
The new conditionality mechanism for the protection of the EU budget: does the CJEU judgement give the all-clear?

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Theme

On 16 February 2022 the Court of Justice of the EU dismissed actions brought by Hungary and Poland against conditionality on the rule of law.

Summary

Regulation 2020/2092¹ on a general regime of conditionality for the protection of the EU budget came into force on 1 January 2021. It created a horizontal ‘conditionality mechanism’ that made Member States’ access to funds from the EU budget conditional on respect for the principles of the rule of law. On 16 February 2022 the Court of Justice of the EU dismissed the actions brought by Hungary and Poland against the regulation. This is a landmark judgement on the nature and purpose of the EU and (finally) provides firm ground for this new instrument that complements existing EU mechanisms for protecting the rule of law.

Analysis

(1) Introduction

In 2017 the European Commission presented a proposal for a Council Decision to determine if there is a ‘clear risk of a serious breach’ of the rule of law in Poland. This was followed by a similar proposal by the European Parliament for Hungary in 2018. For many years the conflict appeared to be off the public’s radar. However, in recent months, it has been given prominent media coverage, since the continuous and systematic attacks by the Polish authorities against the rule of law threaten not only the democratic system of Poland but the functioning and legal order of the EU itself. Recent events underscore the severity of the situation. On 7 October 2021 the Polish Constitutional Tribunal issued a judgement that struck to the heart of the EU’s foundations –the primacy of EU law– and ruled that various articles of the EU treaties are unconstitutional. On 27 October 2021 the Court of Justice of the EU (CJEU) imposed a fine of €1 million a day on Poland for its systematic refusal to comply with the interim measures of the recent infringement proceedings. This was the first time such a large fine had been imposed on

¹ 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: OJ L 433I, 22 December 2020, p. 1-10.

a Member State. Moreover, the European Council has yet to approve the recovery plans of Poland and Hungary, since it is waiting for firm commitments (for example, judicial reform in the case of Poland).

This was the backdrop for the CJEU ruling on 16 February 2022 on the actions for annulment brought by the governments of Poland and Hungary against Regulation 2020/2092² on a general regime of conditionality for the protection of the EU budget.³ The regulation, which came into force on 1 January 2021 establishes a link between investment from the EU budget and breaches of the principles of the rule of law by Member States. The CJEU judgement follows the argument and recommendations of the advocate general, who proposed on 2 December 2021 that the Court dismiss the actions for annulment brought by Hungary and Poland.

Since December 2020 the majority of the European Parliament's political groups have been increasingly vocal in their demands for the application of Regulation 2020/2092.⁴ On October 2021 the Parliament launched a lawsuit in the CJEU against the European Commission for not having activated the new conditionality mechanism.⁵

A number of issues are at stake here, ranging from the fundamental question of the principles on which the legal order of the EU is based, through to the relationship between the rule of law and the sound financial management of the EU budget. The majority of governments of Member States and the EU institutions argue that the principles of the rule of law, traditions and shared values are automatically derived from article 2 of the Treaty on European Union (TEU) and that each Member State must respect them. Limiting these principles based on national identities jeopardises the EU itself. In this context, the majority of the governments of Member States and the EU institutions have highlighted the importance of the effective use of European funds across all EU policies and objectives.

In contrast, the Government of Poland has argued that the rule-of-law principles under Article 2 of TEU are non-binding for Member States, since they only constitute obligations for the EU itself. Warsaw (and Budapest) argue that the EU lacks the powers to define the principles of the rule of law or establish the conditions that determine its compliance. In their actions the two governments also claimed that under Regulation 2020/2092 the EU is pursuing the defence of the values of Article 2 of TEU without following the

² 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: OJ L 433I, 22/XII/2020, p. 1-10, <https://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AL%3A2020%3A433I%3ATOC&uri=uriserv%3AOJ.LI.2020.433.01.0001.01.ENG>.

³ Judgements of the CJEU in Cases C-156/21 Hungary v Parliament and Council, C-157/21 Poland v Parliament and Council, <https://curia.europa.eu/jcms/upload/docs/application/pdf/2022-02/cp220028en.pdf>.

⁴ European Parliament resolution of 17 December 2020 on the Multiannual Financial Framework 2021-2027, the Interinstitutional Agreement, the EU Recovery Instrument and the Rule of Law Regulation (2020/2923(RSP)), https://www.europarl.europa.eu/doceo/document/TA-9-2020-0360_EN.html.

⁵ European Parliament resolution of 21 October 2021 on the rule of law crisis in Poland and the primacy of EU law (2021/2935(RSP)).

procedure in Article 7 of TEU. Lastly, they argued that the lack of clarity between the principle of the rule of law and sound financial management of the budget breaches the principle of legal certainty. The two governments base their arguments on the confidential ruling of the legal service of the European Council on the proposal for the regulation issued by the European Commission in May 2018, when it set out its proposals for the multiannual financial framework for 2021-27.

However, the text of the legislation has evolved since then. The extraordinary [European Council on 17-21 July 2020](#) also marked a turning point in the debate on conditionality on the rule of law. The conclusions stated that the conditionality regime should also apply to the [Next Generation EU programme](#). They also stated that the effect of a breach of the principles of the rule of law on financial management must be ‘sufficiently direct’ and not generalised, as was the case in the European Commission proposal. Finally, the conclusions state that the European Council will act quickly on the matter, which undoubtedly led to a misunderstanding with the governments of Poland and Hungary, which approved the document. The European Council and the European Parliament continued to take different views on what would become Regulation 2020/2092. The Parliament sought to protect the rule of law through the budget, while the Council focused the instrument on protecting the EU budget through respect for the requirements of the rule of law.⁶ Moreover, the European Parliament argued for a broad application of the regulation, whereas the European Council sought to limit it, arguing there must be a direct relationship between breaches of the rule of law and the specific negative effects on the EU budget.

Under the German Presidency of the European Council, the European Council and the European Parliament reached a legislative agreement in November 2020. However, the agreement was opposed by the governments of three Member States (Hungary, Poland and Slovenia), who threatened to veto the decision on the multiannual financial framework for 2021-27 and Next Generation EU. As a concession to demands from these Member States, the conclusions of the [European Council on 10-11 December 2020](#) contained substantial guidelines on when the regulation should apply and how to apply it. First, the conclusions stress the subsidiary nature of the regulation, meaning it will only apply where no other measures are able to achieve the same effect. They also reinforce the regulation’s objective of safeguarding the EU’s financial interests and specify that the measures adopted under the mechanism must be proportionate to the repercussion of the breach of the rule of law on the sound financial management of the EU budget or the EU’s financial interests. Like the conclusions in July, they stress that the causal link between this breach and the negative consequences for the financial interests of the EU must be ‘sufficiently direct’. While the European Council does not play a formal role in the legislative process, it has nonetheless set out guidelines on when and how the European Commission should apply the regulation.

⁶ Conclusions of the Advocate General, Case C-156/21, *op. cit.*

However, is there really a clear and direct link between respect for the rule of law and the efficient implementation of the budget and its sound financial management? Moreover, if this is the case, how does the link manifest in practice?⁷ In addition to these fundamental questions, the conflict also touches on a number of other tensions.

(2) Council versus Commission

The dispute is a classic in the European integration process. On this occasion, it is focused on the powers of the European Commission with respect to the European Council: should the European Commission examine issues related to the rule of law of a Member State, how much room for discretion should it have and what should its role be in making decisions? Or should the procedure in Article 7 of TEU, led by the European Council, remain the sole and exclusive legal vehicle for the EU to address these concerns? This situation led to the European Commission's proposal for the regulation in 2018 remaining stuck in limbo in the European legislative process for a number of years following its publication. As mentioned above, at various European Councils, the governments of Member States took steps to limit the European Commission's discretion in applying the mechanism, until the conclusions of the European Council on 10-11 December 2020, which included specifications for the application of the regulation, with the clear intention of rendering it practically unworkable.⁸

(3) Commission versus Parliament

Since the approval of Regulation 2020/2092 in December 2020, the majority of the political groups of the European Parliament have called for its application, criticising the inaction of the European Commission,⁹ with various groups voicing their concerns at the State of the Union debate in 2021. As mentioned, in October the European Parliament submitted a lawsuit against the European Commission for not having activated the mechanism.¹⁰ Nonetheless, the conclusions of the European Council on 10-11 December 2020 contained substantial guidelines on when and how the regulation should be applied (conditions imposed by the Polish and Hungarian governments to allow the approval of the multiannual financial framework 2021-27 and Next Generation EU). This meant the European Commission would not be able to apply the regulation before the creation of guidelines, which should be produced 'in close consultation with the Member States' and before a decision by the CJEU on the inevitable action for annulment brought by the Governments of Hungary and Poland in March 2021. Nonetheless, under the correct interpretation of various political groups of the European Parliament, the

⁷ John Morijn (2014), *A Closing of Ranks: 5 Key Moments in the Hearing in Cases C-156/21 and C-157/21*, *VerfBlog*, 14/X/2014, <https://verfassungsblog.de/a-closing-of-ranks/>, DOI: 10.17176/20211014-165321-0.

⁸ Kim Lane Scheppele, Laurent Pech & Sébastien Platón (2020), 'Compromising the Rule of Law while Compromising on the Rule of Law', *VerfBlog*, 13/XII/ 2020, <https://verfassungsblog.de/compromising-the-rule-of-law-while-compromising-on-the-rule-of-law/>, DOI: 10.17176/20201214-060045-0.

⁹ European Parliament resolution of 17 December 2020 on the Multiannual Financial Framework 2021-2027, the Interinstitutional Agreement, the EU Recovery Instrument and the Rule of Law Regulation (2020/2923(RSP)), https://www.europarl.europa.eu/doceo/document/TA-9-2020-0360_EN.html.

¹⁰ European Parliament resolution of 21 October 2021 on the rule of law crisis in Poland and the primacy of EU law (2021/2935(RSP)), https://www.europarl.europa.eu/doceo/document/TA-9-2021-0439_EN.html.

European Commission should not have to wait for these conditions to be met, since the European Council cannot limit the application of a regulation.

(4) Net contributors (and some net beneficiaries)

In 2017 Jean-Claude Juncker, who was President of the European Commission at the time, argued that conditionality on the rule of law in cohesion policy would be 'poison'. There had been calls for greater conditionality for a number of years, primarily from net contributors. In contrast, the net beneficiaries opposed this 'new functionality' in the proposal, insisting on the traditional principles of the redistributive policies of the EU. Regulation 2020/2092 would primarily affect (for the time being) net beneficiaries (Poland and Hungary), which helped soften the opposition from the other Member States. To date, the only open proceedings for rule-of-law breaches are against these two Member States. Poland was the largest net beneficiary in the previous financial period (2014-20) and is the largest net beneficiary for the current period (2021-27). Hungary is the largest per capita beneficiary. However, there is a difference between the two Member States when it comes to the management of European funds. In 2019 Hungary topped the list of countries for which OLAF, the EU anti-fraud office, had issued recommendations for the recovery of European funds (followed by Romania, Italy, Bulgaria and Slovakia). Like Spain, Poland had received just two recommendations.¹¹

(5) The CJEU judgement

The CJEU judgement follows the conclusions of the Advocate General and wholly dismisses the actions brought by Hungary and Poland. The CJEU reaffirms that the EU's legal order is based on clear and binding rules on the rule of law. Moreover, not only are these conditions for candidates for accession but they must also be respected and applied by all Member States in all political areas of the EU, including budget management. In this respect, the regulation does not seek to protect the rule of law through a sanctions mechanism similar to Article 7 of TEU but establishes an instrument of financial conditionality to preserve this value of the EU. The regulation will not apply to all breaches of the rule of law: it aims to protect the EU budget from being affected by breaches of the principles of the rule of law and not to punish such breaches in their own right.¹² The CJEU judgement reaffirms that the financial management of the EU budget and its financial interests are closely and directly related to the principles of the rule of law. This means the creation of a conditionality mechanism is covered by the EU's powers to establish 'financial rules' for the implementation of its budget. Regarding the argument on the lack of legal certainty, specifically the lack of precision in the definition of the concept of 'rule of law', the CJEU stresses that the principles that appear in the regulation have been widely developed in case law and arise from shared values recognised and applied equally by Member States.

¹¹ OLAF (2019), 'Twentieth report of the European Anti-Fraud Office, 1 January to 31 December 2019', <https://op.europa.eu/en/publication-detail/-/publication/bce57864-ee54-11ea-991b-01aa75ed71a1>.

¹² Judgements of the CJEU in Cases C-156/21 Hungary v Parliament and Council, C-157/21 Poland v Parliament and Council, 12/II/2022, <https://curia.europa.eu/jcms/upload/docs/application/pdf/2022-02/cp220028en.pdf>.

Conclusion

The evolution of the legal text based on the European Commission proposal –in which the requirement for a sufficiently direct link between the implementation of the budget and the principles of the rule of law was a key element– has seen the scope of the application of the Commission’s initial proposal reduced. The limitation of the European Commission’s discretion in the adaptation of the measures has also been fundamental, changing the nature of the regulation. Regulation 2020/2092 does not seek to protect the rule of law through a sanctions mechanism similar to Article 7 of the TEU but instead establishes an instrument for financial conditionality. The regulation has gone from being an instrument whose primary objective was the protection of the rule of law to a budget tool. It should also be noted that, in contrast to the European Commission’s original proposal, the title of Regulation 2020/2092 no longer contains a reference to the rule of law. Yet the regulation provides the European Commission with an additional mechanism in its toolbox. It remains problematic, however, since, in the majority of cases, the causal link between the erosion of the rule of law and breaches of the EU’s financial interests will be subtle.

Following the judgement, statements by the European Commission suggest the regulations will not be applied immediately. In line with the procedure established by the regulation, the process may take up to nine months. The Hungarian parliamentary elections on 3 April 2022 may be a key factor in the timeline, since the European Commission will not wish to harm the chances of the common European candidate for the opposition parties by giving the Hungarian government material to bolster anti-European sentiment.

This is a landmark judgement on the nature and purpose of the EU and (finally) provides firm ground for a new instrument to complement existing EU mechanisms to protect the rule of law. However, deciding if a breach of the rule of law is causally linked to the financial interests of the EU also looks set to be addressed by the courts in the near future.