, and suspensions, while 'administrative recommendations' may serve to highlight systematic issues in national management and control systems.

The table below lists the main 'layers of protection' of the EU budget. Annex 3 describes each layer. In the remainder of this chapter, we will discuss their scope and effectiveness separately. In Chapter 5 we will look at their potential overlap and complementarity with the rule of law Conditionality Mechanism.

Table 5: Main layers of protection of the EU budget (excluding the Conditionality Regulation)

Description	Legal basis	Scope of application
Suspensions and financial corrections in case of serious deficiencies in Member States' Cohesion policy management and control systems	Art 97 and 104 CPR ⁶¹	EU Cohesion policy funds (ERDF, ESF+, CF, JTF, EMFAF) and measures financed under shared management by 'Home' funds (AMIF, ISF and BMVI)
Non-reimbursement of expenditures in case of non-compliance with horizontal enabling conditions	Art 15 and Annex III CPR	
Suspension of the approval of a programme or an amendment of a programme in case of non-compliance with the EU Charter of Fundamental Rights	Art 23 and 24 CPR	
Suspension of payments in case of an infringement procedure on a matter putting at risk the legality and regularity of expenditure	Art 97(1)(d) CPR	
Suspensions and net financial corrections in case of serious deficiencies in national CAP governance systems	Art 42 and Art 55 CAP Horizontal Financial Regulation ⁶²	European Agriculture Guarantee Fund (EAGF) and European Agriculture Fund for Rural Development (EAFRD)
Suspension of the approval of a CAP strategic plan or an amendment of a CAP strategic plan in case of non-compliance with the EU Charter of Fundamental Rights	Art 9 and 118(4) Regulation on CAP strategic plans ⁶³	
RRF reduction and recovery procedure	Art 22(5) RRF Regulation + Art 19 and 20 RRF financing agreements	Recovery and Resilience Facility (RRF)
Audit and control and rule of law-related RRF milestones and targets	Art 24 RRF Regulation ⁶⁴ + Art 6(5) of RRF financing agreements	
Suspension, reduction or termination of award procedures or agreements	Art 131 Financial Regulation	EU funds under direct and indirect management
Early Detection and Exclusion System (EDES)	Art 135 Financial Regulation	EU funds under direct and indirect management
Ex ante assessment of implementing partners	Art 154 Financial Regulation	EU funds under indirect management
Early repayment of loans (Macroeconomic Financial Assistance)	Art 220(6) Financial Regulation	Financial assistance (EU loans to Member States)
Recoveries under own resources	Art 96(2) Financial Regulation	EU own resources

Source: own elaboration

⁶¹ Regulation 2021/1060 of 24 June 2021
⁶² Regulation 2021/2116 of 2 December 2021
⁶³ Regulation 2021/2115 of 2 December 2021
⁶⁴ Regulation 2021/241 of 12 February 2021

4.1 Procedures set out in the Common Provisions Regulation

The Common Provisions Regulation (CPR) lays down common financial rules for all EU cohesion policy funds - the Regional Development Fund (ERDF), the European Social Fund Plus (ESF+), the Cohesion Fund (CF), the Just Transition Fund (JTF) and the European Maritime, Fisheries and Aquaculture Fund (EMFAF) – and for measures financed under shared management by the so-called ‘Home’ funds - the Asylum, Migration and Integration Fund (AMIF), the Internal Security Fund (ISF) and the Instrument for Financial Support for Border Management and Visa Policy (BMVI). The Regulation applies to all expenditures incurred during the 2021-2027 programming period and replaces the pre-existing 2013 CPR, which covered the period 2014-2020⁶⁵.

Under the CPR, the Commission has various mechanisms to protect the EU’s financial interests.

4.1.1 Interruptions, suspensions and financial corrections in case of major deficiencies in the national management and control system

The most well-known procedure is the possibility to interrupt payment deadlines, suspend interim payments or apply financial corrections in case of serious deficiencies in the national management and control systems (Art. 97 and 104 CPR). The first two measures (interruptions and suspensions) are used any time the Commission has evidence of deficiencies at any level of the control systems in the Member State. They have a preventive aim: by temporarily stopping the payments, they aim to force the Member State to correct these deficiencies to prevent them from generating future irregular payments. Interruptions can last up to 6 months (9 months at the request of the concerned Member State). If, after this lapse of time, the Member State has not corrected the problem, the Commission may suspend the payments until the deficiency is corrected.

Financial corrections, on the contrary, have a corrective goal. They serve to exclude irregular expenditure approved by the Member State from the amounts being reimbursed by the Commission. Financial corrections are primarily implemented by national authorities themselves if they find evidence of irregular payments done to final beneficiaries. In this case, they withdraw the irregular amounts from the programme accounts. They must be also implemented by the national authorities at the request of the Commission if the latter finds evidence of irregularities through its own audits. In this case, national authorities can reuse the money excluded from the accounts to finance other operations within the same programme. However, if the Commission finds evidence of irregularities after the accounts are submitted (at year n+1), these irregularities have not been identified, reported and corrected by the Member State authorities and they result from serious deficiencies in national management and control systems, the Commission shall open a procedure to apply net financial corrections. In this case, the amounts subject to financial correction are deducted as net corrections – i.e. the Member State cannot reuse the money cancelled (Art. 104 CPR).

A delegated regulation establishes detailed rules to determine what is a ‘serious deficiency’ based on a list of key requirements that all cohesion policy managing and control systems must fulfil as well as rules to calculate the level of financial corrections (from 5% to 100%) according to the relative importance of the deficiency, the frequency and the degree of risk of loss for the EU budget⁶⁶. It should be noted that the effective recovery of undue payments from the beneficiary is not among the list of key requirements from management and control imposed on national authorities implementing cohesion policy. The latter have to keep an ‘appropriate and complete account of amounts recoverable,

⁶⁵ It should be noticed that the CPR for 2014-2020 had a slightly different scope of application, as it did not cover the ‘Home’ funds but included the European Fund for Rural Development (EFRD), one of the two CAP funds.

⁶⁶ Commission Delegated Regulation 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013

recovered and withdrawn' but there is no obligation of result. The 'effective implementation of proportionate anti-fraud measures' is a key requirement but the non-fulfilment of this criterion cannot trigger by itself a procedure of corrections.

Frequency of use and effectiveness

The Commission makes extensive use of the preventive procedures (interruptions and suspensions) and particularly of warning letters preceding interruptions, suspensions and corrections⁶⁷. In 2021 and early 2022 DG REGIO sent a total of 60 warning letters alerting of possible corrections, interruptions or suspensions of payments (Table 6) whereas only one suspension decision was adopted, linked to a payment claim of less than EUR 30,000. According to the Commission these preventive measures, together with the threat of net financial corrections, work as a strong incentive for the Member States to improve their management and control systems and correct all detected irregularities and possible deficiencies. In effect, since the beginning of the 2014-2020 period, Member States have deducted cumulatively EUR 12.2 billion from the ESIF accounts through financial corrections applied by themselves (Table 7).

At the same time, however, the possibility to apply net financial corrections may not be a fully effective tool to deal with systemic or recurrent deficiencies extending beyond individual programmes. EU officials note that the procedure is subject to such strict cumulative conditions that it is practically impossible to trigger it. In particular, net corrections can be applied only if the Member State has not reported and remedied the irregularity, but the Commission should always inform the Member State of the opening of a procedure and allow the Member State to apply itself the financial correction. Since the Member State can avoid a net cut by correcting the irregularity, it has a strong incentive to do so by itself and re-use the money, without necessarily remedying the systemic deficiency (see Box 1). Since the start of the 2014-2020 programming period, the Commission has never applied a net financial correction as the conditions have never been met.

Table 6: Preventive measures adopted in 2021 and Q12022 by DG REGIO

Measure	2021	Q12022
Warning letters of corrective measures	15	11
Warning letters of possible interruptions	22	11
Interruptions of payment	4	4
Pre-suspension letters	1	0
Suspension decisions	0	1

Source: DG Regio Annual Activity Report 2021, Annex 7G

Table 7: Financial corrections: cumulative amounts deducted from ESIF accounts since the start of the 2014-2020 period and up to end of 2021 (in EUR million)

Measure	Amount
Financial corrections applied by Member States at their own initiative	12 178.7
Financial corrections requested by the Commission after the submission of annual accounts and implemented by Member States	281.6
Net financial corrections applied by the Commission	0

Source: DG Regio Annual Activity Report 2021, Annex 7H

⁶⁷ The sending of warning letters is an informal procedure not included in the regulation.

Box 1: Case study 1 – Application of financial corrections for deficiencies in the public procurement system

In 2017, the Commission identified serious deficiencies in a national public authority responsible for controls on public procurement contracts. Following the procedure, the Commission asked the Member State to apply a net correction (a 10% flat rate cut) on all contracts awarded under this authority. This represented a huge sum, of approximately EUR 1.6 billion. Even if this was presented by the media as a 'big penalty' from the EU Commission for mismanagement of EU funds, in practice it consisted of a financial correction applied by the Member State at the request of the Commission. This allowed the government to re-use the EU funds allocated to finance other projects not affected by the irregularity. Despite the application of this correction, the government did not correct the systemic deficiency in the public procurement system.

Source: own elaboration

4.1.2 Non-reimbursement of costs in case of non-compliance with horizontal enabling conditions

Another mechanism at the hands of the Commission is the possibility to exclude costs from the reimbursement if a Member State does not comply with one of the enabling conditions set out in Annex III of the CPR (Art. 15 CPR). If a Member State does not fulfil a thematic enabling condition the Commission shall not reimburse the expenditure related to operations linked to the concerned specific objective(s). In the case of 'horizontal' enabling conditions, applicable to all specific objectives, non-fulfilment implies a non-reimbursement of any costs except for those related to actions contributing to the fulfilment of these conditions.

There are four horizontal enabling conditions, two of them impose basic requirements on public procurement and state aid arrangements whereas the other two require compliance with the EU Charter of Fundamental Rights and with the UN Convention on rights of persons with disabilities.

The procedure in case of non-compliance with enabling conditions has been improved in comparison to the 2014-2020 rules on ex-ante conditionalities. In the previous programming period, the Commission had the power to suspend interim payments in case of non-compliance with ex-ante conditions but could only do so if the Member State failed to adopt some agreed remedial actions within a given calendar. In practice, the Commission did not suspend any payments due to non-fulfilment of ex-ante conditions even if many Member States failed to complete the remedial actions in due time (ECA 2017)⁶⁸.

Under the new Article 15 CPR, the suspension is automatic: if the condition is not fulfilled, the programme will be adopted and the Member State will receive the pre-financing but further costs will not be reimbursed until the enabling condition is fulfilled⁶⁹. Besides, the Commission has the power to stop payments at any time throughout the whole period of execution if it finds evidence proving that the enabling condition is no longer fulfilled.

Frequency of use and effectiveness

Article 15 CPR is applicable since the beginning of the 2021-2027 programming period. So far there has not been any case of non-reimbursement of costs due to non-compliance with horizontal enabling

⁶⁸ European Court of Auditors, "Ex ante conditionalities and performance reserve in Cohesion: innovative but not yet effective instruments". Special report num 15, 2017

⁶⁹ Legally speaking, it is not a suspension of payments but a non-reimbursement of costs. Unlike suspensions, non-reimbursement does not require the adoption of a decision by the Commission.

conditions but the threat of non-reimbursement of costs can be very powerful to induce changes at national level.

In particular, the procedure can be very effective to deal with systemic deficiencies in the public procurement system. It allows the Commission to stop all cost reimbursements in case of evidence of deficiencies without having to provide proof of irregular payments. However, some Commission officials note that the enabling condition on public procurement is defined in a very narrow and rather restrictive way.

It requires Member States to have 'effective monitoring mechanisms of the public procurement market' (Box 2). Compliance with this condition may not be sufficient to ensure a well-functioning public procurement market with adequate levels of competition and transparency. The same can be said of the enabling condition on state aid; it guarantees the public authority's capacity to apply the state aid rules but does not necessarily prevent an arbitrary application of these rules (Box 2).

Box 2: The horizontal enabling conditions on public procurement and state aid (Annex III Common Provisions Regulation)

Effective monitoring mechanisms of the public procurement market

Monitoring mechanisms are in place that cover all public contracts and their procurement under the Funds in line with Union procurement legislation. That requirement includes:

- 1) Arrangements to ensure compilation of effective and reliable data on public procurement procedures above the Union thresholds in accordance with reporting obligations under Articles 83 and 84 of Public procurement Directive
- 2) Arrangements to ensure the data cover at least the following elements:
 - (a) quality and intensity of competition: names of winning bidder, number of initial bidders and contractual value;
 - (b) information on final price after completion and on participation of SMEs as direct bidders, where national systems provide such information.
- 3) Arrangements to ensure monitoring and analysis of the data by the competent national authorities in accordance with public procurement EU directive
- 4) Arrangements to make the results of the analysis available to the public in accordance with public procurement directive
- 5) Arrangements to ensure that all information pointing to suspected bid-rigging situations is communicated to the competent national bodies

Tools and capacity for effective application of State aid rules

Managing authorities have the tools and capacity to verify compliance with State aid rules:

- 1) For undertakings in difficulty and undertakings under a recovery requirement
- 2) Through access to expert advice and guidance on State aid matters, provided by State aid experts of local or national bodies

Source: Annex III Common Provisions Regulation

Another relevant enabling condition is the one requiring compliance with the EU Charter of Fundamental Rights. The Charter contains various principles and rights to which all EU citizens are entitled. Some of them derive from the application of general rule of law principles enshrined in Article 2 TEU, such as the principle of non-discrimination, effective judicial protection or equality before the law (Box 3).

Box 3: The content of the EU Charter of Fundamental Rights

The Charter contains rights and principles in relation to six themes: Dignity, Freedoms, Equality, Solidarity, Citizens' Rights, and Justice.

'Dignity' (Articles 1-5): human dignity, the right to life, the right to the integrity of the person, prohibition of torture and inhuman or degrading treatment or punishment, prohibition of slavery and forced labour;

'Freedoms' (Articles 6-19): the right to liberty and security, respect for private and family life, protection of personal data, the right to marry and found a family, freedom of thought, conscience and religion, freedom of expression and information, freedom of assembly and association, freedom of the arts and sciences, the right to education, freedom to choose an occupation and the right to engage in work, freedom to conduct a business, the right to property, the right to asylum, protection in the event of removal, expulsion or extradition

'Equality' (Articles 20-26): equality before the law, non-discrimination, cultural, religious and linguistic diversity, equality between men and women, the rights of the child, the rights of the elderly, integration of persons with disabilities;

'Solidarity' (Articles 27-38): workers' right to information and consultation within the undertaking, the right of collective bargaining and action, the right of access to placement services, protection in the event of unjustified dismissal, fair and just working conditions, prohibition of child labour and protection of young people at work, family and professional life, social security and social assistance, health care, access to services of general economic interest, environmental protection, consumer protection;

'Citizens' rights' (Articles 39-46): the right to vote and stand as a candidate at elections to the European Parliament and at municipal elections, the right to good administration, the right of access to documents, the right to refer to the European Ombudsman, the right to petition, freedom of movement and residence, diplomatic and consular protection;

'Justice' (Articles 47-50): the right to an effective remedy and a fair trial, presumption of innocence and the right of defence, principles of legality and proportionality of criminal offences and penalties, the right not to be tried or punished twice in criminal proceedings for the same criminal offence

Source: own elaboration

Member States have a general obligation to respect the Charter's principles and rights when implementing EU law. The enabling condition requires in particular compliance with the Charter when implementing the ESIF and 'Home Funds' as well as the establishment of a compliance procedure to report non-respect of the Charter to the programme's monitoring committee⁷⁰ (Box 4).

⁷⁰ Monitoring committees monitor the implementation of operational programmes under cohesion policy. They oversee implementation and review issues affecting the progress of the programme towards achieving its objectives.

Box 4: The horizontal enabling condition 'Effective application and implementation of the Charter of Fundamental Rights' (Annex III Common Provisions Regulation)

Effective mechanisms are in place to ensure compliance with the Charter of Fundamental Rights of the European Union ('the Charter') which include:

1. Arrangements to ensure compliance of the programmes supported by the Funds and their implementation with the relevant provisions of the Charter.
2. Reporting arrangements to the monitoring committee regarding cases of non-compliance of operations supported by the Funds with the Charter and complaints regarding the Charter submitted in accordance with the arrangements made pursuant to Article 69(7).

Source: Annex III Common Provisions Regulation

Which types of actions or omissions by public authorities can be covered by this provision is not clear. A restrictive interpretation would be that the provision only covers actions taken by public authorities in charge of designing and implementing the EU funds, such as the adoption of tender rules or the selection of operations. This interpretation seems in line with the guidelines published by the Commission in 2016 on how to assess compliance with the Charter in the implementation of ESIF⁷¹. However, the Hungarian 2021-2027 Strategic Partnership Agreement⁷², adopted in December 2022, seems to indicate that this legal provision could also allow the Commission to block legislative reforms in areas such as the judiciary system, the education or the asylum system, insofar as such reforms infringe the Charter and have a concrete and direct impact on the implementation of ESIF or 'Home Funds' (see Box 5).

Box 5: Hungary's 2021-2027 Strategic Partnership Agreement and the enabling condition on compliance with the Charter of Fundamental Rights

The Commission adopted the Hungarian Strategic partnership agreement the 22nd of December 2022. The Partnership Agreement has not been posted at the Commission's website, but the press release informing about the approval of the agreement explains that, in the case of Hungary, the horizontal enabling condition on the Charter of Fundamental Rights will be considered fulfilled 'once Hungary has taken the measures on the judiciary to which it has committed under the country's Recovery and Resilience Plan'¹. This refers to a series of reforms aimed at the strengthening of judicial independence which have been included as milestones under the country's Recovery and Resilience Plan.

In addition to that, the Commission considers that 'the provisions of Hungary's so-called child-protection law, and serious risks to academic freedom and the right to asylum have a concrete and direct impact on the compliance with the Charter in the implementation of certain specific objectives of three cohesion programmes and of the Asylum Migration and Integration Fund respectively. For these parts of those programmes, 'Hungary is therefore currently not fulfilling the horizontal enabling condition on the EU Charter of Fundamental Rights'.

¹https://commission.europa.eu/publications/partnership-agreement-hungary-2021-2027_en

Source: own elaboration

⁷¹ 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'), 2016/C 269/01

⁷² Strategic Partnership Agreements are the strategic documents signed between the European Commission and EU Member States which lay down the national authorities' plans on how to use ESI and Home Funds during the 2021-2027 period.

4.1.3 Suspension of the approval of a programme or the amendment of a programme in case of non-compliance with the EU Charter of Fundamental Rights

EU funds in shared management (ESIF and 'Home Funds') are used according to operational programmes prepared by national authorities and approved by the Commission. Article 23 CPR stipulates that, at the moment of approving the programmes, the Commission shall assess if the programme complies with the obligations set out in the CPR, including a series of horizontal principles set out in Article 9 CPR. One of these principles is the need to 'ensure respect for fundamental rights and compliance with the Charter of Fundamental Rights of the European Union in the implementation of the Funds' (Art. 9(1) CPR).

If, at the moment of assessing the programme, the Commission considers that the programme is in breach of an obligation established in the CPR – and, particularly, that structures and procedures foreseen for the management, monitoring and control of the ESIF and 'Home Funds' do not guarantee compliance with the Charter - it may suspend the adoption of the programme and ask the Member State to review it. The suspension can last until five months after the first submission of the programme by the Member State (Art. 23 CPR), or four months in case of an amendment of the programme.

Frequency of use and effectiveness

The threat to suspend the approval of a programme or an amendment of a programme has been used once, and it has proved to be very effective to prevent the introduction of anti-discriminatory measures in Operational Programmes (see Box 6). However, it is a measure that can be applied only before the approval of the relevant programme or amendment and does not guarantee compliance with the EU Charter of Fundamental Rights during the implementation phase. Besides, the Commission can only suspend the approval of the programme for up to five months. After this period, the Commission shall decide on whether or not to approve the programme. While theoretically possible, it is hard to imagine the Commission rejecting the approval of a programme unless a Member State takes a confrontational stance against the Commission.

Box 6: Case study 2 – Suspension of the approval of the REACT-EU programme in response to 'anti-LGTBI' resolutions

During 2019 and 2020, five regional governments of a Member State passed resolutions opposing 'public activities aimed at promoting the ideology of LGTBI movements' and declaring themselves 'LGTBI-ideology free zones'. In response to this, the Commission sent a letter to the ESIF regional Managing Authorities of these regions in which they informed them that declaring LGTBI-free/unwelcome territories is against the Charter of Fundamental Rights and that, in consequence, they put on hold the REACT-EU programme amendments in relation to their regions. The threat of suspension was effective and all six regions ended up withdrawing their anti-LGTBI resolutions.

Source: own elaboration

4.1.4 Suspension of payments in case of an infringement procedure putting at risk the legality and regularity of expenditure

The CPR (Art. 97(1)(d)) also allows the Commission to suspend interim payments in cases in which there is an infringement procedure against a Member State on a matter putting at risk the legality and regularity of EU expenditure. This provision was first introduced in the 2000-2006 financial period. It was maintained during the 2007-2013 financial period, then removed in the 2014-2020 period and has been re-instated in the current 2021-2027 period.

Frequency of use and effectiveness

This provision has been rarely used. In the 2000-2006 period, it was activated once to deal with a situation in which a Member State infringed an EU sectoral law, the compliance with which was deemed necessary for the implementation of ESIF-related actions. This case was brought to the CJEU by the concerned Member State, and the Court held that the Commission could suspend ESIF payments as long as it proved the existence of a 'sufficiently direct link' between the ESIF financed measure and the EU sectoral law (see Box 7).

Box 7: Case study 3 – Suspension of payments due to non-compliance with the EU waste directive

In 2007, the Commission launched a procedure against a Member State for infringement of the EU Waste Directive. The Commission claimed in particular that the Member State had not adopted the necessary measures to ensure that the waste management system of a given region complied with all the EU health and environmental standards. In parallel to this, the Commission decided to suspend all ESI payments related to the operations included in the measure 1.7. of the Regional ERDF operational programme, which regrouped a number of actions to support the regional waste management and control system. The Member State brought the case to the EU Court of Justice as it considered that this infringement procedure did not enter into the scope of application of Article 97.(1).(d) of the CPR. In particular, the government argued that the infringement of the EU Directive had not put at risk the legality of the specific operations co-financed by the ESIF programme. The Court rejected the government's argument, and concluded that it was not necessary for the Commission to prove a link between the infringement of the EU law and specific ESIF co-financed projects. To suspend payments, it was 'sufficient for the Commission to establish that the matter covered by that procedure has a sufficiently direct link with the 'measure' governing the 'operations' to which the payment applications concerned relate'.

Source: own elaboration

Different interpretations of this 'sufficiently direct link' could justify a more extensive or more restrictive use of the Article 97(1)(d) procedure. For instance, the Commission has launched infringement procedures against 17 Member States for incorrect transposition of the PIF Directive (the Directive on the Protection of the EU's financial interests). This Directive sets common standards on criminal offences affecting the EU's financial interests. It is also the legal basis that ensures the good development and deployment of EPPO because the EPPO's powers are defined by reference to the PIF Directive. The PIF Directive also facilitates the recovery of misused EU funds through criminal law. Some experts interviewed for this study consider that, given all these arguments, an incorrect transposition of the PIF Directive could justify a suspension of payments under Article 97(1)(d) CPR.

Another element to take into account is that this provision only allows the Commission to suspend payments, not to apply corrections (e.g., cut) EU funds.

4.2 Procedures set out in the CAP legislation

The EU agricultural policy has been subject to an important reform in its objectives and mode of delivery. The new CAP became applicable in January 2023. Its legal basis is laid down in three regulations: (1) the CAP Strategic Plan Regulation, setting rules on the content, approval and implementation of the recently created 'national CAP strategic plans'; (2) the CAP Horizontal Financial Regulation, setting common financing rules for the two European agricultural funds: the European Agricultural Guarantee Fund (EAGF), which finances direct payments to farmers and market measures and the European Agricultural Fund for Rural Development (EAFRD), which finances rural development

measures; and (3) the Common Market Organization (CMO) Regulation, which regulates the use of market-support tools, exceptional measures and aid schemes for certain sectors.

Under the new CAP rules, the Commission has two mechanisms to protect the EU's financial interests. These two mechanisms only apply to expenditure under the CAP strategic plans; those market-support measures which are outside the CAP strategic plans are subject to other rules and procedures.

4.2.1 Suspensions and net financial corrections in case of serious deficiencies in national CAP governance systems

The CAP Horizontal Regulation⁷³ allows the Commission to apply interruptions, reductions or suspensions of monthly payments (EAGF) and suspensions of interim payments (EAFRD) when there is missing information or evidence of irregularities (Art 32(10), Art 39 and Art 40 CAP Horizontal Regulation). In these cases, the Commission shall offer to the Member State the possibility to provide the required documents or contest the Commission's findings, and this may eventually lead to the lifting of the suspension or a reimbursement (in case of reductions).

The Commission can also suspend payments in case of serious deficiencies in the proper functioning of the CAP governance systems (Art. 42 CAP Horizontal Regulation). Suspension can be due to deficiencies in key aspects of the management and control system but also in case of serious deficiencies in the system for the recovery of irregular payments from the final beneficiary. In case of identifying such serious deficiencies, the Commission will first ask the Member State to submit an action plan including the necessary remedial actions and clear progress indicators. Only if the Member State fails to submit or to implement the action plan, if the action plan is manifestly insufficient or if it has not been implemented in accordance with the Commission's request, the Commission can suspend the payment.

The suspension cannot last for more than 24 months. If, after this period, the deficiency has not been resolved, the Commission will take into account the amounts suspended when adopting financial corrections under Article 55.

In parallel to asking for an action plan, the Commission can launch a conformity procedure to determine whether to impose a financial correction on the Member State (Art. 55 CAP Horizontal Regulation). Unlike under the CPR, financial corrections under CAP are always net, e.g. they result in a permanent reduction of the Member State's funds. The conformity procedure is subject to a contradictory process which gives the concerned Member State wide possibilities to contest the Commission's findings. Before implementing any net financial correction, the Commission must offer the Member States the opportunity to provide evidence and arguments that contradict its findings. If there is no agreement between the two parts, the Member State may request the opinion of an independent conciliation body. The Commission shall take into account this opinion and provide justification if it decides to depart from it. The final decision shall be taken following the comitology's advisory procedure (that is, after having consulted the national representatives sitting at the Agricultural Funds Committee). The procedure is finalised with the adoption of a Commission Implementing Decision applying the financial correction (so-called 'ad hoc decisions')⁷⁴.

Finally, as in cohesion policy, a Commission Delegated Regulation⁷⁵ establishes detailed rules on how to calculate the level of financial corrections. Financial corrections are calculated on the basis of the

⁷³ Regulation (EU) 2021/2116 of the European Parliament and of the Council of 2 December 2021 on the financing, management and monitoring of the common agricultural policy

⁷⁴ The Ad hoc Decision can be challenged by the interested Member State before the EU General Court

⁷⁵ Regulation (EU) 2022/127

loss actually caused to the EU budget or on the basis of extrapolation if possible. If it is not possible to calculate or extrapolate the loss 'with proportionate effort' the Commission can apply flat-rate corrections. The level of flat-rate corrections can range from 2% to 25% and only in exceptional cases go beyond 25%. The Commission has detailed guidelines to determine and calculate financial corrections. The guidelines for the current programming period are under preparation. The past guidelines⁷⁶, which were built on CJEU case law, stipulated that, to apply flat-rate corrections, the Commission must prove the existence of a serious deficiency in the national CAP control system entailing a real risk of financial damage for the EU budget ('real risk' defined as a situation in which the Commission has 'reasonable and serious doubts' that the CAP financed operations have been executed in accordance with the applicable EU and national law).

Frequency of use and effectiveness

The Commission makes regular use of interruptions and suspensions/reductions of CAP payments when it has inconsistent or unclear information or suspicion of irregularities. In most cases, this concerns tiny amounts of money, affecting a large majority of Member States (20 countries in 2020) and part of this money is later returned to the Member States in the form of reimbursements, once they submit the required information. Both in 2020 and 2021, for instance, amounts reduced from EAGF monthly payments were lower than reimbursements (Table 8). In contrast, suspensions due to major deficiencies in the control system are more significant in terms of amounts affected but concern very few Member States. There were no such suspensions for deficiencies in 2021 and only 2 in 2020, amounting to EUR 175.4 million and EUR 12.3 million respectively.

Table 8: Preventive measures adopted in 2020 and 2021 by DG AGRI (EUR million)

Measure	2020	2021
Reductions of EAGF monthly payments	36.9	2.2
Reimbursements of EAGF amounts (from the Commission to Member States)	189.4	12.7
Suspensions of EAGF payments for deficiencies in control systems	187.7	0
Interruptions of EAFRD interim payments	16.8	10.2
Suspensions of EAFR interim payments	7.08	3.4

Source: DG AGRI Annual Activity Report 2020, Annex 7, part 10, p. 274 and DG AGRI Annual Activity Report 2020, Annex 7, part 10 p.281

As regards net financial corrections, the Commission adopts on average three ad-hoc decisions per year. The average amount of net financial corrections per year for the five-year period 2017-2021 was EUR 439.2 million for direct payments to farmers and EUR 172.2 million for rural development actions⁷⁷. A 2022 ECA report on the Commission's response to fraud on CAP concludes that the current system is overall effective⁷⁸. However, it points to some weaknesses. In particular, it highlights the limits to detect fraud resulting from illegal land grabbing.

⁷⁶ European Commission, "Guidelines on the calculation of the financial corrections in the framework of the conformity and financial clearance of accounts procedures", C(2015) 3675 final

⁷⁷ DG AGRI Annual Activity Report 2021, Annex 7, p.256.

⁷⁸ European Court of Auditors (2022), The Commission's response to fraud in the Common Agricultural Policy: Time to dig deeper, Special Report num 14.

Illegal land grabbing refers to the practice of obtaining land through illegal actions and then claiming CAP support on it. In certain circumstances, illegal land grabbing might be detected by CAP paying agencies (e.g. if the fraudster uses grossly falsified documents). However, if the fraudster obtains the land through a crime – e.g., coercion to farmers, extortion or collusion with public officials– but uses a formally legal document to claim CAP subsidies, the CAP paying agencies will not necessarily detect the issue (see Case study 4 – Box 8).

Box 8: Case study 4 – Problems of illegal land grabbing affecting CAP payments

In 2018, a delegation composed of CONT and LIBE Members of the European Parliament went on a fact-finding mission in a given Member State following numerous accusations of illegal land grabbing. In this Member State, due to the communist heritage, an important part of the land is owned by the State and managed by a ‘public land fund’ which can lease it out to farmers or agricultural companies on time-restricted contracts.

The delegation was faced with evidence of intimidation and physical violence against small farmers and confronted with accusations of malfunctioning against some public authorities. In particular, farmers complained that officials from the ‘public land fund’ collected bribes from interested farmers and agro-companies to secure long-term leases and cancelled contracts with farmers to lease the land to other interested parties with a remarkable degree of arbitrariness.

In 2020, OLAF concluded a series of investigations into this country and confirmed the existence of problems of illegal land grabbing. OLAF investigators pointed also to weaknesses in the verification procedures on land ownership applied by the CAP payment agency and addressed an administrative recommendation for action to DG AGRI which addressed it through its system audits. However, the investigation also revealed the malfunctioning of the ‘public land fund’ in the concerned Member State. The OLAF report concluded that the fund’s own procedures to provide contract leases ‘should be improved as regards its transparency and legal certainty’ and raised questions on ‘whether the process was applied in an efficient and non-discriminatory way’.

The ECA report mentioned above (ECA SR 14/2022) presents this case study as an example of weaknesses in the CAP management and control system. In its reply to the report, the Commission argues that the issues described in this case study ‘are not necessarily related to weaknesses in checks performed by the CAP paying agencies but rather to the shortcomings of how land ownership and land leases are managed in the specific Member State’. While it stresses the importance of improving controls applied by CAP paying agencies it concludes that ‘the focus should be the urgent need for those systems to be improved rather than looking at the side of Paying Agency controls as such’.

Source: own elaboration

4.2.2 Suspension of the approval of a CAP Strategic Plan or an amendment of a plan in case of non-compliance with the EU Charter of Fundamental Rights

Under the new CAP, the Member States have to design a ‘CAP Strategic Plan’ laying down how they intend to use the EU funds for CAP income support, rural development and certain market measures. As ESIF Strategic Plans, these new national CAP Strategic Plans have to be approved by the Commission.

The CAP Strategic Regulation stipulates that to approve the Plans, the Commission shall check that the Plan is compatible with the CAP rules and, particularly, with the general principles set in Article 9. One of these principles is the need to design the interventions in the CAP Plans ‘in accordance with the Charter of Fundamental Rights of the European Union and the general principles of Union law’. If the Commission considers that the Plan does not guarantee compliance with the Charter, it may suspend

the adoption of the programme for up to six months and ask the Member State to review the programme (Art. 118(5) CAP Strategic Regulation), or four months in case of an amendment of the Plan (Art. 119(6) CAP Strategic Regulation).

Frequency of use and effectiveness

This procedure is a novelty introduced in the post-2020 CAP. It has not been used so far as the Commission has approved all 27 national CAP Strategic Plans without any suspension.

4.3 Procedures set out in the RRF Regulation

The Recovery and Resilience Facility (RRF) is a new EU programme financed by Next Generation EU, which provides grants and access to concessional loans to Member States to finance National Recovery and Resilience Plans (NRRP).

The RRF is different to all other EU programmes. It is a performance-based instrument implemented through direct management, where the Member States are the beneficiaries. RRF payments are not conditioned to the respect of certain eligibility rules and not made on the basis of costs incurred; they are conditioned to the fulfilment of agreed objectives defined through milestones and targets. This has important implications from the point of view of the procedures to protect the EU's financial interests. Unlike with cohesion or CAP funding, the Commission cannot interrupt or suspend RRF payments any time it finds evidence of irregular use of RRF funds, i.e. a use not in conformity with the relevant EU and national laws. It can only do so if this irregularity endangers the satisfactory fulfilment of RRF milestones and targets. This does not mean that the Commission does not have any powers to protect the EU's financial interests under the RRF. As for programmes under shared management, the Commission checks that the management and control systems put in place by the Member States are appropriate and can step in, when there are deficiencies at the national level. In addition to that, through the establishment of milestones linked to reforms, the RRF can induce Member States to adopt and implement 'rule of law' related reforms.

4.3.1 The RRF recovery and reduction procedure

Article 22(5) of the RRF Regulation allows the Commission to reduce, recover or – in case of a loan – ask for early repayment of RRF funds if it finds evidence of fraud, corruption or conflicts of interests which have not been corrected by the Member State. These irregularities shall be found among the operations provided by the Member State as evidence for the fulfilment of the milestone or target as only in this case do they constitute an attack on the EU's financial interest, and must therefore be corrected either by the Member State, or if not, by the Commission.

Article 22(5) also allows the Commission to apply reductions or to ask for recovery of funds in cases of 'serious breaches of an obligation' resulting from the RRF grants and loans agreements signed with the Member State. The RRF Financial Agreements (Art. 3(15)) define 'serious breach of obligations' as a breach by the Member State of the obligations incorporated in the financial agreement concerning double funding (Art. 4), pre-financing (Art. 5), communication and visibility of Union funding (Art. 10), protection of EU's financial interest (Art. 11) and obligation to allow verifications and checks by the Commission, OLAF, ECA and EPPO (Art. 12), insofar as the breach 'adversely affects, in a material or substantial manner, the rights of the Commission or the proper implementation of Union funds'.

When the recovery or the reduction is due to irregularities (fraud, corruption or conflict of interest), the amount of the reduction will correspond to the amount affected. In case of reductions due to deficiencies in the Member State's RRF control systems, the Commission will apply a flat-rate reduction which can range from 5% to 100% depending on the frequency and extent of the deficiency (Art.

19(2)(b) RRF Financial Agreements). In all other cases of breaches of obligations resulting from the RRF Agreements, the Commission has wide discretion to set the amounts to be recovered even if it has to respect the principle of proportionality.

Frequency of use and effectiveness

The provisions of Article 22 (5) RRF Regulation have not yet been applied. On paper, they look quite powerful. Unlike the procedures for financial corrections under the CPR or the CAP Regulations, the Commission can cut RRF funds in cases there is a serious deficiency in the Member State's control system without having to find evidence of irregularities, and even if the milestones and targets have been fulfilled⁷⁹

The Commission has also wider discretion than under cohesion policy or CAP to calculate the amounts to be cut or recovered. Article 19 of the RRF Financial Agreement imposes a duty of proportionality and establishes some guidelines to calculate the percentage to be reduced (from 5% to 100% depending on the frequency and extent of the deficiency) but the guidelines are less detailed than those imposed under CAP or Cohesion policy. Finally, a 'serious breach of obligation' under RRF rules goes beyond a serious deficiency in the national management and control system. It can also include a breach of the Member States' obligation to allow verifications and checks by the Commission, OLAF, ECA and EPPO (Art. 12 RRF Bilateral Agreements).

4.3.2 RRF milestones and targets on audit/control and rule of law

The RRF conditions the payments to the fulfilment of certain reforms and actions. Progress in the achievement of these reforms is monitored through milestones (qualitative objectives) and targets (quantitative objectives). The commitments taken by Member States in the form of milestones and targets, as agreed with the Commission and approved by the Council, as well as the Commission's capacity to suspend RRF payments in case of non-fulfilment of milestones and targets constitute another important mechanism at the hands of the Commission to protect the EU's budget.

There are two relevant types of milestones and targets related to the protection of the EU's financial interests. On the one hand, the Commission can require the inclusion of 'audit and control' milestones in NRRPs, that is, actions to remedy detected deficiencies in the RRF management and control systems. These milestones, also called 'super milestones', are imposed as pre-conditions to receive the first RRF payment (aside from the pre-financing payment). Apart from these 'super milestones', NRRPs can include milestones and targets related to reforms or actions aimed at strengthening compliance with some rule of law principles, such as reforms to guarantee the independence of the judicial system, to strengthen the anti-corruption system or improve the anti-money laundering system. The inclusion of specific rule of law reforms in the NRRPs can be requested from Member States having received Country-Specific Recommendations (CSRs) on these topics⁸⁰.

Progress in the achievement of each reform or action is monitored through the achievement of intermediate and final milestones and targets. To receive RRF funding, Member States have to submit payment requests. The calendar for payments and the corresponding milestones or targets to be

⁷⁹ The Commission regularly assesses the functioning of national RRF control systems through controls carried out on payment requests submitted by Member State. In addition to that, the Commission undertakes system audits on the protection of the financial interests of the European Union to provide assurance that the Member States' control systems are fully effective regarding the prevention, detection and correction of fraud, corruption and conflict of interests and are compliant with the financing and loan agreements signed with the Commission. 19 national systems have already been audited to date, three of which are finalised. The Commission intends to audit all remaining ones by the end of 2023

⁸⁰ In some cases (notably in the Hungarian and Polish NRRPs) some 'rule of law' milestones considered instrumental to address rule of law challenges are at the same time deemed necessary to remedy deficiencies in the audit and control system. For instance, in the case of Poland, the two super milestones on the disciplinary regime for Polish judges are relevant both to ensure compliance with Article 22 of the RRF Regulation (EU's financial interests) and to address the CSR on the investment climate and judicial independence.

fulfilled to receive each payment are defined in a Council Implementing Decision (CID). The so-called 'Operational Arrangements' (OA) establish in detail the type of documents or data (i.e., the verification mechanism) required to certify the fulfilment of each milestone or target. The Commission is in charge of assessing whether the Member State has achieved the required milestones and targets. If the assessment is negative, it will apply a partial or total suspension of the payment. If, after six months, the milestone is still unfulfilled the Commission will reduce the amount of RRF funds.

Frequency of use and effectiveness

The Commission has made extensive use of the possibility to require control and audit milestones. Out of the 27 plans adopted so far, 23 Member States have been required to include specific milestones to remedy certain deficiencies in their management and control systems. The actions required are very varied but most of them are specific and not necessarily related to potential breaches of rule of law principles – e.g. requests to set up a repository system able to collect and store RRF data on actions and final beneficiaries or to strengthen the administrative capacity of the RRF implementing and audit bodies. Certain Member States, however, are requested to introduce or improve their audit strategy or anti-fraud measures.

However, given that these 'super milestones' are imposed as conditions for the first payments, most of them consist of rather formal or legal obligations, such as the requirement to set up new laws, administrative procedures or structures. Fulfilment with these conditions is not sufficient to guarantee that these new rules, procedures or structures will function correctly throughout the whole period of the RRF implementation (see Box 9). But they guarantee that these new rules, procedures or structures should remain in place as their reversal would allow for the Commission to suspend and – where relevant - recover RRF funding (see Art. 24(3) RRF Regulation).

Box 9: Case study 5 – Fulfilment of an 'audit and control' milestone requiring the establishment of a repository system able to collect and store RRF data

One Member State had to comply with an 'audit and control' milestone requiring the establishment of a repository system able to collect and store RRF data. The Council Implementing Decision and the Operational Agreement stipulated that, for the satisfactory fulfilment of this milestone, the Member State had to design the new system but not necessarily prove it to be fully functional.

The audit report by the Commission therefore concentrated on the design of the system, and not its actual operation. The Commission however asked for supplementary information to verify whether the system was actually able to collect and store data on beneficiaries, contractors, subcontractors, and beneficial owners. It detected some weaknesses in the functioning of the system. The Commission discussed these weaknesses with the national authorities, who agreed to resolve them but alerted that the solutions would take between six and nine months to implement. Despite that, the Commission considered that the milestone had been satisfactorily fulfilled, made a positive assessment of the payment request and did not impose any formal action plan to the national authorities to remedy this deficiency.

Source: ECA

As regards the 'rule of law' milestones, these are related to three main groups of actions or reforms: those aimed at strengthening judicial independence, those aimed at strengthening anti-fraud and anti-corruption policies and structures and those aimed at improving anti-money laundering procedures and structures. Unlike the 'super milestones', which are imposed as conditions for the first payment, 'rule of law' milestones can be imposed in successive payments, as both intermediary and final milestones to assess the adoption and successful implementation of certain reforms. Having said so, some milestones related to anti-fraud and anti-corruption have been defined as 'super milestones' and,

in two NRRPs (those of Hungary and Poland), some milestones related to the independence of the judicial system have been also defined as ‘super milestones’ and thus been imposed as pre-conditions to receive the first payment.

Table 9: Rule of law measures included in NRRPs

Overall objective	Main actions or reforms required	Member States from which these actions or reforms have been required
Judicial Independence	Reforms aimed at separating prosecution services from the investigative branch, encouraging the independence of magistrates, strengthening the legislative framework and transparency in the area of courts, judges, prosecutors and bailiffs or strengthening judicial independence and transparency by making legislative changes	CZ, HU, MT, PL, RO, SK
Anti-fraud and anti-corruption	Adoption of national anti-corruption action plans, the establishment of independent anti-corruption bodies, strengthening mechanisms for the data collection on fraud and corruption, new legislation on conflict of interest, new legislation to protect whistle-blowers, new legislation on asset declarations, new legislation against tax evasion and fraud	CY, CZ, HR, HU, IT, LT, MT RO, SK, ES
Anti-money laundering	Measures to strengthen prevention and detection of money laundering and terrorist financing, new legislation on business register, enforcement of investigation and judicial prosecution of money laundering	EE, FI, IE, LV, LU, SK

Source: European Commission, ‘Recovery and Resilience Scoreboard thematic analysis: rule of law and judicial systems’ and ‘Recovery and Resilience Scoreboard thematic analysis: anti-corruption and anti-fraud’, April 2022, complemented with information from the Hungarian and Polish NRRPs

It is still too early to judge the effectiveness of these rule of law milestones. The most important ones are those related to reforms aimed at strengthening judicial independence. At the moment of writing, among the six Member States whose NRRPs include milestones on judicial independence, three have already submitted RRF payment requests conditioned to the fulfilment of such milestones. In all cases (Czechia, Malta and Slovakia) these were reforms enacted before the adoption of the NRRPs and thus not imposed by the Commission. The big test will be countries having systemic problems of judicial independence and to which milestones on judicial independence have been imposed, i.e., Poland and Hungary. At the moment of writing, neither of these two countries has presented an RRF payment request.

It is also important to highlight that, in the case of Hungary, RRF milestones have been used in coordination with the application of the Conditionality Mechanism. More specifically, in the rule of law conditionality procedure, Hungary submitted 17 remedial measures intended to address the Commission’s findings. To monitor the effective implementation of these measures – which could lead to a lifting of the measures applied under the Conditionality Regulation – the Commission has defined intermediate and final implementation milestones and has conditioned the disbursement of the RRF funds to the fulfilment of these milestones.

Leaving aside whether or not these milestones will be effective, some of the limitations in using rule of law milestones as a way to improve respect for rule of law principles should be noted. The most important one is that this is a ‘one-shot’ measure: only those countries having received country-specific recommendations on rule of law issues in 2019 or 2020 - as well as Bulgaria and Romania, which have received rule of law recommendations in the context of their Cooperation and Verification Mechanisms

- have been requested to include milestones and targets on these issues to get their NRRPs approved. Except if the Member State requests to amend its plan, these milestones and targets cannot be modified. Thus, if, in the coming years, a Member State experiences a process of rule of law backsliding, the Commission cannot use this tool of its own accord to remedy this and impose new 'rule of law' milestones to this country. However, the Commission can suspend and – where relevant - recover RRF funding were the Member State to backtrack on previously met rule of law milestones (see Art. 24(3) RRF Regulation).

4.4 Procedures set out in the Financial Regulation

The Financial Regulation (FR) includes various procedures and mechanisms to protect the EU's financial interests in areas under direct or indirect management as well as in the use of Macro-economic financial assistance loans.

4.4.1 Suspension, reduction or termination of award procedures or agreements

Article 131 FR allows the Commission to suspend an award procedure if there is suspicion of irregularities or fraud being committed in the preparation of the procedure. If these suspicions are confirmed, the Commission will cancel the procedure.

The article also allows the Commission to suspend payments or interrupt the implementation of a grant agreement or a contract in case of suspected fraud, irregularities or breaches of obligations by the entity or person signing the agreement or by some final recipients (e.g. in case of a framework financial partnership agreement). If the presumed fault is confirmed, the Commission can terminate the agreement as a whole (if the fault is committed by the entity or person signing the agreement) or in part (if the fault only concerns some final recipients).

Frequency of use and effectiveness

Article 131 FR allows the Commission to apply preventive and corrective measures in areas of direct or indirect management. In 2021, preventive measures (deduction of amounts before payment) amounted to EUR 298 million whereas the corrections implemented by the Commission after payment/acceptance amounted to EUR 765 million. These are minor amounts if compared with the total amount of EUR 4 557 million deducted by Member States in areas of shared management through preventive and corrective measures⁸¹.

From a rule of law perspective, it should be noted that contracts and grant agreements can be suspended or cancelled as a result of fraud or corruption but also as a result of a breach of the obligations included in the agreement. In addition to that, the Commission can cut EU funds to implementing partners having signed global grant agreements (so-called 'framework financial partnership agreements') if they do not respect these principles of transparency and equal treatment when distributing the EU funds to the final recipients (Art. 130(4)(d) FR).

4.4.2 The Early Detection and Exclusion System (EDES)

The Early Detection and Exclusion System (EDES) is a system established in 2016 and revised in 2018, which allows the Commission to blacklist and exclude unreliable economic operators (individuals or public or private entities) from future EU tenders. The EDES procedure only applies to EU funds under

⁸¹ European Commission, Annual Management and Performance Report for the EU Budget - Financial Year 2021, Annex II, COM(2022) 401 final/2

direct or indirect management. In the context of the upcoming revision of the Financial Regulation, the Commission proposes to extend the use of EDES to shared management.

The Commission's authorising officers of the different 'spending' DGs are responsible for detecting unreliable operators and registering them in the EDES database. As a first step, they can blacklist the operator. This does not prevent operators from applying to tenders and receiving EU funds but serves as an alert for the other authorising officers. In a second step, if the Commission has conclusive evidence about the situation rendering the economic operator unreliable, the operator can be excluded. Exclusion can be based on different grounds; some of them related to lack of capacity to execute the projects (e.g. bankruptcy, insolvency, non-payment of taxes or social security contributions) and others related to issues of integrity (having committed fraud, corruption or other illegal activities in the past, significant non-compliance with main obligations under EU contracts, grave professional misconduct). The exclusion procedure depends on the type of exclusion situation. Authorising officers can directly exclude counterparties for bankruptcy or insolvency as well as for non-payment of taxes or social security contributions based on final judgements or administrative decisions. For the other situations, the authorising officer shall send a request for exclusion to an independent EDES panel composed of an independent chair, two permanent members designated by DG BUDG and a representative of the DG making the request. In some cases, the exclusion decision can be accompanied by a financial penalty and the decision to publish the name of the operator on the Commission's webpage.

Frequency of use and effectiveness

According to a 2022 ECA report on EDES⁸², between 2016 and 2020 the EDES database resulted in the exclusion of 448 economic operators. The overwhelming majority of cases (430, or 98% of cases) were exclusions due to insolvency and bankruptcy and only 18 cases were exclusions related to other reasons. Only two cases of exclusion were cases related to fraud and corruption. Nearly half of all cases registered to EDES were included by the Commission's departments and agencies responsible for research and innovation spending (DG RTD and REA).

The ECA report concludes that the system has a broad scope and robust decision-making procedures but that the Commission services have made little use of it. Whereas EDES has an exclusion rate of 2.5 (number of excluded operators per billion euros), its equivalent US federal exclusion system obtains a rate of 25. Besides, exclusion has been focused on cases of bankruptcy and insolvency but has not been much used to deal with problems of fraud or corruption.

In the context of the upcoming revision of the Financial Regulation, the Commission proposes to add new grounds for exclusion under EDES. On the one hand, two new situations of 'grave professional misconduct' are listed as potentially leading to an exclusion: an entity which attempts to influence the award of EU funds by taking advantage of a conflict of interest and an entity having engaged in incitement to discrimination, hatred or violence against a group of persons or a member of a group where such misconduct negatively affects or concretely risks affecting the performance of the legal commitment with the Commission. On the other hand, an additional autonomous ground for exclusion is included: the refusal to cooperate with OLAF, EPPO or the Court of Auditors.

4.4.3 Ex ante assessment of implementing partners

The Commission can entrust budget implementation tasks to Member States' organisations (Art. 62(1)(c)(v) FR) or national bodies governed by private law with a public service mission (Art. 62(1)(c)(vi)

⁸² European Court of Auditors (2022), Protecting the EU budget: Better use of blacklisting needed, special report number 11

FR). Before signing contribution agreements or guarantee agreements with these entities, the Commission shall carry out an ex-ante assessment of the systems, rules and procedures of the entities implementing Union funds. If it concludes that entities' internal control systems are not sufficiently robust to prevent and correct fraud, that rules and procedures for providing financing to third parties do not respect certain principles (such as the principles of transparency and non-discrimination), that they do not have efficient and effective review procedures or do not have effective rules for recovering funds unduly paid they will not sign an agreement with these entities (Art. 154 FR).

Frequency of use and effectiveness

Indirect management is particularly important in areas of the EU's external action where implementing partners are third countries and international organisations. Within the Union, national public authorities act as implementing partners in some tiny EU programmes, such as Erasmus+ (EUR 2.3 billion in 2021-2027) or the EU solidarity corps (EUR 114.4 million). In addition to that, during the 2021-2027 period, national promotional banks can act as implementing partners of the InvestEU guarantee, alongside the EIB group and some other international public bank institutions.

According to the DG Education and Culture 2021 annual activity report, implementation through Erasmus+ national agencies does not raise major concerns. The aggregate 2014-2020 residual error rate for the implementation through these entities is estimated to be very low (0.83%), with only some weaknesses having been detected in the national Erasmus national agencies of Bulgaria and North Macedonia. As regards national promotional banks, their role as implementing partners is a novelty as the predecessor of the InvestEU guarantee, the EFSI guarantee, was exclusively implemented through the EIB group.

4.4.4 Early repayment of loans

EU countries can receive financial assistance in form of loans guaranteed by the EU budget. The Commission releases the loans in instalments conditioned on the fulfilment of pre-defined conditions. Article 220 FR stipulates that loan agreements must include the obligation of the beneficiary country to take appropriate measures to prevent irregularities and fraud, and, if necessary, take legal action to recover any funds misused (Art. 220(5)(a) FR). The agreement shall also entitle the Commission to early repayment of the loan where it has been established that, in relation to the management of the financial assistance, the beneficiary country has engaged in any act of fraud or corruption or any other illegal activity detrimental to the financial interests of the Union (Art. 220(5)(d) FR).

Frequency of use and effectiveness

We have not found any evidence of a situation in which the Commission has made use of Article 220(5)(d) FR and required the early repayment of loans for reasons of fraud, corruption or any other illegal activity committed by the beneficiary country. On paper, however, the provision looks rather restrictive. It can only be used when there is established evidence of fraud, corruption or another illegal activity committed by the Member State and directly related to the management of the EU loan.

4.5 Recoveries under own resources

Member State authorities are responsible for collecting and making the amounts of Traditional Own Resources (TOR) available in a timely manner to the Commission, whereas the other own resources are calculated and called from the Member States by the Commission. The methods and procedure to make available the OR are set out in the Council Regulation 609/2014 (Making Available Regulation –

MAR)⁸³, which was amended in 2022 to enhance predictability and clarify procedures for dispute resolution.

Member States make available the TOR every two months after establishment, on the basis of Member States' collection of the relevant duties and levies and after the deduction of the collection costs. Contributions for VAT, GNI own resources and the resource based on non-recycled plastic packaging waste are also made available every month based on the call sent by the Commission. The amounts transferred to the EU are one-twelfth of the estimated annual contribution per Member State, which is in a first stage defined based on a forecast and ultimately on the information provided by the Member State (the harmonised VAT base, the GNI data and the annual statement of the amount of the own resource based on non-recycled plastic packaging waste).

The Commission conducts on-the-spot inspections to check that national customs authorities correctly apply the EU customs legislation and carry on the necessary controls to prevent and detect customs tax fraud. If the Commission detects deficiencies in the national customs systems, it will issue a recovery order - Member States are financially responsible for any resulting loss of EU revenue. As regards the GNI own resource, the GNI data provided by the Member State is verified by Eurostat officials and is formally presented for opinion to the GNI expert group, composed of representatives of the Member States. The verification may be done for the current year or on a multi-annual basis and it may lead to an upward or downward revision of the Member State's GNI contribution and a corresponding adjustment of future payments.

The Member States shall make the payments of own resources within the period requested. A delay in paying own resources might give rise to payment of interest (Art. 12 MAR). If the Member State refuses to make the payment, the Commission will consider launching an infringement procedure.

Frequency of use and effectiveness

The system to collect EU revenues is generally effective. In its 2021 annual EU budget report, the Court of Auditors classified the revenue system as free from material error (i.e. all payments were made in line with the rules and requirements). A recent ECA special report identifies some problems in the application of customs control by Member States⁸⁴. There are also problems with VAT fraud, particularly intra-community fraud⁸⁵, but most of the time these weaknesses are corrected without creating disputes with the Commission. The Commission's 2021 annual budget management report indicates the existence of only one reservation on the revenue side.

4.6 Overall assessment and conclusions

The various layers of protection described in this chapter protect the EU budget from different types of risks. Some of them (the EDES system) protect the EU budget from risks of insolvency, negligence, fraud or irregularity committed by private actors (potential beneficiaries of EU funds). The most important layers of protection, however, are 'second-level' layers, applied to EU funds managed by national authorities (Cohesion, 'Home' and CAP Funds, RRF) and protecting the EU budget from actions or omissions by public authorities.

These second-level 'layers of protection' can cover different types of risks. To start with, all EU sectoral regulations endow the Commission with powers to 'step in' in case of malfunctioning of national authorities in charge of implementing or controlling the use of EU funds. The specific procedures and

⁸³ Council regulation 609/2014 of 26 May 2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources, amended by Council Regulation 2022/615 of 5 April 2022

⁸⁴ European Court of Auditors (2021) Customs controls: insufficient harmonisation hampers EU financial interests, special report 4/2021.

⁸⁵ Pouwels, Alexandra (2021), Missing Trader Intra-Community Fraud, Briefing requested by the CONT committee, European Parliament.

rules vary from one fund to the other. However, generally speaking, they all build upon the assumption that the malfunctioning is not intentional and does not result from a breach of a rule of law principle but is due to deficiencies or lack of administrative capacity. Consequently, they favour the use of preventive remedies (interruptions and suspensions) rather than corrective tools, allowing the Member State to correct the deficiency in the national system. Besides, they are designed to deal with individual deficiencies affecting a given institution or body in charge of managing and controlling a specific EU programme. Thus, they are not very effective to deal with systemic deficiencies introduced through changes in the legal framework or general, nation-wide administrative decisions.

They are also ineffective to protect the EU's financial interests from the malfunctioning of public authorities not directly involved in the management or control of the EU funds. This includes public prosecution or judicial authorities, which are essential to guarantee that fraudsters of EU funds or public authorities mismanaging EU funds are properly prosecuted and receive appropriate and dissuasive penalties. This can also include other public authorities whose actions or omissions have indirect effects on the use of EU funds. This is the case, for instance, of public land registry or land management authorities, which are in charge of registering land ownership and thus, indirectly, determine eligibility for CAP payments.

Apart from the classic procedures to react to deficiencies in the management and control of EU funds, Cohesion policy and 'Home Funds' Regulations allow the Commission to suspend payments or the adoption of new programmes (or amendments to these programmes) in case of non-compliance with the EU Charter of Fundamental Rights. This is a powerful provision which has proved to be effective to prevent the adoption of anti-LGTBI measures in some regions. The Hungarian 2021-2027 ESIF Strategic Partnership agreement seems to indicate that this legal provision could also allow the Commission to block legislative reforms in areas such as the judiciary system, the education or the asylum system, insofar as such reforms infringe the Charter and have a concrete and direct impact on the implementation of ESIF or 'Home Funds'.

Finally, through the establishment of RRF milestones related to rule of law issues, the Commission can induce national governments to adopt reforms in the area of judicial independence, fight against corruption or anti-money laundering. The real effectiveness of this instrument has not yet been tested at the moment of writing this study, but a considerable limitation in using RRF rule of law milestones is that this is a 'one-shot' measure: only those countries having received country-specific recommendations on rule of law issues in 2019 or 2020 (plus Bulgaria and Romania) have been requested to include milestones and targets on these issues to get their Plans approved, and these milestones and targets cannot be modified in the future, unless the Member State agrees to do so through an amendment of the Plan. Thus, if in the coming years, a Member State experiences a process of rule of law backsliding, the Commission cannot use this tool to remedy this and impose new 'rule of law' milestones to this country.

5 TOWARDS A TYPOLOGY

Chapter summary

The Conditionality Regulation can in some cases be more effective than other instruments in protecting the EU budget against breaches of the principles of the rule of law. As long as it complies with the principle of proportionality, the mechanism allows for a considerable degree of flexibility in the measures to be adopted. It is also the only procedure covering risks affecting all EU revenues and expenditure, and has more comprehensive (and effective) coverage of potential risks stemming from breaches of the rule of law principles. Its procedure follows a fundamentally case-by-case approach, allowing the consideration of several case-specific dimensions, and involves the Council. However, it might not always be the most effective solution. The ‘complementarity test’ with other mechanisms therefore plays a critical role in determining the most appropriate mechanism to be used.

The notion of a ‘sufficiently direct link’ between breaches of the rule of law principles and the effect or serious risk of effect on the EU’s financial interests is a new concept, and the Court rulings do not clarify this link in a definitive manner. This gives rise to different interpretations of what constitutes a link that would allow this mechanism to be triggered.

The typology presented in this chapter describes hypothetical situations that could – but do not necessarily – trigger the Conditionality Mechanism. It classifies the potential situations into three groups according to the type of public authority concerned:

1. Administrative authorities directly involved in the implementation, management and control of EU funds
2. Public prosecution and judicial authorities
3. Other administrative authorities not directly involved in the management and control of EU funds, but whose actions are relevant to the sound management of the EU budget or the protection of the EU’s financial interests

In particular, the typology covers situations that fulfil two conditions: 1) there is a breach of one or various rule of law principles resulting into real or potential damage for the EU’s budget or the EU financial interests; 2) the Conditionality Mechanism is likely to be more effective than existing layers of protection to address this situation. For each situation, we discuss how different interpretations of the “sufficiently direct link” may or may not allow the triggering of the Conditionality Regulation. In all cases, the Commission will need robust evidence to prove that these conditions are met, which may be difficult in certain circumstances.

This chapter presents a typology of hypothetical situations that could, under certain circumstances, justify the triggering of the rule of law Conditionality Regulation. More specifically, it defines scenarios in which (a) there are breaches of the principles of rule of law that may have a negative impact on the EU budget or the EU’s financial interests and (b) the Conditionality Regulation would likely be more effective than existing layers of protection to address the situation.

Each of these situations could fall within the scope of application of the Regulation if a third, important condition is fulfilled: the existence of a ‘sufficiently direct link’ between the breaches of the principles of rule of law and the effect or the serious risk of effect on the EU’s financial interests. The notion of ‘sufficiently direct link’ is new. There is still no CJEU jurisprudence on that and there may be different

visions of what constitutes a link that would lead to the triggering of the mechanism. In the presentation of our hypothetical cases, we discuss how different interpretations of this notion may or may not allow the triggering of the Conditionality Regulation in each case.

The chapter starts with a discussion of the ‘complementarity test’, describing in general terms the situations in which the new rule of law Conditionality Mechanism can be more effective than other existing layers of protection, either applied alone or in combination with these other instruments. We then discuss the notion of ‘sufficiently direct link’, pointing at different possible interpretations of this expression. In section 5.3 we present our typology of possible non-exhaustive situations that may fall within the scope of the Regulation. For each hypothetical situation, we present a script of a fictitious case to illustrate it in a non-technical language.

5.1 The ‘complementarity test’ – when would the Conditionality Mechanism be more effective?

According to the Commission’s Guidelines, to evaluate if the Conditionality Mechanism is more effective than other existing ‘layers of protection’ the Commission will use two indicative criteria applied in the light of the specific circumstances of each situation: the scope of the effect (or the risk of effect) to the EU budget resulting from the breach of the rule of law principle and the types of remedies available to respond to this risk. The Commission Guidelines also explain that the Conditionality Mechanism can be used as an alternative to the other layers of protection when there is a risk to the EU budget not or insufficiently covered by the existing provisions⁸⁶. It can also be deployed alongside or after the adoption of other provisions, if the Commission considers that a cumulative application will protect the EU budget more effectively.

The effectiveness of an instrument in the light of the two indicative criteria will depend on various features of the instrument, particularly its coverage (whether it covers all EU revenues and spending or only EU revenues or some specific EU spending programmes), the type of risk to the EU budget it addresses as well as the measures that can be applied with this instrument. Table 10 in Annex 2 presents the Conditionality Mechanism and the other layers of protection according to these three features.

The first thing to notice is that the Conditionality Mechanism is the only procedure covering risks affecting all EU revenues and expenditure. Even if the EDES is extended to EU spending under shared management (as proposed by the Commission in the revision of the Financial Regulation), it will not cover risks linked to the collection of EU revenues – leaving aside the fact that EDES is not designed to cover risks arising from actions or omissions by public authorities. Thus, as argued by the Commission’s assessment of the Hungarian case, the Conditionality regulation is particularly appropriate to reinforce the action of the existing layers of protection in cases of issues having a widespread effect on the whole EU budget.

Second, as regards the type of risk addressed (second column) the existing layers of protection do not allow the Commission to protect the EU budget from all possible risks resulting from actions or omissions by national public authorities. The Commission has mechanisms to react in case of malfunctioning of the authorities in charge of managing and controlling EU funds, be it under shared management or direct or indirect management (situations referred to in Article 4(2) (a) and (b) of the Conditionality Regulation). However, leaving aside the specific case of rule of law RRF milestones, existing procedures cannot protect the EU financial interests from the malfunctioning of public

⁸⁶ Using the language of the guidelines, ‘situations where the measures under the Conditionality Regulation can be more effective in protecting the Union budget’

prosecution and judicial authorities (situations referred to in Article 4(2) (c) and (d)) including the lack of effective and dissuasive penalties imposed on fraudsters by independent courts (Article 4(2) (e)). They are also unable to respond to the malfunctioning of administrative authorities which are not directly involved in the implementation or control of the EU funds but whose actions indirectly influence how these funds are used. The Conditionality Regulation is more effective than existing layers of protection to address these situations – even if, as discussed in the subsequent section, it can only be activated if the Commission proves that the malfunctioning of these authorities results from a breach of a rule of law principle and the latter affects or risks affecting the Union budget in a sufficiently direct way.

Third, the various existing procedures to protect the EU budget may have specific gaps in terms of coverage or effectiveness. Concerning coverage, deficiencies in the system for the recovery of irregular payments constitute a ground for suspending or cutting CAP funds but not for suspending, let alone reducing, cohesion policy funds. The same can be said about the lack of effective and timely cooperation with OLAF and EPPO (Article 4(2) (g)), which can be a ground for cutting RRF funds but not cohesion or CAP funds. Regarding effectiveness, the imposition of net corrections under cohesion policy is subject to very strict and restricting conditions, rendering the procedure practically useless. In these cases, the Conditionality Mechanism can be used in addition to or following the adoption of other procedures to ensure better protection of the EU's financial interests.

Fourth, generally speaking, existing procedures and mechanisms are not very effective to deal with risks to the EU budget resulting from changes in the legal framework or general, nationwide administrative decisions having an impact on the implementation of EU funds. Most of them are designed to deal with individual deficiencies affecting a given institution or body in charge of managing and controlling a specific EU programme. In some cases, to be applied, the Commission even needs to prove that the risk to the EU budget has materialised (e.g., net corrections under cohesion policy). Only some layers of protection can be used in a more forward-looking manner and in response to general changes in EU laws or nationwide administrative decisions. For instance, the Commission may suspend cohesion or 'Home Funds' if a Member State infringes an EU sectoral law whose compliance is deemed necessary for the implementation of EU-funded actions without having to prove that this infringement has caused a material loss to the EU budget. The Commission can also suspend the approval or the amendment of a cohesion policy programme, a 'Home' fund's programme or a CAP strategic plan if it considers that these programmes or plans do not ensure compliance with the EU Charter of Fundamental Rights. In application of the horizontal enabling condition, it can also suspend the reimbursement of costs related to operations co-financed with cohesion or 'Home Funds' at any time throughout the whole period of execution if it has evidence proving that the Charter is no longer respected in the implementation of the programme. These provisions have proved to be very powerful in the past. However, they only cover certain EU programmes. Besides, the scope of the enabling condition is more restrictive than the one of the Conditionality Regulation. Whereas breaches of some rule of law principles almost automatically entail non-respect of fundamental rights and freedoms in the exercise of public action – e.g., prohibition of arbitrariness of the executive power, non-discrimination, effective judicial protection or equality before the law – in other cases, the link is not so direct and automatic – e.g. legality and legal certainty, separation of powers.

Fifth, if we look at the type of remedy applied, the Conditionality Mechanism offers a lot of flexibility regarding the measures to be adopted, even if there is a duty of proportionality. Not only the Commission has a wide range of possible measures to propose but the Member State concerned can propose and adopt remedial measures, both before and after the adoption of measures by the Council. This flexibility and the capacity to combine it with other procedures (as seen in the application of the

Conditionality mechanism to Hungary) render this instrument quite powerful vis-à-vis the other layers of protection.

Finally, a last point to take into account is that the ‘complementarity test’ is a relative test of effectiveness and thus it should not be presumed that the Regulation will be an effective solution in all cases. In some situations, the Commission may conclude that the Regulation is not very effective because, for instance, there is a need for a quick response or there are no clear and monitorable remedial actions to be imposed to the Member State to address the situation.

5.2 The notion of ‘sufficiently direct link’ - different possible interpretations

Under Article 4(2) of the Regulation, for the Conditionality Regulation to apply, breaches of the rule of law must affect or seriously risk affecting the EU budget in a sufficiently direct way. As discussed in Chapter 3, whereas the Court repeatedly reiterated in its judgments that this condition requires that a ‘genuine’ link be established between the breach of the rule of law and the EU budget, it does not go into further detail *when* such a link is genuine. The Guidelines complement the CJEU ruling by saying that the notion of ‘genuine link’ refers to the fact that the Regulation ‘should not be triggered with regard to situations in which the connection is merely hypothetical, too uncertain or too vague’. Despite this clarification, there are still several possible interpretations of what makes a link sufficiently direct, or certain, to allow the application of the Conditionality Regulation.

The existence of such a link is clear in cases in which the breach of rule of law results from actions or omissions by public authorities in charge of managing and controlling the use of EU funds. As repeatedly mentioned in the CJEU jurisprudence on CAP corrections, serious deficiencies in national management and control systems entail a direct and real risk of financial damage to the EU budget. A different situation is when the infringement comes from the adoption of a national law or a nationwide administrative decision which is of relevance for the implementation of EU funds. In this case, it is worth recalling the CJEU jurisprudence as regards the application of the CPR provision allowing the Commission to suspend EU payments in case of an infringement procedure putting at risk the legality and regularity of EU expenditure (see section 4.1.4 and box 7). In a CJEU case of 2013, the Court concluded that to suspend EU cohesion payments, it was sufficient for the Commission to prove the existence of a ‘sufficiently direct link’ between the national law object of an infringement procedure and the type of measures eligible under the Member State’s cohesion programme, without having to prove the existence of a link between the law and the legality of the operations co-financed by the Member States’ cohesion programme (see box 7). Following the same reasoning, we can conclude that a ‘sufficiently direct link’ can be established in case a national law infringes some rule of law principles and has concrete and direct implications for measures eligible under EU spending programmes implemented by national public authorities.

A third, more difficult type of situation is when the breach stems from actions or omissions of public authorities not directly involved in the use of EU funds or not directly determining how these funds will be used but playing a role in the protection of the EU’s financial interests. This is the case of national public prosecution services, judicial authorities or administrative authorities in charge of investigating and sanctioning fraud. In these cases, one may imagine different possible interpretations of the notion of ‘sufficiently direct link’. If we take the case of the judiciary, for instance, under a more restrictive interpretation the mere lack of an independent judiciary would not suffice to establish a sufficiently direct link. Rather, to establish such a link, evidence would be needed to prove that a judge in charge, for instance, of reviewing decisions taken by national authorities implementing EU funds has been subjected to disciplinary proceedings or relocated without their consent, thereby barring them from

working on the cases concerned. Under a broader interpretation, one could argue that a situation in which there is strong evidence of total absence of independence in the judiciary – i.e. lack of proper legal and institutional safeguards, evidence of repeated political interference in judiciary decisions or decisions concerning the appointment or reassignment of judges - there is a clear and serious risk of lack of effective judicial review over the actions of public authorities in charge of managing and controlling the use of EU funds. One may argue that this wider interpretation of the ‘sufficiently direct link’ is in line with the preventive nature of the Regulation, which does not require hard proof of an effect of rule of law breaches on the EU budget but proof of a high probability of a risk occurring.

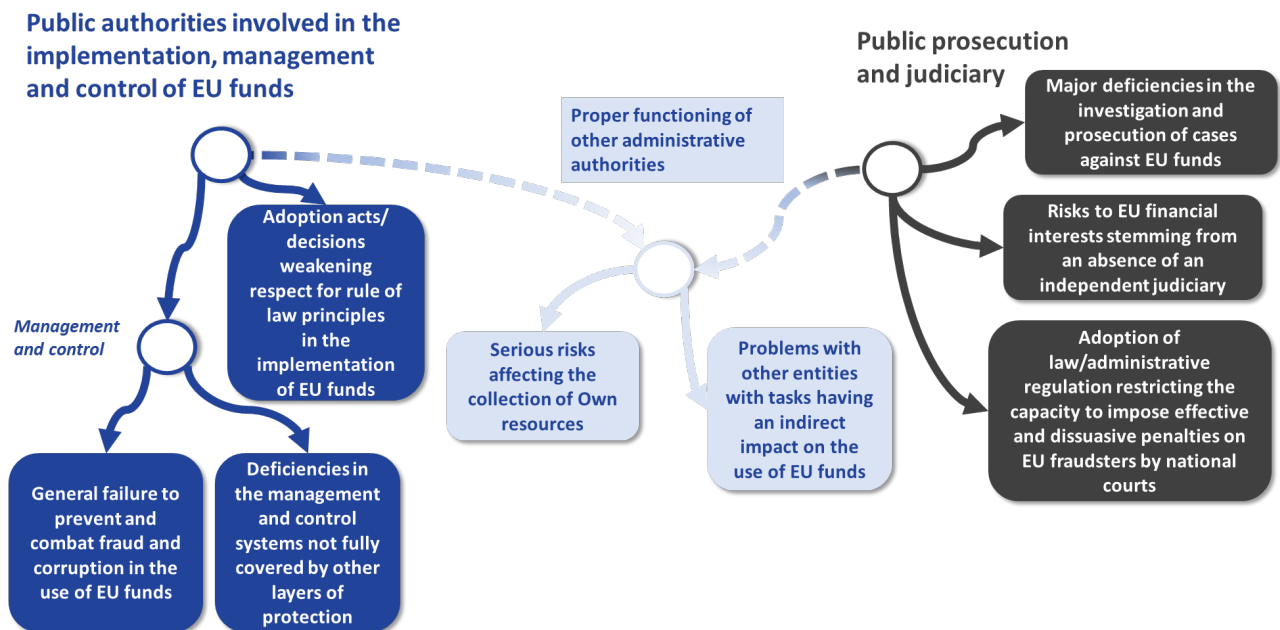
5.3 Developing a typology

The analysis of the CJEU rulings and the Commission’s Guidelines in Chapter 3 and the discussion on the ‘complementarity’ test in section 5.1. allow us to create a typology as illustrated in the chart below. The categories within the typology are inspired by Article 4(2) of the Conditionality Regulation, which lays out situations that may be concerned with a breach of a rule of law principle affecting the sound financial management of the Union budget or the protection of the Union’s financial interests.

Article 4(2) combines two criteria to classify situations; criteria relating to the public authority whose actions or omissions result in a breach of rule of law principles (administrative authorities in charge of implementing EU funds, public prosecution bodies...) and criteria relating to specific tasks or activities whose performance may result in a breach of rule of law principles (recovery of EU funds, imposition of effective penalties to fraudsters, effective cooperation with OLAF and EPPO...). Our typology uses the first criteria and classifies the potential situations into three groups according to the type of public authority concerned:

1. Administrative authorities directly involved in the implementation, management and control of EU funds
2. Public prosecution and judicial authorities
3. Other administrative authorities not directly involved in the management and control of EU funds but whose actions are relevant to the sound management of the EU budget or the protection of the EU’s financial interests

Figure 5: Typology of situations that may fall within the scope of the Conditionality Mechanism



Source: own elaboration

In the following sections we discuss hypothetical situations within each of these categories that could fall within the scope of the regulation; that is, could fulfil the conditions indicated in Article 4 of the Regulation to initiate the procedure. Before presenting these situations, it is important to note that the fulfilment of these various conditions may be difficult to prove. As discussed in Chapter 3, the assessment shall be based on facts or robust evidence and shall be carried out on a case-by-case basis, taking due account of the specific circumstances and contexts as well as the overall situation in the Member State concerned. At the same time, it shall respect the principle of equality of Member States before the Treaties. This means, for instance, that if the Commission considers that a given breach of a rule of law principle falls within the scope of the regulation the same conclusion shall apply to another Member State unless a different treatment is objectively justified based on the specific circumstances characterising the concrete situation.

5.4 Situations related to public authorities in charge of the implementation, management and control of EU funds

The first group of situations are those affecting the functioning of administrative authorities involved in the implementation, management and/or control of EU funds. This includes authorities in charge of managing cohesion policy, CAP, Home and RRF funds but also public entities having signed framework financial partnership agreements or public guarantee agreements with the Commission to manage EU funds on its behalf (e.g. national public development banks, Erasmus national agencies, Universities...).

These situations correspond to those listed in Article 4(2) a and b of the Conditionality Regulation. They may also include some tasks cited in the remaining part of article 4.2. and which are part of the duties of such authorities, such as the prevention and sanctioning of fraud and corruption (4(2) (e)), the recovery of funds unduly paid; (4(2)(f)) and the effective and timely cooperation with OLAF and, subject to the participation of the Member State concerned, with EPPO (Art 4(2)(g)).

As seen in section 5.1., the Commission has many procedures to react in case of risks to the EU budget arising from the malfunctioning of national authorities in charge of managing and controlling EU funds.

However, they are rather ineffective in case of widespread and recurrent risks. These risks can originate from two situations: a Member State adopting legislative acts or general executive decisions that weaken the respect for rule of law principles in the management of the EU funds or a general failure by the national authorities to prevent and combat fraud and corruption in the use of EU funds. Apart from situations of systemic risks, we can imagine the use of the Regulation to address individual risks which are not well covered by existing layers of protection.

5.4.1 Adoption of legislative acts or general executive decisions weakening the respect of rule of law principles in the implementation of EU funds

A first hypothetical situation is a situation in which a Member State adopts a legislative act or a national-level administrative decision which weakens the respect of rule of law principles in the implementation of EU funds. This could involve, for instance, the adoption of a public procurement law which does not guarantee basic principles of transparency and fair competition, a legal decision to exempt some persons or entities which are potential recipients of EU funds from conflict-of-interest rules or the adoption of laws or decisions offering preferential treatment to some categories of citizens and being of relevance to determine the eligibility of citizens to certain EU funds.

All these cases constitute a breach of a rule of law principle that may be of relevance for the sound financial management of the Union budget or the protection of the EU's financial interests. In all cases, the 'complementarity test' would be likely passed. As explained above, classic procedures of suspensions or corrections are designed to deal with individual deficiencies affecting a given institution or body in charge of managing and controlling a specific EU programme but not with systemic deficiencies introduced through changes in the legal framework or general, nationwide administrative decisions. The horizontal enabling condition imposing respect to the Charter of Fundamental Rights could be of help. However, it would not protect all EU funds, only cohesion and 'Home Funds'. Besides, whereas a non-compliance with the Charter of Fundamental Rights is evident in cases in which a law or a national-level decision creates discrimination in the access to EU funds it may be less evident in other situations of breaches of rule of law principles affecting the EU's financial interests – e.g. in case of weak public procurement rules.

Finally, to trigger the rule of law Conditionality Regulation, the Commission would have to prove the existence of a 'sufficiently direct link' between the breach of the rule of law principle and the impact or serious risk of effects on the EU budget. As discussed in section 5.2. following the CJEU jurisprudence we could interpret this notion of 'sufficiently direct link' as requiring that the EU law has concrete and direct implications for a category of actions potentially eligible under EU spending programmes but not necessarily affecting specific EU-financed operations.

Script 1. Inclusion of a 'national priority clause' in the Constitution

A Member State holds elections and a new party obtains a large majority of seats in the Parliament and forms a new government. Following the promises made during the elections, it adopts a Constitutional Reform to include a new 'national priority clause'. The inclusion of this clause makes it possible to reserve a certain number of social benefits for national citizens and grants them priority access to various social and employment benefits.

While most of the social benefits are entirely financed by the Member State's social protection system, some of them are financed or co-financed by EU funds. In particular, some social and employment grants are co-financed by the European Social Fund (ESF) and some support social housing - particularly grants to finance energy renovation works - , whose access is given in priority to national citizens, is financed by the National Recovery and Resilience Plan.

The application of this 'national priority clause' in these grants receiving EU funds is against Article 18 of the TFEU and Article 21(2) of the Charter of Fundamental Rights which stipulates that, within the scope of EU law, any discrimination on grounds of nationality shall be prohibited.

The Commission decides to suspend ESF payments on the basis of the horizontal enabling condition on compliance with the Charter. However, it realises that the impact of this 'national priority clause' on the Union budget is larger as it also affects the distribution of RRF funds. Given the inclusion of this clause in the Constitution, it concludes that there is a serious risk that this clause results in discrimination in the access to other measures and grants financed or co-financed by EU funds, such as Erasmus grants, CAP payments or public employment services. It therefore concludes that the application of the Conditionality Regulation alongside the application of the horizontal enabling condition would more effectively protect the EU's financial interests.

5.4.2 General failure to prevent and combat fraud and corruption in the use of EU funds

Another situation is a Member State without effective national-level administrative structures and tools to prevent and combat fraud in the use of EU funds (i.e., an independent and well-staffed administrative body in charge of investigating fraud, effective data-mining tools to prevent and detect situations of fraud and conflict of interest, etc...). This will result in a major failure to prevent, correct or sanction an improper use of EU funds at lower levels and, ultimately, a serious risk to the EU's financial interests.

This general failure may be due to different factors. One may imagine a Member State which does not take a proactive approach to protect the EU's financial interests. It does not follow OLAF's recommendations on how to improve its anti-fraud policy, is in delay as regards the transposition of the Directive on the Protection of EU's Financial Interests (PIF directive), does not use the Commission's ARACHNE data-mining tool or a national IT tool having equivalent functionalities and does not participate in the EPPO. It is also possible, however, to imagine a Member State which adopts all the relevant legislation and puts in place all necessary administrative structures but suffers from poor enforcement due to a lack of support by lower-level administrative bodies or a lack of administrative capacity.

Both cases constitute a breach of rule of law principles as defined in Article 3(b) of the Regulation, 'failing to prevent, correct or sanction arbitrary or unlawful decisions by public authorities'. Relevance for the sound financial management of the Union budget can be presumed insofar as it relates to actions or omissions explicitly aimed to prevent and fight fraud and corruption in the use of EU funds.

Despite that, whether the Commission could prove the existence of a 'sufficiently direct link' in this situation remains open. Proving the existence of this link requires proving that the weaknesses of the

national anti-fraud policy result in a **certain** – and not only hypothetical – and **serious risk** of negative effect on the EU's financial interests. Two considerations could be made in this respect. First, only in case of a major and systemic failure of various mechanisms and tools to prevent and fight fraud with the use of EU funds can we imagine a serious and certain risk for the Union budget. An additional consideration is that this risk would be more certain and serious in Member States with high levels of fraud and corruption in the public sector than in those in which the levels of fraud or corruption are relatively low.

Finally, it is unclear whether the 'complementarity test' would be passed. While existing layers of protection are not very effective to address systemic risks affecting all EU funds, the effectiveness of using the Regulation could be also questionable, particularly when the failure to combat fraud and corruption is not intentional but rather the result of poor enforcement. In these cases, the complementarity test would require a case-by-case approach: if the Commission can identify clear and monitorable remedial actions the Member State can put in place to address the situation it may make sense to use the Regulation, otherwise, it is doubtful that it can be of help (Script 2).

Script 2. Systemic failure to prevent and fight fraud and corruption in the use of EU funds

A Member State scores very high in all international corruption indices. National surveys on citizens' perceptions confirm that corruption in the public sector is very high. The Commission regularly detects cases of fraud and corruption in the use of EU funds through its own audits and OLAF investigations. The Member State is continuously subject to interruptions, suspensions of payments and corrections. The Member State regularly cooperates with OLAF in the investigations of fraud cases and has imposed the use of the ARACHNE IT tool to all public authorities in charge of managing EU funds, but this has not resulted in a reduction of cases of fraud and corruption.

Following the Commission's recommendations, the government has created a new independent body in charge of investigating cases of fraud and corruption. However, the new authority is understaffed and does not have sufficient investigative powers. There is also evidence of a lack of systematic recovery of the amounts affected by irregularities. Moreover, staff working in ESI managing and control authorities are not properly trained in the use of the ARACHNE IT tool and the number of public prosecutors in charge of investigating and prosecuting EU fraud is very low.

Given all this evidence, the Commission concludes that the conditions are met to trigger the Regulation. The systemic failure to combat fraud and the persistently high levels of corruption at lower level result in a serious risk for the EU's financial interests. Before sending a written notification, it contacts the Member State and ask it to propose or adopt remedial measures to address the Commission's concerns regarding the effectiveness of the anti-fraud body, the recovery of undue amounts, the capacity to effectively use ARACHNE and the number of public prosecutors.

5.4.3 Deficiencies in the management and control systems which are not fully covered by existing layers of protection

Apart from a situation of widespread failure to prevent and combat fraud and corruption, the rule of law Conditionality Regulation could be used when national structures and procedures in charge of managing EU funds present certain deficiencies in the prevention and fight of fraud which are not well covered by existing layers of protection. For instance, a case explicitly mentioned in article 4(2) (g) is the recovery of EU funds unduly used. As seen in section 5.1., deficiencies in the recovery procedures constitute a ground for suspending or cutting CAP funds but it cannot be a ground for suspending, let alone reducing, cohesion policy funds. The same happens with the lack of effective and timely

cooperation with OLAF and EPPO, mentioned in art 4(2) (g)⁸⁷. The Financial Regulation imposes an obligation on Member States to cooperate with the Commission, OLAF and EPPO but refusal to cooperate is a ground for cutting EU funds only under RFF, not for cohesion or CAP funds.

All these cases constitute breaches of rule of law principles of relevance for the sound financial management or the protection of the EU's financial interests. It may consist of an individual breach – e.g., a refusal to cooperate with OLAF in a given investigation – but the Regulation explicitly says that it covers both individual and systemic breaches. As all cases relate to actions or omissions by public authorities in charge of managing or controlling EU funds, a 'sufficiently direct link' is presumed. Finally, the 'complementarity test' would in principle be passed as the Regulation would be used to cover 'gaps' from other layers of protection.

An argument against the application of the Regulation in these situations is that the risk to the EU budget may be minor. Take the case of a lack of effective recovery of amounts unduly paid. Under shared management, the Commission applies a correction to national authorities in case of irregularities and then national authorities recover these funds unduly spent from the final beneficiary. While having effective recovery procedures is important to dissuade potential fraudsters, one could argue that this does not have a direct and significant effect on the EU's financial interests as the Commission has already deducted the amounts irregularly spent from the national authorities. Another counterargument is that, being related to individual breaches and not to systemic and recurrent breaches, the Regulation may not be able to provide a fast and quick fix to these problems.

However, this understanding presumes that the application of the Regulation starts with the written notification and necessarily ends with the Council imposing measures. It ignores the importance of the 'preliminary' phase i.e., the exchanges with the Member State before sending the written notification, and the possibility to end the procedure with the Member State adopting remedial actions before a decision is taken by the Council. If we look at the rule of law Conditionality Regulation from a broader perspective, we can imagine situations in which the Commission concludes that there are reasonable grounds for the application of the procedure but starts with a preliminary phase of contacts and bilateral exchanges with the Member State to try to resolve the issue before involving the Council (see Script 3).

⁸⁷ It is worth noting that art 4(2) g only mentions effective and timely cooperation with EPPO for Member States participating in the enhanced cooperation establishing EPPO. However, the EU law also imposes an obligation to these countries to cooperate with EPPO for certain issues. A lack of cooperation in these cases could be considered as falling within article 4(2)h, "other situations or conduct of authorities that are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union" (see script 3).

Script 3. Refusal to cooperate with OLAF

In a Member State, there are issues with the cooperation between the national anti-fraud authorities and OLAF. Specifically, the national authorities have, despite numerous requests, failed to specify an authority to assist OLAF in cases where an economic operator refuses to cooperate during its on-the-spot-checks. In addition, the Member State regularly withdraws projects from EU funding when it becomes clear that OLAF has opened an investigation.

OLAF addresses a letter to the concerned ministry, but the situation is not resolved. It then informs the Commission of this refusal to cooperate with OLAF and provides evidence of various ongoing OLAF investigations negatively affected by the conduct of the Member State.

The Commission assesses the situation and concludes that there are reasonable grounds to apply the Regulation. Before sending a written notification, it informs the Member State of the situation and invites it to propose and adopt remedial measures to address the Commission's concerns.

5.5 Situations relating to public prosecution and judiciary

The second group of situations are those related to the malfunctioning of investigation and public prosecution services that concern the investigation and prosecution of fraud, corruption and other rule of law breaches in the implementation of the EU budget (situations referred to in Article 4(2)(c)). They also relate to the lack of effective judicial review by independent courts of actions or omissions of public authorities managing or controlling the use of EU funds or investigating the misuse thereof (situations referred to in Article 4(2) (d) or the absence of effective or dissuasive penalties imposed on fraudsters by national courts (situations referred to in Article 4(2) (e), insofar as they are relevant to the sound financial management of the EU budget.

The application of the 'complementarity test' is rather straightforward in these cases. As discussed in section 5.1., leaving aside the specific case of the RRF, there are no layers of protection that would be applicable to address risks to the EU budget arising from the malfunctioning of public prosecution and judicial authorities. What is more difficult to prove is the existence of a breach of rule of law principles which affects, or seriously risks affecting, the sound financial management of the Union budget or the protection of the financial interests of the Union 'in a sufficiently direct way'.

We can imagine different situations potentially falling within the scope of the Regulation. One situation is a Member State where there are major deficiencies in the investigation and prosecution cases against the EU's financial interests. Another situation is a Member State in which there are serious concerns about the lack of judicial independence which results in a lack of effective and independent judicial review of actions taken by public authorities in charge of managing and controlling the use of EU funds or investigating and prosecuting cases against the EU's financial interests. Finally, a third situation is a Member State which has not adopted the relevant legal acts allowing the imposition of effective and dissuasive sanctions to EU fraudsters by national courts or administrative authorities.

5.5.1 Major deficiencies in the investigation and prosecution of cases against EU funds

A first hypothetical situation is a Member State in which there are serious limitations in the capacity to investigate and prosecute cases of fraud, corruption and conflict of interest affecting the EU's financial interests. These limitations can be the result of different actions or omissions taken by public authorities; they can result from legal or executive decisions restricting the powers or independence of the criminal police in charge of EU fraud investigations or public prosecution services working on cases of EU fraud or from decisions to withhold financial and human resources of these authorities.

These cases constitute indicative breaches of rule of law principles of relevance for the sound financial management of the Union budget or the protection of the EU's financial interests. As said above, the 'complementarity test' would be easily passed. However, to trigger the rule of law Conditionality Regulation, the Commission would have to establish the existence of a 'sufficiently direct link' between the breach of the rule of law principle and the impact or serious risk of effects on the EU budget. For instance, proving that the criminal police is under-staffed or that the General prosecutor has wide discretionary powers to allocate cases to different prosecutors alone may not be enough to conclude that there is such a sufficient and direct link; the Commission would have to demonstrate limitations and problems with the specific units of the criminal police or the specific prosecution services in charge of investigating offences against the EU's financial interests or show that there is a lack of determined action to investigate and prosecute corruption cases related to the use of EU funds.

It is also important to highlight the specific situation of Member States not participating in the EPPO. As noted by the Commission in its proposal of the Council Implementing Decision against Hungary, in those Member States not participating in the EPPO the national prosecutor's office is the only office conducting criminal investigations into crimes affecting the EU financial interests. A lack of effective functioning of this service is particularly worrying, as well as a lack of effective and timely cooperation between this service and OLAF and the EPPO – for investigations having a cross-border nature (see Script 4).

Script 4. Refusal to cooperate with EPPO from a non-participating Member State

Member States that do not take part in the enhanced cooperation on the establishment of the EPPO have an obligation to cooperate with the EPPO for cross-border criminal investigations. A Member State which does not participate in the EPPO refuses to recognise EPPO as a competent authority and consistently rejects the EPPO's requests for judicial cooperation since the start of its operations on 1 June 2021. The European Chief Prosecutor addresses a letter to the concerned Member State but it continues to refuse to cooperate. She then informs the Commission of this refusal to cooperate with EPPO and provides evidence of up to six ongoing investigations involving this Member State which may be negatively affected by this refusal to cooperate.

The Commission assesses the situation and concludes that there are reasonable grounds to apply the Regulation. Before sending a written notification, it informs the Member State of the situation and invites it to propose and adopt remedial measures to address the Commission's concerns.

5.5.2 Risks to the EU financial interests stemming from an absence of an independent judiciary

Another situation that could fall within the scope of the Regulation is one where the Member State takes decisions endangering the independence of the judiciary (Article 3). Such decisions would constitute a breach of rule of law principles falling within the Regulation if they result in a lack of independent and effective judicial review of actions or omissions of public authorities in charge of managing and controlling EU funds or investigating and prosecuting cases against the EU financial interests (Article 4(2) (d)) or a lack of effective and dissuasive penalties to EU fraudsters by courts (Article 4(2) (e)).

These cases constitute indicative breaches of rule of law explicitly mentioned in Article 3, 'endangering the independence of the judiciary'. Independence in the context of a judicial system can mean two

things⁸⁸: First, external independence, meaning that the courts act autonomously, do not take instructions from any third party and are protected against external pressure. Second, internal independence and impartiality, meaning that they remain neutral towards all parties in the proceedings and do not have any conflicts of interest.⁸⁹ Actions endangering the independence of the judiciary basically consist of regulatory changes endangering the independence of the bodies governing the judiciary administration (judicial councils), changes in the rules governing the functioning of courts or changes in the rules and procedures for the appointment, promotion and sanctioning of judges. As above, the ‘complementarity test’ would be easily passed as the other layers of protection are largely ineffective to address these types of situations. The most difficult thing would be to prove the existence of a ‘sufficiently direct link’ between the action endangering judicial independence and the effect or risk of effect on the EU budget.

Article 4 explicitly indicates that the action endangering judicial independence must result in either a lack of effective judicial review of actions of public authorities relevant to the protection of the EU financial interests or problems with the application of effective sanctions to EU fraudsters. As discussed in section 5.2., one can imagine different ways of interpreting the requirements of a ‘sufficiently direct link’. Under an extensive interpretation, it could be argued that strong evidence of a total absence of independence in the judiciary - i.e., evidence of repeated political interference in judicial decisions or decisions concerning the appointment or reassignment of judges – inevitably affects the judges’ ability to take independent decisions and thus entails a real and serious risk of political interference in all judicial decisions, including those related to cases of corruption with the use of EU funds. Under a restrictive interpretation, it will be necessary for the Commission to provide evidence of political interference in judicial decisions concerning offences against the EU financial interests (see Script 5).

Script 5. Ineffective judicial review stemming from the lack of an independent judiciary

The Commission has serious concerns about the independence of the judiciary in a Member State. In particular, it is concerned about the fact that the body involved in the appointment of judges is composed of members chosen by parliament and hence not sufficiently independent from political control by the legislature and executive. It finds that the majority of the members are political appointees. In addition, a disciplinary regime is in place in the Member State, which allows ordinary court judges to be subject to disciplinary investigations and sanctions by a disciplinary chamber based on the content of their judicial decisions, including decisions concerning authorities carrying out financial control, monitoring and audit.

The Commission finds evidence of a particular case where the disciplinary chamber has sanctioned a judge who had become known for having condemned a high-level public official for passive corruption in the use of EU funds. The judge has been transferred to a different court against their will, thereby impeding them to work on similar cases of offences against EU financial interest. The Commission concludes that this proves the existence of a ‘sufficiently direct link’ between the breach of the rule of law principle and a serious risk to EU financial interests and informs the Member State that there are reasonable grounds to apply the Regulation.

⁸⁸ EU Justice Scoreboard 2022

⁸⁹ EU Justice Scoreboard 2022

5.5.3 Adoption of a new law or administrative regulation restricting the capacity to impose effective and dissuasive penalties on EU fraudsters by national courts

Another hypothetical situation that could fall within the scope of the rule of law conditionality is a situation in which the Member State adopts a legislative act or an administrative regulation which limits the capacity of courts to impose effective and dissuasive penalties on fraudulent recipients of EU funds (Article 4(2) (e)). This could include different scenarios, such as a lack of a national law codifying illegal activities affecting the Union's financial interests as criminal offences within the national criminal code, or an amendment of the national criminal procedure act imposing very restrictive procedural rules, 'de facto' limiting the availability and effectiveness of legal remedies and the effective sanctioning of EU fraud.

These cases constitute indicative breaches of rule of law explicitly mentioned in Article 3 (c), 'limiting the availability and effectiveness of legal remedies (...) the effective sanctioning of EU fraud'. As in the previous situations, the 'complementarity test' would be easily passed; the most difficult thing would be to prove the existence of a 'sufficiently direct link' and a 'serious risk' for the EU budget.

Script 7. Stricter procedural rules preventing the imposition of dissuasive sanctions on EU fraudsters

A Member State amends the Criminal Code shortening the timespan available for the detection, prosecution and trials related to criminal offences. In this Member State, national case law requires that all cases of fraud and corruption pending before a higher-level court must be re-examined on appeal. According to the EPPO, as a result of the legal amendments, EPPO prosecutors will have drastically less time to investigate offences against the EU financial interests and prepare indictments while many ongoing cases would need to be closed immediately and definitively. The EPPO informs the Commission about this situation and provides evidence of ongoing investigations in the country that risk being compromised due to the new law. In addition to that, it also notes that such an amendment may negatively affect investigations and prosecutions initiated in other Member States participating in the EPPO, under which assisting measures would need to be performed in the concerned Member State.

The Commission assesses the situation of the Member State. It finds evidence of a drop in the number of investigations and indictments on alleged EU fraud and corruption following the introduction of the Law. It also finds evidence that, due to the complexity and length of the re-examination on appeal, many cases of EU fraud and corruption have become time-barred. It concludes that there are reasonable grounds to apply the Regulation.

5.6 Situations relating to the proper functioning of other public authorities

Actions and omissions by public authorities not directly involved in the management and control of EU funds or the protection of EU financial interests can also potentially fall within the scope of the Regulation. This category includes two potential situations. The first one includes actions taken by public authorities involved in the collection of own resources on behalf of the Commission. The second one entails actions taken by administrative bodies whose tasks can indirectly influence the decisions of managing authorities in charge of implementing EU funds. None of these two cases is explicitly mentioned in Article 4(2) but they could fall within point h ('other situations or conduct of authorities that are relevant to the sound financial management of the Union budget or the protection of the financial interests of the Union').

5.6.1 Serious risks affecting the collection of Own resources

A situation that could fall within the scope of the Regulation is a case in which there is a major problem with the collection of Own resources in a given Member State, resulting in serious damage to the EU budget. This may happen in case of major deficiencies in the national customs systems. However, this case would probably not pass the ‘complementarity test’, as there are mechanisms to protect the EU budget from deficiencies in the national customs systems (see Chapter 4). Besides, it is not clear that the Regulation would be very effective to address problems of customs control and collection of taxes, as all the measures listed in Article 6 are designed to respond to breaches affecting the use of EU funds rather than the collection of Own resources.

A more appropriate situation is one in which a Member State collects the revenues from the traditional Own Resources and the VAT but refuses to transfer these revenues and/or to pay its GNI-based contribution to the EU Commission. In this case, the Commission could argue that the decisions taken by the government are in breach of the principle of legality and have a severe negative impact on the EU budget ‘in a sufficiently direct way’. The existing layers of protection of the EU budget would not be effective to deal with such a situation, and thus the activation of the Regulation could be justified.

Script 8 Opposition to pay the GNI contribution

Eurostat conducts a verification of the GNI data of previous years and concludes that a Member State has to pay an additional EUR 2.1. billion to the EU budget in view of its GNI own resource. In a context of pre-elections and with the party in favour of exiting the Union surging in the polls, the Member State announces that it refuses to pay the extra surcharge to the EU budget.

The Commission opens an infringement procedure against the Member State. In parallel to this, it concludes that there are reasonable grounds to apply the Regulation. Before sending a written notification to start the procedure, it informs the Member State to explain the factual elements and specific grounds on which it bases its findings and invites it to take remedial measures to address the situation.

5.6.2 Problems with other entities whose tasks have an indirect impact on the use of EU funds

Another situation that may fall within the scope of the Regulation is in case of breaches of the rule of law principles by public authorities which are not in charge of managing, controlling or investigating the use of EU funds but whose tasks indirectly impact how these funds would be used. An illustrative case would be the situation in case study 4 (Section 4.2.1): a case in which there is clear evidence of corruption and favouritism in the functioning of the national agency in charge of registering land ownership. This has an incidence on the distribution of titles of land ownership and therefore on the eligibility of citizens to CAP payments.

As explained in section 4.2.1., in this case, the ‘complementarity test’ would be passed as the existing layers of protection are not effective to deal with this problem. The actions of the public land registry agency would be clearly constitutive of a breach of the rule of law principles of relevance for the sound financial management of the Union budget. The most difficult thing would be to prove the existence of a ‘sufficiently direct link’ and a ‘serious risk’ for the EU budget. It is doubtful that simply proving the irregular functioning of the public land registry agency would be sufficient to activate the Regulation; the Commission would probably need to provide evidence of cases in which this malfunctioning has resulted in the deprivation of CAP payments for certain farmers.

6 CONCLUSIONS

Due to its relatively recent adoption, several questions remain open related to the potential scope of application of the Conditionality Regulation. The European Commission has published guidelines, but without sufficient jurisprudence to go on they leave some room for interpretation.

This study explores the potential scope of application of the Conditionality Mechanism, in particular by analysing how this new mechanism can interact with the various other instruments and mechanisms available to the Commission to protect the Union's financial interests.

These other procedures, referred to as 'other layers of protection' throughout this study, cover different types of risks. Some of them (the EDES) protect the EU budget from the risk of insolvency, negligence, fraud or irregularity committed by private actors (potential beneficiaries of EU funds). From the point of view of this study, however, the most relevant layers of protection are 'second-level' layers, applied to those EU funds managed by national authorities (cohesion, 'Home' and CAP funds, Recovery and Resilience Facility) and protecting the EU budget from actions or omissions by public authorities as their scope of action partly overlaps with that of the Conditionality Mechanism.

The first important finding from this study is that existing layers of protection can, to some extent, protect the EU budget against breaches of the principles of the rule of law (see Chapter 4).

In particular, some layers of protection can be used in a preventive manner and in response to general changes in EU law or nationwide administrative decisions indicative of breaches of the rule of law principles. For instance, the Commission can suspend the approval or amendment of Member States' cohesion policy programmes, national programmes under the Home Funds or the national CAP strategic plan if it finds that these programmes or plans do not ensure compliance with the EU Charter of Fundamental Rights. In applying the horizontal enabling conditions, it can also suspend the reimbursement of costs related to operations co-financed by Cohesion or Home Funds at any time throughout the whole period of execution if it has evidence that the Charter is no longer being respected in the implementation of the programme. These provisions have proved to be very powerful in the past and will remain important in the future.

However, they are less effective than the Conditionality Regulation in two respects. First, they are more restricted in their scope of application than the Regulation, which covers risks affecting all EU revenues and expenditure and resulting from breaches of all types of rule of law principles, not only those directly relevant to the exercise of citizens' fundamental rights and freedoms. Most of the existing layers of protection are designed to deal with individual deficiencies affecting a given institution or body in charge of managing and controlling a specific EU programme. Second, the Commission needs to prove that a risk to the EU budget has materialised before some of the procedures can be applied, thus when the harm has already been done (e.g. net corrections under the cohesion policy).

The second finding from the study is that the new rule of law Conditionality Mechanism has several advantages vis-à-vis other tools (see Section 5.1). First, it is the only procedure that protects the EU's financial interests from the malfunctioning of public prosecution and judicial authorities. Second, even with the need to adhere to the principle of proportionality, the mechanism allows for a considerable level of flexibility on the measures to be adopted. Third, its procedure follows a case-by-case approach, thereby allowing several case-specific dimensions to be taken into account.

The third important finding is that the adoption of measures under the Conditionality Regulation does not lead to an either-or situation with other instruments: different mechanisms can be combined to ensure the most adequate setup to protect the EU's financial interests (see Sections 3.2.2. and 5.1). The case of Hungary provides a good example of the simultaneous use of the

Conditionality Mechanism and other layers of protection. Here, the key implementation steps of the remedial measures adopted under the Conditionality Regulation⁹⁰ were integrated as ‘super milestones’ into the Hungarian Recovery and Resilience Plan.

The fourth important conclusion is that the Conditionality Mechanism might not always be the most effective solution. In some cases, the Commission may conclude that a breach of rule of law principles potentially falls within the scope of the Conditionality Regulation, but that the Regulation is not the most effective means to protect the EU budget. This could be, for instance, because a quick response is needed, or because there are no clear and monitorable remedial actions to be imposed on the Member State to address the situation. In other situations, the mere threat of activating the regulation may be sufficient to push the Member State to adopt remedial measures before the Council.

Fifth, the report shows the centrality of the concept of ‘sufficiently direct link’ to be demonstrated between the breach of rule of law and the effects or serious risk of effects on the EU budget. Proving the existence of this ‘sufficiently direct link’ is a key condition for adopting measures under the regulation (see Section 5.2).

In many cases, this link can be presumed in a relatively straightforward manner, for instance when the breach results from the actions of public authorities in charge of managing and controlling the use of EU funds. Whether other situations may fall within the scope of the regulation, however, is subject to debate. This is the case when the breach results from actions or omissions made by the legislature (e.g. new laws having relevance to the use of EU funds), or by public authorities that are important for the protection of the EU’s financial interests but have no direct role in the implementation or control of EU funds. These include national public prosecution services, judicial authorities and administrative authorities in charge of investigating and sanctioning fraud. In these cases, the lack of jurisprudence allows for different interpretations of what would constitute a sufficiently direct link leading to the triggering of this mechanism.

A restrictive interpretation would require this direct link to be demonstrated by hard evidence. This could involve, for instance, proof that certain judges were barred from working on the implementation of the EU budget, or that they were put under direct pressure to reach a certain verdict. A broader interpretation would not necessarily require such a link to be proved with hard facts. For example, in the case of strong evidence of total absence of judicial independence, it could plausibly be concluded that there is a serious risk of cases of fraud and corruption in the use of EU funds not being properly investigated and condemned.

This debate has important practical repercussions for the application of the Conditionality Mechanism. A restrictive reading of what constitutes a ‘sufficiently direct link’ yields cautious application of the mechanism. As furnishing detailed hard evidence to prove a ‘genuine’ link to the EU budget requires time and resources, it might limit the mechanism’s effectiveness by resulting in a longer wait to trigger the procedure and a lower number of overall cases. Insufficiently grounded use of the broad interpretation, on the other hand, risks the same outcome. If the evidence available does not prove to be strong enough to hold up before the Court, the latter could dismiss the case, thereby creating a precedent that would act as a deterrent for future cases, once again constraining the effectiveness of the mechanism.

The sixth and last relevant finding is that the use of the Conditionality Mechanism should not necessarily be limited to cases of systemic and recurrent breaches of the rule of law principles (see Section 5.1). The Conditionality Regulation explicitly allows for the use of the mechanism in

⁹⁰ See Annex to COM(2022) 485 final.

response to individual breaches, and the analysis in this study proves that, in certain circumstances, the mechanism can be more effective than the existing layers of protection in responding to risks to the EU budget resulting from individual and occasional breaches of the rule of law principles. Such breaches could consist, for instance, of a Member State refusing to cooperate with the EPPO⁹¹ or to pay its contribution to the EU budget. In such cases, it is conceivable that the problem could be solved with a quick fix at the written notification stage before it goes any further (i.e. without the involvement of the Council). In some situations, the mere threat of activating the regulation may be sufficient to convince the Member State to adopt remedial measures. In these cases, the regulation could provide a fast procedure for solving problems.

To conclude, our study has looked at the nature of and possibilities offered by the rule of law Conditionality Mechanism from a new angle. In the academic literature and in the press, this new mechanism is often portrayed as a means of last resort, a sort of new ‘nuclear option’⁹² to deal with major and systemic threats to the rule of law in EU Member States. This study has aimed to deconstruct this image, showing it as another instrument to protect the EU’s financial interests. It works alongside other instruments and may be used to support the Commission’s continuous monitoring of the rule of law situation in all 27 Member States.

Treating it as a new ‘nuclear option’ in the EU’s rule of law toolbox risks converting it into a toxic instrument, with a very high application threshold and with considerable political costs attached to it. Following the main argument presented in this study for treating it as another mechanism for the protection of the EU budget would go a long way towards helping avoid this situation. In this respect, clarifying what constitutes a ‘sufficiently direct link’ would be an important step forward.

⁹¹ See, for instance, the cases linked to [Ireland](#) and [Poland](#) refusing cooperation.

⁹² See literature on Article 7.

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ANNEX 2: COMPARISON OF LAYERS OF PROTECTION

Table 10: Comparison of layers of protection according to coverage, risks addressed and type of remedy applied

Name	Coverage	Risks to the EU budget addressed	Type of remedy applied
RoL Conditionality Mechanism	All EU spending and revenue	<p>Actions or omissions by public authorities indicative of a breach of a principle of the rule of law insofar as they affect or seriously risk affecting the sound financial management of the Union budget in a sufficiently direct way.</p> <p>Can be used in case of malfunctioning of public authorities beyond those in charge of managing and controlling the EU funds (e.g. judiciary)</p> <p>No need to prove that the action taken by a public authority has resulted in a loss for the EU budget, just that it creates a “serious risk in a sufficiently direct way”</p>	<p>Considerable flexibility on the measures that can be applied (interruption of payments, suspension of payments, reduction of commitments, suspension of the approval of programmes, termination of a legal commitment, prohibition of entering into new legal commitments, ...) even if there is a duty of proportionality</p> <p>Adoption by the Council (under QM)</p>
Suspensions and financial corrections in case of deficiencies in the management and control system	ESIF and ‘HomeFunds’	<p>Serious deficiencies in national ESIF and ‘Home Funds’ management and control systems</p> <p>Need to prove that the deficiency has resulted in a material loss for the EU budget (irregularity)</p>	<p>Interruptions and suspension of interim payments, reduction of commitments</p> <p>Reduction of commitments (‘net financial corrections’) subject to very strict conditions and detailed rules to calculate the amount of reduction applied</p> <p>Adoption by the Commission</p>
Non-reimbursement of cost in case of non-fulfilment of Horizontal enabling conditions	ESIF and ‘Home Funds’	<p>Certain deficiencies in public procurement systems and procedures to apply state aid rules (lack of mechanisms to monitor the public procurement system, lack of tools and capacity to apply EU state aid rules)</p> <p>Non-compliance with the EU Charter of Fundamental Rights or the UN Convention on rights of persons with disabilities when programming and implementing ESIF or ‘Home Funds’ (e.g.</p>	<p>Non-reimbursement of costs (equivalent to a suspension of interim payments) until the enabling condition is fulfilled</p> <p>Possibility to stop reimbursement of costs at any time during the duration of the programme if the enabling condition is no longer fulfilled</p>

		<p>certain EU-funded actions planned or executed not respecting the principle of non-discrimination)</p> <p>No need to prove that the risk has materialised, suspension of payments is automatic if the deficiency is detected</p>	Adoption by the Commission
Suspension of the approval of an ESIF or 'Home Fund's programme or an amendment of a programme in case of non-compliance with the EU Charter of Fundamental Rights	ESIF and 'Home Funds'	<p>Non-respect of the EU Charter of Fundamental Rights in the design of the programme</p> <p>No need to prove that the risk to the EU budget has materialised</p>	<p>Suspension of the approval of the programme for up to 5 months (4 months in case of an amendment of a programme)</p> <p>Adoption by the Commission</p>
Suspension of payments in case of infringement procedure on a matter putting at risk the legality and regularity of expenditure	ESIF and 'Home Funds'	<p>Adoption of a legal act putting at risk the legality and regularity of EU expenditure and being the object of an infringement procedure</p> <p>No need to prove that the risk has materialised but the Commission has to prove the existence of a 'sufficiently direct link' between the EU-financed measure and the national law object of infringement</p>	<p>Suspension of interim payments for the EU-financed measure affected by the law</p> <p>Adoption by the Commission</p>
Suspensions and financial corrections in case of serious deficiencies in CAP management and control systems	CAP funds	<p>Serious deficiencies in CAP governance systems, including deficiencies in the system for the recovery of irregular and undue payments</p> <p>Need to prove the existence of a real risk of financial damage for the EU budget (there is a reasonable and serious doubt that the measure has been executed in accordance with the applicable EU and national law)</p>	<p>Interruption, suspension or reduction of CAP payments, reduction of commitments ('net financial corrections')</p> <p>Detailed rules for the calculation of net corrections</p> <p>Adoption by the Commission</p>

Suspension of the approval of a CAP strategic plan or an amendment of a plan in case of non-compliance with the EU Charter of Fundamental Rights	CAP funds	<p>Non-respect of the EU Charter of Fundamental Rights in the design of the programme</p> <p>No need to prove that the risk to the EU budget has materialized</p>	<p>Suspension of the approval of the programme for up to 6 months (3 months in case of an amendment)</p> <p>Adoption by the Commission</p>
RRF recovery and reduction procedure	Recovery and Resilience Facility (RRF)	<p>Deficiencies in national RRF management and control systems</p> <p>Serious breach of a Member States' obligation included in the RRF bilateral financing agreements insofar as the breach adversely affects, in a material or substantial manner, the rights of the Commission or the proper implementation of Union funds.</p> <p>No need to prove that the risk to the EU budget has materialised</p>	<p>Reduction of RRF commitments through a reduction of future RRF payments or recovery of RRF amounts already paid.</p> <p>Adoption by the Commission</p>
RRF audit and control and rule of law milestones	Recovery and Resilience Facility (RRF)	<p>Deficiencies in national RRF management and control systems</p> <p>All types of breaches of rule of law principles insofar as the latter have been the object of a country-specific recommendation in 2019 or 2020</p> <p>No need to prove that there is a risk to the EU budget</p>	<p>RRF payments conditioned upon the fulfilment of intermediate and final milestones reflecting the adoption of reforms or remedial actions. Partial or suspension of RRF payments in case of non-fulfilment of a milestone at the moment of submitting payment, permanent cut to RRF funds if the milestone is still unfulfilled after 6 months.</p> <p>Adoption by the Commission</p>
Suspension, reduction or termination of award procedures or agreements	EU funds under direct and indirect management	<p>Irregularities or fraud committed by national public entities being recipients of EU funds and/or managing EU funds on behalf of the Commission (under indirect management)</p> <p>Non-compliance with the obligations included in the grant agreement or contract (e.g. non-compliance with the principles of transparency, equal treatment and non-discrimination).</p> <p>Need to prove that the risk to the EU budget has materialised</p>	<p>Suspension or cancellation of an award procedure</p> <p>Suspension, reduction or termination of a grant agreement or a contract</p> <p>Adoption by the Commission</p>

EDES	EU funds under direct and indirect management	<p>Unreliable economic operators (public or private) posing a risk to the EU budget, either for integrity reasons (e.g. past fraudulent practices) or for reasons of competence (bankruptcy, insolvency and similar reasons).</p> <p>No need to prove that the risk to the EU budget has materialised</p>	Exclusion of the economic operator from receiving EU funds. In severe cases, the operator can be financially penalised and its name can be published as a deterrent.
Ex-ante assessment of implementing partners	EU funds under indirect management	Public entities implementing EU funds on behalf of the Commission not having rigorous internal control systems or not complying with some principles for the management of EU funds (e.g. transparency and non-discrimination)	Refusal to enter into a legal commitment with an entity if it does not have appropriate internal systems and procedures.
Early repayment of loans	EU loans (MFA)	Fraud, corruption or another illegal activity committed by a Member State and directly related to the management of an EU loan.	Early repayment of the loan
Recoveries under Own Resources	Own Resources	<p>Deficiencies in the national customs systems resulting in a lack of prevention and detection of custom fraud</p> <p>Misapplication of the EU VAT legislation when calculating the VAT harmonisation base</p> <p>Refusal by a given Member State to make available the own resources to the Commission</p>	<p>Recovery of due amounts through the issuance of a recovery order or by offsetting the due amounts against future claims to the EU budget.</p> <p>Imposition of interests in case of delays.</p>

ANNEX 3: LAYERS OF PROTECTION FICHES

FICHE 1. SUSPENSIONS AND NET FINANCIAL CORRECTIONS IN CASE OF MAJOR DEFICIENCIES IN NATIONAL MANAGEMENT AND CONTROL SYSTEMS (ESIF AND 'HOME FUNDS')

Under the EU cohesion policy, the main responsibility to protect the EU budget lies with national management and control authorities. During the implementation of the programme, if they detect irregularities in the expenditure declared by the final beneficiaries they shall withdraw the amounts from the interim payment requests sent to the Commission. The Commission can carry out audits at any time. If through its own audits or other means (e.g. OLAF investigations), the Commission detects a deficiency in the Member State's management and control system, it will send a warning letter to the concerned Member State. If the Member State does not correct the deficiency, interim payments will be interrupted (6 months, up to 9 months if requested by the Member State). After this period, if the Member state has not corrected the problem the Commission will suspend the interim payment until remedial measures are applied (Art 96 and 97 CPR).

At the moment of assessing the annual accounts submitted by the Member State (at year N+1), if the Commission detects irregularities not corrected by the Member State it will ask the Member State to apply financial corrections (e.g. exclude the irregular payment from the accounts). In this case, the national authorities can reuse the money cancelled in the subsequent accounting year for another operation within the same programme. However, if the Commission finds evidence of irregularities resulting from "serious deficiencies" in the national management and control system and providing these deficiencies have not been identified, reported and subjected to remedial measures by the Member State, it can open a procedure to apply net financial corrections. In this case, the amounts subject to financial correction are deducted as net corrections – i.e. the Member State cannot reuse the money cancelled (Art 104 CPR).

SCOPE OF APPLICATION

EU cohesion policy funds (ERDF, ESF+, CF, JTF, EMFAF) and 'Home Funds' (AMIF, ISF and BMVI).

RISK TO THE EU BUDGET COVERED

Major deficiencies in the ESIF or 'Home Funds' Operational programmes' management and control systems resulting in irregular payments. A delegated regulation⁹³ establishes detailed rules to determine what is a "serious deficiency" in the effective functioning of management and control systems.

PROCEDURE

Before adopting a net financial correction, the Commission shall inform and give the Member State the opportunity to present its observations within two months. If the Member State accepts the conclusions of the Commission, it can correct the deficiency itself and re-use the amounts concerned. If it does not accept the conclusions, it will be invited to a hearing by the Commission. The Commission will decide on the financial correction through an implementing act within 10 months of the date of the hearing (Art 104.4 CPR).

⁹³ Commission delegated regulation 480/2014

MEASURES THAT CAN BE APPLIED

Suspension of payments and partial or total cancellation of commitments to an operational programme. A delegated regulation⁹⁴ provides detailed criteria to calculate the level of financial corrections (from 5% to 100%) according to the relative importance of the deficiency, the frequency and the degree of risk of loss for the EU budget.

FICHE 2. NON-REIMBURSEMENT OF COSTS IN CASE OF NON-COMPLIANCE WITH HORIZONTAL ENABLING CONDITIONS (ESI AND HOME FUNDS)

The CPR conditions the use of EU funds under shared management on compliance with certain ex-ante conditions, called 'enabling conditions'. There are various thematic conditions which only apply to the EU cohesion policy funds and four horizontal enabling conditions which apply to both cohesion policy and 'home' funds. If a Member State does not fulfil an enabling condition the Commission shall not reimburse the expenditure related to operations linked to the concerned specific objective(s). In the case of 'horizontal' enabling conditions, applicable to all specific objectives, non-fulfilment implies a non-reimbursement of any costs except for those related to actions contributing to the fulfilment of these conditions.

The four horizontal enabling conditions are⁹⁵: the existence of effective monitoring mechanisms of the public procurement market; the existence of tools and capacity for the effective application of State aid rules; effective application and implementation of the Charter of Fundamental Rights and the implementation and application of the United Nations Convention on the rights of persons with disabilities (UNCRPD).

SCOPE OF APPLICATION

EU cohesion policy funds (ERDF, ESF+, CF, JTF, EMFAF) and 'Home Funds' (AMIF, ISF and BMVI).

RISK TO THE EU BUDGET COVERED

Lack of effective monitoring of the public procurement system, lack of tools and capacity for effective application of EU state aid rules, non-compliance with the EU Charter of Fundamental Rights or with the UN Convention on rights of persons with disabilities when implementing ESIF and 'Home Funds'.

PROCEDURE

When preparing a programme the Member State shall assess if horizontal enabling conditions are fulfilled. If the Commission disagrees with the assessment of the Member State, it can carry out its own assessment. In case of non-fulfilment of horizontal conditions, the programme will be adopted and the Member State will start implementing the actions but the Commission will not reimburse any cost until the condition is fulfilled, except for expenditures related to actions contributing to the fulfilment of the condition. The Commission will monitor the fulfilment of conditions throughout the programme and can at any time stop the reimbursement of costs if there is evidence proving that conditions are no longer fulfilled.

⁹⁴ Commission Delegated Regulation 480/2014 of 3 March 2014 supplementing Regulation (EU) No 1303/2013

⁹⁵ Annex III Common Provisions Regulation

MEASURES THAT CAN BE APPLIED

Non-reimbursement of declared expenditures until the condition is fulfilled, except for those expenditures related to actions contributing to the fulfilment of the condition. This measure only applies after the programme is approved by the Commission. It does not apply to pre-financing.

FICHE 3. SUSPENSION OF THE APPROVAL OF A PROGRAMME OR AN AMENDMENT OF A PROGRAMME IN CASE OF NON-RESPECT OF THE EUROPEAN CHARTER OF FUNDAMENTAL RIGHTS (ESIF AND HOME FUNDS)

Under the EU Cohesion policy, the Commission is in charge of approving the Operational programmes prepared by the Member State. To approve a programme, the Commission has to assess that it complies with the CPR provisions, including the horizontal principles set out in Article 9 CPR. One of these principles is the need to 'ensure respect for fundamental rights and compliance with the Charter of Fundamental Rights of the European Union in the implementation of the Funds' (Art 9.1. CPR). If the Commission considers that the structures and procedures foreseen in the plan for the management, monitoring and control of the ESI funds do not guarantee compliance with the Charter, it may suspend the adoption of the programme and ask the Member State to review the programme. The suspension can last until five months after the first submission of the programme by the Member State (Art 23 CPR).

SCOPE OF APPLICATION

EU cohesion policy funds (ERDF, ESF+, CF, JTF, EMFAF) and 'Home Funds' (AMIF, ISF and BMVI).

RISK TO THE EU BUDGET COVERED

National management and control structures and procedures that do not guarantee compliance with the EU Charter of Fundamental Rights. The Charter contains various principles and rights to which all EU citizens are entitled. Some of them derive from the application of general rule of law principles enshrined in Article 2 TEU, such as the principle of non-discrimination, effective judicial protection or equality before the law.

PROCEDURE

If the Commission concludes that the programme does not comply with the CPR provisions, it may send its observations to the Member State within three months of the date of submission of the programme (two months in case of an amendment of the programme) and ask the Member State to review the programme. The suspension can be maintained for up to five months. After that date, the Commission shall adopt a decision of whether or not to approve the programme through an implementing act (Art 23(4) CPR). In the case of amendments to a programme, the Commission shall take its decision no later than four months after its submission by the Member State.

MEASURES THAT CAN BE APPLIED

Suspension of the approval of a programme or an amendment of a programme. The suspension can last a maximum of five months after the first submission of the programme by the Member State (four months in case of amendments to a programme).

FICHE 4. SUSPENSION OF PAYMENTS IN CASE OF AN INFRINGEMENT PROCEDURE ON A MATTER PUTTING AT RISK THE LEGALITY AND REGULARITY OF EXPENDITURE (ESIF AND HOME FUNDS)

Article 97(1) (d) of the CPR 2021-2027 allows the Commission to suspend payments in case there is a Commission's reasoned opinion with respect to an infringement procedure on a matter that puts at risk the legality and regularity of expenditure. This is a procedure that was introduced in the 2000-06 period and maintained in the 2007-13 financial period. It was then removed from the CPR 2014-2020 but has been again re-instated for the 2021-2027 period.

SCOPE OF APPLICATION

EU cohesion policy funds (ERDF, ESF+, CF, JTF, EMFAF) and 'Home Funds (AMIF, ISF and BMVI).

RISK TO THE EU BUDGET COVERED

Non-compliance with EU law by national public authorities putting at risk the legality and regularity of EU expenditure.

PROCEDURE

The Commission suspend payments through an implementing decision, and after having given the Member State the opportunity to present its observations. The suspension shall end when the Member State has taken the measures remedying the causes at the origin of the suspension.

MEASURES THAT CAN BE APPLIED

Total or partial suspension of payments. It does not include pre-financing.

FICHE 5. SUSPENSIONS AND NET FINANCIAL CORRECTIONS IN CASE OF MAJOR DEFICIENCIES IN NATIONAL CAP MANAGEMENT AND CONTROL SYSTEMS (CAP)

Under the CAP, the main responsibility to protect the EU budget lies with national management and control authorities (paying agencies and certification bodies).

The Commission can interrupt, suspend or reduce monthly payments (EAGF) and interim payments (EAFRD) in case of serious deficiencies in the proper functioning of the CAP governance systems or serious deficiencies in the system for the recovery of irregular payments (Art 42 CAP Horizontal Regulation). In this case, the Commission shall first ask the Member State to submit an action plan including the necessary remedial actions and clear progress indicators. Only if the Member State fails to submit or to implement the action plan the Commission can suspend the payment.

The suspension cannot last for more than 24 months. If, after this period, the deficiency has not been resolved the Commission shall launch a conformity procedure to determine whether to impose a financial correction on the Member State (Art 55 CAP Horizontal Regulation). Unlike under the CPR, financial corrections under CAP are always net, e.g. they result in a permanent reduction of the Member State's funds.

SCOPE OF APPLICATION

European Agriculture Guarantee Fund (EAGF) and European Agricultural Fund for Rural Development (EAFRD), only expenditure under the national CAP strategic plans.

RISKS TO THE EU BUDGET COVERED

Serious deficiencies in the proper functioning of the CAP governance systems, which are defined in the CAP Horizontal Regulation (Art 2 (d)) as ‘the existence of a systemic weakness, taking into account its recurrence, gravity and compromising effect on the correct declaration of expenditure, the reporting on performance or the respect of Union law’.

PROCEDURE

When detecting a serious deficiency in the CAP governance system, the Commission shall invite the Member State to submit an action plan to remedy the deficiency, which has to be established in consultation with the Commission. If the Member State fails to submit or to properly implement the plan the Commission may adopt implementing acts suspending the CAP payments. This decision has to be taken after having consulted the Member States’ representatives sitting at the Committee on the Agricultural Funds (Art 42(3) CAP Horizontal Regulation).

When opening a conformity procedure, the Commission shall inform the Member State and give it the opportunity to challenge its findings as well as the method to calculate the net correction. If there is no agreement, the Member State may submit the case to an independent ‘Conciliation Body’, which will try to reconcile the positions between the Commission and the Member State. After having examined the Conciliation Body’s report, the Commission will adopt a final decision after having consulted the Member States’ representatives sitting at the Committee on the Agricultural Funds.

MEASURES THAT CAN BE APPLIED

Suspension of payments for a maximum of 24 months and net financial corrections (exclusion of amounts from Union financing). Financial corrections are determined on the basis of the loss actually caused to the EU budget or on the basis of extrapolation. Only when it is not possible to calculate or extrapolate the cost ‘with determined effort’ the Commission can apply flat-rate corrections. These can range from 2% to 25% and only in exceptional cases go beyond 25%. The Commission has detailed guidelines to determine financial corrections which complement these provisions⁹⁶. The guidelines for the current programming period are under preparation. The past guidelines, which were built on CJEU case law, stipulated that to apply flat-rate corrections, the Commission must prove the existence of a serious deficiency in the national CAP control system entailing a real risk of financial damage for the EU budget (‘real risk’ defined as a situation in which the Commission has ‘reasonable and serious doubts’ that the CAP financed operations have been executed in accordance with the applicable EU and national law)⁹⁷.

FICHE 6. SUSPENSION OF THE APPROVAL OF A CAP STRATEGIC PLAN OR AN AMENDMENT OF A PLAN IN CASE OF NON-RESPECT OF THE EUROPEAN CHARTER OF FUNDAMENTAL RIGHTS

Under the new CAP policy, Member States have to design a ‘national CAP strategic plan’ to use the EU funds for CAP income support, rural development and market measures. These Plans have to be approved by the Commission. When assessing the Plans, the Commission shall check that the Plan is

⁹⁶ European Commission, “Guidelines on the calculation of the financial corrections in the framework of the conformity and financial clearance of accounts procedures”, C(2015) 3675 final

⁹⁷ European Commission, “Guidelines on the calculation of the financial corrections in the framework of the conformity and financial clearance of accounts procedures”, C(2015) 3675 final

compatible with the CAP rules and, particularly, with the general principles set in Article 9. One of these principles is the need to design the interventions in the CAP plans 'in accordance with the Charter of Fundamental Rights of the European Union and the general principles of Union law'. If the Commission considers that the Plan does not guarantee compliance with the Charter, it may suspend the adoption of the programme until the Member State remedies it.

SCOPE OF APPLICATION

European Agriculture Guarantee Fund (EAGF) and European Agricultural Fund for Rural Development (EAFRD)

RISKS TO THE EU BUDGET COVERED

National CAP strategic plans that do not guarantee compliance with the EU Charter of Fundamental Rights. The Charter contains various principles and rights to which all EU citizens are entitled. Some of them derive from the application of general rule of law principles enshrined in Article 2 TEU, such as the principle of non-discrimination, effective judicial protection or equality before the law.

PROCEDURE

If the Commission concludes that the Plan does not comply with the CAP regulation, it may ask the Member State to review the Plan. The suspension can be maintained for up to six months. After that date, the Commission shall adopt a decision on whether or not to approve the Plan.

MEASURES THAT CAN BE APPLIED

Suspension of the approval of a Plan (for six months) or an amendment of a Plan (for three months).

FICHE 7. REDUCTION AND RECOVERY PROCEDURES UNDER THE RECOVERY AND RESILIENCE FACILITY (RRF)

At the time of assessing RRF payment requests, the Commission checks if the national RRF management and control system works well through the analysis of information provided by the Member State (the national management declaration and a summary of audits conducted). It can also carry out, at any time, systems audits and audits on operations financed by the RRF.

If the Commission finds cases of **fraud, corruption, and conflict of interests which have not been corrected by the Member State** among the operations provided as evidence for the fulfilment of the milestone or target, it can reduce proportionately the support under the RRF or recover any amount due to the EU budget⁹⁸. The Commission can also reduce the RRF support in cases of "**serious breaches of an obligation**" resulting from the bilateral RRF grants and loans agreements. The RRF bilateral financial agreements (Art 3(15)) define "serious breach of obligations" as a breach by the Member State of the obligations incorporated in the financial agreement concerning double funding (Art 4), pre-financing (Art 5), communication and visibility of Union funding (Art 10), protection of EU's financial interest (Art 10) and obligation to allow verifications and checks by the Commission, OLAF, ECA and EPPO (Art 12), insofar as the breach "adversely affects, in a material or substantial manner, the rights of the Commission or the proper implementation of Union funds".

⁹⁸ Art 22.5 RRF regulation

SCOPE OF APPLICATION

Recovery and Resilience Facility (RRF)

RISK TO THE EU BUDGET COVERED

Risks from Member States' "serious breaches of obligations" resulting from the RRF bilateral grants and loans agreements signed with the Commission. The bilateral agreements (Art 3.15) define 'serious breach of obligations' as a breach by the Member State of the obligations incorporated in the financial agreement concerning double funding (Art 4), pre-financing (Art 5), communication and visibility of Union funding (art 10), protection of EU's financial interest (art 10) and obligation to allow verifications and checks by the Commission, OLAF, ECA and EPPO (art 12), insofar as the breach "adversely affects, in a material or substantial manner, the rights of the Commission or the proper implementation of Union funds".

PROCEDURE

When finding evidence of irregularities (fraud, corruption or conflict of interest not corrected by the Member State) or evidence of a serious breach of obligation, the Commission shall publish a provisional report and formally notify the Member State⁹⁹. The Member State shall be given the opportunity to submit observations within a period of two months, which can be extended¹⁰⁰. After this period, the Commission must notify the Member State within 60 calendar days. When there is RRF money to be recovered, the Commission notifies the Member State in a form of a debit note and gives at least 30 calendar days to the Member State to pay the note. If payment is not made by the date specified in the debit note, the amount to be recovered is increased by late-payment interest¹⁰¹.

MEASURES THAT CAN BE APPLIED

Reduction of RRF commitments through a reduction of future RRF payments or recovery of RRF amounts already paid. When the reduction is due to irregularities (fraud, corruption or conflict of interest), the amount of the reduction will correspond to the amount affected. In case of deficiencies in the Member State's RRF control systems, the Commission will apply a flat-rate reduction which can range from 5 to 100% depending on the frequency and extent of the deficiency¹⁰².

FICHE 8. RRF MILESTONES AND TARGETS

At the moment of assessing the draft national plans (NRRP), the Commission checks if the Member State has an effective RRF management and control system in place. If it detects deficiencies in the Member States' control systems, it may require the Member State to develop an action plan to remedy the deficiencies as a matter of urgency. Milestones for these measures are then established and become a pre-condition to receiving the first RRF payment aside from the pre-financing payment.

In addition to these audit and control milestones (also called 'super milestones'), the Commission can request Member states to include actions aimed at strengthening the rule of law such as reforms to guarantee the independence of the judicial system, to strengthen the anti-corruption procedures or to improve the anti-money laundering system. This request can only be done to Member States having

⁹⁹ Art 12.7 RRF financial agreements

¹⁰⁰ Art 15 RRF financial agreements

¹⁰¹ Art 20 RRF financial agreements

¹⁰² Art 19.2.b RRF financial agreements

received country-specific recommendations on these issues. In some cases (Hungary and Poland), ‘rule of law’ milestones related to the independence of the judicial system have been defined as ‘super milestones’ and hence imposed as pre-conditions to receive the first payment.

SCOPE OF APPLICATION

Recovery and Resilience Facility (RRF)

RISK TO THE EU BUDGET COVERED

Deficiencies in the Member States’ RRF management and control systems and breaches of the Rule of Law principles which were previously raised in country-specific recommendations.

PROCEDURE

The calendar for payments and the corresponding milestones or targets to be fulfilled to receive each payment are defined in a Council Implementing Decision (CID). The so-called ‘Operational Arrangements’ (OA) establish in detail the type of documents or data (i.e., the verification mechanism) required to certify the fulfilment of each milestone or target.

After receiving the payment request, the Commission has two months to assess whether the corresponding milestones and targets are fulfilled. If it considers that there is a need for major additional information or corrections, it has the capacity to ‘stop the clock’ (e.g., to suspend the two months period) and ask the country to provide additional or corrected documents¹⁰³. If the assessment is positive, it prepares a decision authorising the disbursement of the payment. This decision is adopted unless there is a qualified majority of members of the Economic and Financial Committee (EFC) – composed of senior officials of EU finance ministers – against it¹⁰⁴. There is also the possibility that one or more EFC members have serious doubts about the Commission’s assessment and request the matter to be discussed in the European Council. In this case, the Commission’s authorising decision is suspended until the European Council discusses the matter and up to a maximum of three months (Art 24(10) RRF regulation). If the Commission’s assessment is negative, the Commission will suspend the RRF payment or part of the payment. The decision to suspend the RRF payment is taken by the Commission alone after having received the observations from the Member State concerned.

MEASURES THAT CAN BE APPLIED

Partial or total suspension of the RRF payments. The amount to be suspended will be calculated by following a methodology which takes into account the relative importance of each milestone¹⁰⁵. Reduction of RRF support if the Member State does not take the necessary measures within a period of six months from the suspension, and after having given the Member State concerned the possibility to present its observations within two months from the communication of its conclusions¹⁰⁶.

¹⁰³ Art 6.4 of the RRF financing agreements signed between the Commission and each Member State

¹⁰⁴ Art 24 RRF regulation

¹⁰⁵ The methodology is described in Annex II of Commission’s Communication “Recovery and Resilience Facility: Two years on. A unique instrument at the heart of the EU’s green and digital transformation” COM(2023) 99 final

¹⁰⁶ Art 24.8 RRF Regulation

FICHE 9. SUSPENSION, REDUCTION OR TERMINATION OF AWARD PROCEDURES OR AGREEMENTS

Art 131 FR allows the Commission to suspend or cancel an EU tender organised in areas under direct or indirect management if there is evidence of irregularities or fraud being committed in the preparation of the tender.

The article also allows the Commission to suspend payments or interrupt the implementation of a grant agreement or a contract in case of suspected fraud, irregularities or breaches of obligations by the entity or person signing the agreement or by some final recipients (e.g. in case of a framework agreement). If the presumed fault is confirmed, the Commission can terminate the agreement as a whole (if the fault is committed by the entity or person signing the agreement) or in part (if the fault only concerns some final recipients).

SCOPE OF APPLICATION

EU funds under direct and indirect management.

RISK TO THE EU BUDGET COVERED

Irregularities or fraud committed in the preparation of an award procedure (e.g. non-respect of principles of transparency and equal treatment as stipulated in the EU public procurement directive); irregularities or fraud committed during the implementation of a grant agreement or a contract; non-compliance with the obligations included in the grant agreement or contract signed with the Commission (including, inter alia, respect of the principles of transparency, equal treatment and non-discrimination).

MEASURES THAT CAN BE APPLIED

Suspension or cancellation of an EU award procedure, refusal to sign a grant agreement or a contract with an operator that won an EU tender affected by fraud or irregularities; suspension, reduction or termination of a grant agreement or a contract in case of fraud, irregularity or breach of obligations.

FICHE 10. EARLY DETECTION AND EXCLUSION SYSTEM (EDES)

The Early Detection and Exclusion System (EDES) is a system established in 2016 to protect the EU budget from unreliable economic operators. The system is regulated in Article 135 of the Financial Regulation and allows the Commission to blacklist (early detection) and exclude unreliable economic operators (individual persons or entities) from receiving EU funds. The EDES procedure only applies to EU funds under direct or indirect management (which roughly represent 26% of the EU budget) but the revised Financial Regulation (currently under negotiation) foresees the extension of EDES to shared management.

It is possible to blacklist and exclude economic operators on various grounds:

- Bankruptcy, insolvency and similar situations
- Grave professional misconduct
- Non-payment of taxes or social security contributions
- Fraud, corruption, and other illegal activities
- Irregularities relating to EU-funded activities
- Significant non-compliance with main obligations under contracts financed by the EU budget

- Circumvention of fiscal, social and other legal obligations or creation of an entity for this purpose

Exclusion lasts one to five years. In severe cases, the operator can be financially penalised and its name can be published as a deterrent.

SCOPE OF APPLICATION

EU funding under direct or indirect management (roughly representing 26% of EU funds).

RISK TO THE EU BUDGET COVERED

Economic operators (individuals or public or private entities) that pose a risk to the EU budget, either for integrity reasons (e.g. past fraudulent practices) or for reasons of competence (bankruptcy, insolvency and similar reasons).

PROCEDURE

Commission's authorising officers of the different 'spending' DGs are responsible for detecting risky operators and registering them in the EDES database. As a first step, they can blacklist the operator (early detection) if they presume it is in an exclusion situation but need to collect the necessary evidence to make an exclusion. This does not prevent operators from applying and receiving EU funds but serves as an alert for the other authorising officers.

If they have the necessary information, they can exclude the operator. The exclusion procedure depends on the type of exclusion situation. Authorising officers can directly exclude counterparties for bankruptcy or insolvency as well as for non-payment of taxes or social security contributions based on final judgements or administrative decisions. In the other exclusion situations, the authorising officer should send a request for exclusion to an EDES panel composed of an independent chair, two permanent members designated by DG Budget and a representative of the authorising officer making the exclusion request. The authorising officer takes the final decision after receiving the panel's opinion.

MEASURES THAT CAN BE APPLIED

Exclusion of the economic operator from receiving EU funds. In severe cases, the operator can be financially penalised and its name can be published as a deterrent.

FICHE 11. EX ANTE ASSESSMENT OF IMPLEMENTING PARTNERS

The Commission can entrust budget implementation tasks to Member States' organisations (Art 62.1.c.v FR) or national bodies governed by private law with a public service mission (Art 62.1.c.vi FR). Before signing contribution agreements or guarantee agreements with these entities, the Commission carries out an ex-ante assessment of the systems, rules and procedures of the entities implementing Union funds. If it concludes that entities' internal control systems are not sufficiently robust to prevent and correct fraud, that rules and procedures for providing financing to third parties do not respect certain principles (such as the principles of transparency and non-discrimination), that they do not have efficient and effective review procedures or do not have effective rules for recovering funds unduly paid they will not sign an agreement with these entities (Art 154 FR).

SCOPE OF APPLICATION

EU funds under indirect management.

RISK TO THE EU BUDGET COVERED

Public entities implementing EU funds on behalf of the Commission and not complying with some basic rules and principles (e.g. transparency and non-discrimination) in the implementation of contribution or guarantee agreements signed with the Commission.

MEASURES THAT CAN BE APPLIED

Refusal to enter into a legal commitment with an entity if it does not have appropriate internal systems and procedures.

FICHE 12. EARLY REPAYMENT OF LOANS

Article 220 FR stipulates that loan agreements signed between the Commission and a Member State must include the obligation of the beneficiary country to take appropriate measures to prevent irregularities and fraud, and, if necessary, take legal action to recover any funds misused (Art 220(5) (a) FR). The agreement shall also entitle the Commission to early repayment of the loan where it has been established that, in relation to the management of the financial assistance, the beneficiary country has engaged in any act of fraud or corruption or any other illegal activity detrimental to the financial interests of the Union (Art 220(5) (d) FR).

SCOPE OF APPLICATION

Financial assistance (support in form of loans to Member States in difficulty).

RISK TO THE EU BUDGET COVERED

Fraud, corruption or another illegal activity committed by a Member State and directly related to the management of an EU loan.

MEASURES THAT CAN BE APPLIED

Early repayment of the loan.

FICHE 13. RECOVERIES UNDER OWN RESOURCES

Member States' authorities are responsible for collecting, calculating and making the amounts of Own Resources (OR) available in a timely manner to the Commission. The methods and procedure to make available the OR are detailed in a 2014 Council regulation, which was amended in 2022 to enhance predictability and clarify procedures for dispute resolution¹⁰⁷.

The management and control procedures vary for each own resource. Contributions for Traditional Own Resources (TOR) are made every two months, on the basis of Member States' actual collection of the relevant duties and levies. The Commission may conduct on-the-spot inspections to verify that national customs authorities correctly apply the EU customs legislation and carry on the necessary

¹⁰⁷ Council regulation 609/2014 of 26 May 2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources, amended by Council Regulation 2022/615 of 5 April 2022

checks and controls to prevent and detect fraud. If it detects uncollected amounts resulting from deficiencies in the national customs system, it will issue a recovery order against the Member State.

Contributions for VAT own resources are made every month, based on Member States' annual forecasts of the VAT base. The Commission conducts checks to verify that the national authorities have correctly calculated the annual harmonised VAT base. If it detects errors in the calculus of the VAT base it will correct the calculation and adjust the payment orders correspondingly. Adjustments can also be made in subsequent years to adapt payments to the actual VAT data. Contributions to GNI-based own resources are also made every month, based on the Commission's calculations and by using Member States' GNI data. The Commission verifies this data and may conclude that there are errors in the way the Member State has calculated its GNI. In this case, it will make adjustments to the amounts to be paid. Adjustments will be made by changing the payment requests in subsequent years.

SCOPE OF APPLICATION

EU Own Resources.

RISK TO THE EU BUDGET COVERED

Deficiencies in the national customs systems resulting in a lack of prevention and detection of customs fraud; misapplication of the EU VAT legislation when calculating the VAT harmonisation base, refusal by a given Member State to make available the own resources to the Commission.

PROCEDURE

If the Commission detects irregularities in the collection of TOR, it will issue a recovery order against the Member State for the loss of amounts resulting from errors in the national customs system. The Member State can contest the Commission's decision and ask the Commission to review it, but this will not suspend its obligation to provide the payment. Any delay in paying will give rise to the payment of interest by the Member State concerned.

If the Commission detects that the Member State has not correctly calculated the VAT harmonised base, it will apply an adjustment. The Member State can contest this adjustment and raise a reservation. This interrupts the period for which interest accrues but does not suspend the obligation of payment. Any delay in paying will give rise to the payment of interest by the Member State concerned.

If the Commission concludes that there are errors in the way a Member State has calculated its GNI it will apply adjustments. Any delay in paying the GNI own resources or upward adjustments gives rise to the payment of interest by the Member State concerned.

MEASURES THAT CAN BE APPLIED

Recovery of due amounts through the issuance of a recovery order (Art 101 FR) or by offsetting the due amounts against future claims to the EU budget (Art 102 FR). Imposition of interests in case of delays in making available the own resources to the Commission.

The rule of law Conditionality Mechanism is a new instrument that entered into force in January 2021. It allows the EU to take measures in cases of breaches of the rule of law principles that affect or seriously risk affecting the sound financial management of the EU budget or the EU's financial interests in a sufficiently direct way. This study discusses the potential scope of application of this new mechanism. In particular, it analyses how it can be used either as an alternative to, or in combination with, other tools and mechanisms aimed at protecting the EU's financial interests.

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